Karnataka State Open University

Mukthagangothri, Mysore-570 006

MBA (First Semester)

BUSINESS ENVIRONMENT

Department of Studies and Research in Management

Course-6

Block-1

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DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

M.B.A I Semester

COURSE - 6

BUSINESS ENVIRONMENT

BLOCK

1

BUSINESS ENVIRONMENT

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BLOCK-1 : BUSINESS ENVIRONMENT

Organisational success dependents on many factors. A manager who sets strategy and leads the firm need to have sound knowledge of business environment. Block one is divided into 4 units.

Unit- 1 deals with the basic aspects such as meaning, nature and scope of bussiness environment. It focusess on characteristics of bussiness, evolution of bussiness and classification of bussiness objectives. Also discussed scope of bussiness.

Unit -2 concerned with internal and external environment. It deals with features of bussiness environment, different types of environmental factors. Further this unit also focuses on environmental learning, its importance and methods and techniques.

Unit- 3 focuses on the impact of social, legal and political environment on business. These are important facotros which have greater influence on the business operations. Thus, a manager has to take into consideration all these factors.

Unit- 4 deals with impact of demographic, economic and technological environment on bussiness. A firm needs to have complete knowledge of its demographic environment , economic and technological environment to set a sucessful strategy. At the out set various demographic factors affection of bussiness are addressed. The unit also focusses on the economic environment. The unit explains in detail the technological factors which affect a business.

UNIT – 1 : MEANING, NATURE AND SCOPE OF BUSINESS ENVIRONMENT

STRUCTURE

1.0 OBJECTIVES

After reading this unit, you should be able to:

- define the term 'business
- identify the various characteristics of business
- explain the objectives of business
- enumerate the evolution of business
- classify of objectives of business
- discuss nature of business
- explain the scope of business.
- explain the Economic environment and Non-economic environment.

1.1 INTRODUCTION

We live in a business environment. It is an indispensable part of society. It satisfies our wants by providing variety of goods and services through wide networking of business activities. This module has been designed to enable the learners to be aware of the world of business, recognizes its importance.

1.2 MEANING OF BUSINESS

Business refers to any human activity undertaken on a regular basis with the objective to earn profit through production, distribution, sale or purchase of goods and services. Business may be defined as "an activity involving regular production or purchase of goods and services for sale, transfer and exchange with an objective of earning profit".

1.3 CHARACTERISTICS OF BUSINESS

The essential characteristics of business are as follows:

Deals in goods and services: People in business are engaged in production and distribution of goods and services. The goods may be consumer goods like bread, butter, milk, tea, etc. or capital goods like plant, machinery, equipments, etc. The services may be in the form of transportation, banking, insurance, warehousing, advertising and so on.

Sale or exchange of goods and services: If a person produces or buys a product for self-consumption or for gifting it to another, he is not engaged in business. But when he produces or buys goods to sell it to somebody, he is engaged in business. Thus, in business the goods and services produced or purchased must be exchanged for money or for goods (under barter system) between the buyers and sellers. Without sale or exchange of goods the activities cannot be treated as business.

Regular exchange of goods and services: The production or buying and selling activities must be carried out on a regular basis. Normally, an isolated transaction is not treated as business. For example, if Venkatesh sold his old car to Vishwas, it is not considered as business, unless he continues to carry buying and selling of cars on a regular basis.

Aims at earning profit: Business activities are performed with the primary objective of earning income by way of profit. Without profit it is not possible to survive for a long period. Earning of profit is also required to grow and expand the business.

Involves risk and uncertainty of income: We know that every business aims of earning profit. A businessman who invests various resources expects a fair amount of return. But, inspite of his/her best efforts, the reward he/she gets is always uncertain. Sometimes he/she enjoys profits and also times may come when he suffers heavy losses. This happens because the future is unpredictable and businessperson has practically no control over certain factors that affects his/her earnings.

1.4 EVOLUTION OF BUSINESS

We all know that India has a very rich cultural heritage. However, it is not known to many that India was a well developed country in terms of its economy and business. The Indian civilization was not only agriculture based but there was also flourishing trade and commerce both inside and outside the country. It had contributed immensely to the world of business in different fields. Indian business was unique, innovative, dynamic and qualitatively superior to many other countries of that time.

In the early days Indian economy was totally based on agriculture. People used to produce whatever they required for their self-consumption. There was no need for sale or exchange of goods. But later on, needs of the people increased and so did the production. People began to specialize in producing different items of luxury and daily use and did not have skills and time left for producing other items of their use. However, they were able to produce surplus items with increase in their efficiency. So, a system

of exchanging surplus items with the items of need was evolved. This was the beginning of trade. It is normally understood that India has progressed a great deal in the modern time, especially after independence, in the field of business and trade. India has become a strong country in terms of industrial growth so much so that we are able to produce almost all goods of our use indigenously. This however, does not mean that there was no growth and development in these fields in the past in India. In fact, India has a very rich heritage in trade and commerce, which can make any Indian feel proud of. People will be surprised to know that India began its journey in the field of trade and commerce as back as 5000 B.C. Historical evidence are there to prove that there were planned cites were available in India at that time and Indian textile, jewellery and perfumes used to be admired by the people all over the world. Indian traders were using currency for business since a long time. There used to be guilds to protect the interest of traders, artisans and producers. This is an indication of the complex development of trade and commerce in India. Apart from the strong network of internal trade routes, India had also established trade links with the Arabs and Central and South East Asia. India had been in the business of producing a number of metal items like brass and copper idols, vessels, ornaments and pieces of decoration. India used to export as well as import a number of items to and from different part of the world. It is also well known that the British first came to India as traders, which led to the establishment of their rule here. India has also contributed to the world of trade and business in a number of ways. The numerical system of calculation used even in modern time, was developed in India. The joint family system and division of labour in business have evolved here, which are practiced even today. The modern technique of customer focused business has been an integral part of Indian business since long. Thus, we can say that India has a rich heritage in trade and commerce which has contributed to its growth.

1.5 CLASSIFICATION OF OBJECTIVES OF BUSINESS

All the business activities are performed with some objectives. The objectives of business may be classified as –

1.5.1 ECONOMIC OBJECTIVES

Economic objectives of business refer to the objective of earning profit and also other objectives that are necessary to be pursued to achieve the profit objective, which includes creation of customers, regular innovations and best possible use of available resources.

i) Profit Earning: Profit is the lifeblood of business, without which no business can survive in a competitive market. Thus, profit making is the primary objective for which a business unit is brought into existence. Profits help businessmen not only to earn their living but also to expand their business activities by reinvesting a part of the profits. In order to achieve this primary objective, certain other objectives are also necessary to be pursued by business, which are as follows:

ii) Creation of customers: A business unit cannot survive unless there are customers to buy the products and services. Again a businessman can earn profits only when he/she provides quality goods and services at a reasonable price. For this it needs to attract more customers for its existing as well as new products. This is achieved with the help of various marketing activities.

iii) Continuous innovations: Business is highly dynamic and an enterprise can continue to be successful only by adopting itself to change in its environment. Innovation means changes, which bring about improvement in products, process of production and distribution of goods. Reduction in cost and increase in sales gives more profit to the businessman.

iv) Best possible use of resources: As you know, to run any business you must have sufficient capital or funds. The amount of capital may be used to buy machinery and raw materials, to employ men and have cash to meet day-to-day expenses. Thus, business activities require various resources like men, materials, money and machines. This objective can be achieved by employing efficient workers, making full use of machines and minimizing wastage of raw materials.

1.5.2 SOCIAL OBJECTIVES

Social objectives are those objectives of business, which are desired to be achieved for the benefit of the society. No activity of the business should be aimed at giving any kind of trouble to the society. Social objectives of business include production and supply of quality goods and services, adoption of fair trade practices and contribution to the general welfare of society and provision of welfare amenities.

1) Production and supply of quality goods and services: Since the business utilizes the various resources of the society, the society expects to get quality goods and services from the business. The objective of business should be to produce better quality goods and supply them at the right time and at a right price. They should charge the price according to the quality of the goods and services provided to the society.

2) Contribution to the general welfare of the society: Business units should work for the general welfare and upliftment of the society. This is possible through running of schools and colleges for better education, opening of vocational training centers to train the people to earn their livelihood, establishing hospitals for medical facilities and providing recreational facilities for the general public like parks, sports complexes etc.

1.5.3 HUMAN OBJECTIVES

Human objectives refer to the objectives aimed at the well-being as well as fulfillment of expectations of employees as also of people who are disabled, handicapped and deprived of proper education and training. The human objectives of business may thus include economic well-being of the employees, social and psychological satisfaction of employees and development of human resources.

(i) Economic well being of the employees: In business employees must be provided with fair remuneration and incentives for performance, benefits of provident fund, pension and other amenities like medical facilities, housing facilities etc. By this they feel more satisfied at work and contribute more for the business.

(ii) Social and psychological satisfaction of employees: It is the duty of business units to provide social and psychological satisfaction to their employees. This is possible by making the job interesting and challenging, putting the right person in the right job and reducing the monotony of work. Further, grievances of employees should be given prompt attention and their suggestions should be considered seriously when decisions are made. If employees are happy and satisfied they can put their best efforts in work.

(iii) Development of human resources: Employees as human beings always want to grow professionally. Their growth requires proper training as well as development. Business can prosper if the people employed can improve their skills and develop their abilities and competencies in course of time. Thus, it is important that business should arrange training and development programmes for its employees.

(iv) Well being of socially and economically backward people: Business units being inseparable parts of society should help backward classes and also people those are physically and mentally challenged. This can be done in many ways. For instance, vocational training programme may be arranged to improve the earning capacity of backward people in the community. Business units can also help and encourage meritorious students by awarding scholarships for higher studies.

1.5.4 NATIONAL OBJECTIVES

Being an important part of the national economy, every business must have the objective of fulfilling national goals and aspirations. The following are the national objectives of business.

1) Creation of employment: One of the important national objectives of business is to create opportunities for gainful employment of people. This can be achieved by establishing new business units, expanding markets, widening distribution channels, etc.

2) Promotion of social justice: As a responsible citizen, a businessman is expected to provide equal opportunities to all persons with whom he/she deals. She/he is also expected to provide equal opportunities to all the employees to work and progress. Towards this objective special attention must be paid to weaker and backward sections of the society.

3) Production according to national priority: Business units should produce and supply goods in accordance with the priorities laid down in the plans and policies of the Government. One of the national objectives of business in our country should be to increase the production and supply of essential goods at reasonable prices.

4) Contribute to the revenue of the country: The business owners should pay their taxes and dues honestly and regularly. This will increase the revenue of the government, which can be used for the development of the nation.

Self-sufficiency and Export Promotion: To help the country to become self-reliant, business units have the added responsibility of restricting import of goods. Besides, every business unit should aim at increasing exports and adding to the foreign exchange reserves of the country.

1.5.5 GLOBAL OBJECTIVES

Earlier India had a very restricted business relationship with other nations. There was a very rigid policy for import and export of goods and services. But, now-a-days due to liberal economic and export–import policy, restrictions on foreign investments have been largely abolished and duties on imported goods have been substantially reduced. This change has brought about increased competition in the market. Today because of globalization the entire world has become a big market. Goods produced in one country are readily available in other countries. So, to face the competition in the global market every business has certain objectives in mind, which may be called the global objectives.

(i) Raise general standard of living: Growth of business activities across national borders makes available quality goods at reasonable prices all over the world. The people of one country get to use similar types of goods that people in other countries are using. This improves the standard of living of people.

(ii) Reduce disparities among nations: Business should help to reduce disparities among the rich and poor nations of the world by expanding its operation. By way of capital investment in developing as well as underdeveloped countries. It can foster their industrial and economic growth.

(iii) Make available globally competitive goods and services: Business should produce goods and services which are globally competitive and have huge demand in foreign markets. This will improve the image of the exporting country and also earn more foreign exchange for the country.

1.6 NATURE OF BUSINESS

Business refers to an occupation in which goods and services are produced and sold in return of money. It is carried out on a regular basis with the prime objective of making profit. Mining, manufacturing, trading, transporting, storing, banking, and insurance are examples of business activities.

Businesses vary in size, as measured by the number of employees or by sales volume. Large organizations such as Tata steel, Reliance, Shell count their employees in the hundred thousand and their sales revenues in thousands of crores. But most business units in our country are small units – independently owned and managed and employing fewer than twenty employees each. Whether a business unit has one or two people working at home, 10 operating in a retail store, 1000 employed in a factory, or 100,000 operating in multiple units spread across the country, all business share the same purpose : to earn profits.

The purpose of business

- Goes beyond earning profit. - It is an important institution in society. Be it for the supply of goods and services
- To Creation of job opportunities
- To Offer better quality of life
- Contributing to the economic growth of the country and putting it on the global map

- The role of business is crucial
- Society cannot do without business
- It needs no emphasis that business needs society as much.

1.7 SCOPE OF BUSINESS

Business is an integral part of modern society. It is an organized and systematic activity for earning profit. It is concerned with activities of people working towards a common economic goal. Modern society cannot exist without business. The Scope of business can be described as follows:

(a) Business improves the standard of living of the people by providing better quality and large variety of goods and services at the right time and at the right place.

(b) It provides opportunities to work and earn a livelihood. Thus, it generates employment in the country, which in turn reduces poverty.

(c) It utilises the scarce resources of the nation and facilitates mass production of goods and services.

(d) It improves national image by producing and exporting quality goods and services to foreign countries. By participating in international trade fairs and exhibitions it also demonstrates the progress and achievements of its own country to the outside world.

(e) It enables the people of a country to use quality goods of international standard. This is possible by way of importing goods from foreign countries or by producing quality goods in the country by applying modern methods of production.

(f) It gives better return to the investors on their capital investment and also provides opportunities to grow and expand the business.

(g) It promotes social interest by providing tourist services, sponsoring cultural programmes, trade shows etc. in the country, which enable people of different parts of the country to exchange their culture, traditions and practices. Thus, it promotes national integration.

(h) It also facilitates exchange of culture among the people of different nations and thus, maintains international harmony and peace.

(i) It helps in the development of science and technology. It spends large amount of money on research and development in search of new products and services. Hence a number of innovative products and services are developed through industrial research

1.8 SUMMARY

This chapter has been concerned with the Business and the scope of business. We have covered:

- Business refers to any human activity undertaken on a regular basis with the object to earn profit through production, distribution, sale or purchase of goods and services.
- The essential characteristics of business are Deals in goods and services, Sale or exchange of goods and services, Regular exchange of goods and services, , Aims at earning profit, Involves risk and uncertainty of income.
- All the business activities are performed with some objectives. The objectives of business may be classified as – economic objectives, social objectives, human objectives, national objectives and global objectives.
- The Scope of business can be described as follows: Business improves the standard of living of the people by providing better quality and large variety of goods and services at the right time and at the right place, it provides opportunities to work and earn a livelihood. It gives better return to the investors on their capital investment, It also facilitates exchange of culture among the people of different nations and it helps in the development of science and technology.
- Business environment may be classified as Economic environment and Non-economic environment. The economic environment includes economic conditions, economic policies and economic system of the country. Non-economic environmental factors refer to social, political, legal, technological and cultural factors.

1.9 KEY WORDS

Business : An organisation or economic system where goods and services are exchanged for one another's or for money.

Profit : Financial gain, especially the difference between income and expenditure.

Employment : the state of having paid work

Risk : a situation involving exposure to danger.

1.10 SELF ASSESSMENT QUESTIONS

1. What is business?
2. Explain the characteristics of Business.
3. Discuss the classification of objectives of business.
4. State the nature of business.
5. Discuss the scope of business.
6. Explain the Economic and Non- economic environment.

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UNIT- 2 : INTERNAL AND EXTERNAL ENVIRONMENT, SCANNING OF THE ENVIRONMENT– IMPORTANCE, METHODS AND TECHNIQUES OF SCANNING

STRUCTURE

2.0 OBJECTIVES

After working through this unit, you should be able to :

- describe Features of business environment
- discuss the Different types of environmental factors
- examine the Environmental scanning
- discuss the Important needs and importance of environmental scanning
- discuss the Methods and techniques for environmental scanning

2.1 INTRODUCTION

The formula for business success requires two elements - the individual and the environment. Remove either value and success becomes impossible. Business environment consist of all those factors that have a bearing on the business. The term business environment implies those External forces, factors and institutions that are beyond the control of individual business organizations. It implies all external forces within which a business enterprise operates. Business environment influence the functioning of the business system. Thus, business environment may be defined as all those conditions and forces which are external to the business and are beyond the individual business unit, but it operates within it. These forces are customer, creditors, competitors, government, socio-cultural organizations, political parties, national and international organizations etc. some of those forces affect the business directly which some others have indirect effect on the business.

2.2 FEATURES OF BUSINESS ENVIRONMENT

The following are the features of Business environment:

- **Totality of External forces**: Business environment is the sum total of all things external to business firms and, as such, is aggregative in nature.
- **Specific and general forces**: Business environment includes both specific and general forces. Specific forces affect individual enterprises directly and immediately in their day-to-day working. General forces have impact on all business enterprises and thus may affect an individual firm only indirectly.

- **Dynamic Nature**: Business environment is dynamic in that it keeps on changing whether in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market.

2.3 DIFFERENT TYPES OF ENVIRONMENTAL FACTORS

On the basis of the extent of intimacy with the firm, the environmental factors may be classified into different types-

2.3.1 INTERNAL ENVIRONMENT

2.3.2 EXTERNAL ENVIRONMENT

2.3.1 INTERNAL ENVIRONMENT

The internal environment is the environment that has a direct impact on the business. Here there are some internal factors which are generally controllable because the company has control over these factors. It can alter or modify such factors as its personnel, physical facilities, and organization and functional means, like marketing, to suit the environment. The important internal factors which have a bearing on the strategy and other decisions of internal organization are discussed below.

1) Value system

The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and the objectives of the organization, business policies and practices.

2) Mission, Vision and Objectives

Vision means the ability to think about the future with imagination and wisdom. Vision is an important factor in achieving the objectives of the organization. The mission is the medium through which the objectives are achieved.

3) Management structure and nature

The structure of the organization also influences the business decisions. The organizational structure like the composition of board of directors influence the decisions of business as they are internal factors. The structure and style of the organization may delay a decision making or some other helps in making quick decisions.

4) Internal power relationships

The relationship among the three levels of the organization also influences on the business. The mutual co-ordination among those three is an important need for

a business. The relationship among the people working in the three levels of the organization should be cordial.

5) Human resource

The human resource is the important factor for any organization as it contributes to the strength and weakness of any organization. The human resource in any organization must have characteristics like skills, quality, high morale, commitment towards the work, attitude, etc. The involvement and initiative of the people in an organization at different levels may vary from organization to organization. The organizational culture and overall environment have bearing on them.

6) Miscellaneous factors

The other factors that contribute to the business success or failure are as follows:

Physical assets and facilities

Facilities like production capacity, technology are among the factors which influences the competitiveness of the firm. The proper working of the assets is indeed for free flow of working of the company.

Research and development:

Though R&D department is basically done external environment but it has a direct impact on the organization. This aspect mainly determines the company's ability to innovate and compete.

Marketing resources

Resources like the organization for marketing, quality of the marketing men, brand equity and distribution network have direct bearing on marketing efficiency of the company.

Financial factors

A factor like financial policies, and financial strategies financial positions and capital structure is also important internal environment affecting business performances, strategies and decisions.

2.3.2 EXTERNAL ENVIRONMENT

It refers to the environment that has an indirect influence on the business. The factors are uncontrollable by the business. There are two types of external environment.

I. Micro Environment

The micro environment is also known as the task environment and operating environment because the micro environmental forces have a direct bearing on the operations of the firm.

"The micro environment consists of the actors in the company's immediate environment that affects the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the public" The micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. When the competing firms in an industry have the same micro elements, the relative success of the firms depends on their relative effectiveness in dealing with these elements.

i) Suppliers

An important force in the micro environment of a company is the suppliers, i.e., those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious.

ii) Customer

The major task of a business is to create and sustain customers. A business exists only because of its customers. The choice of customer segments should be made by considering a number of factors including the relative profitability, dependability, stability of demand, growth prospects and the extent of competition. Competition not only include the other firms that produce same product but also those firms which compete for the income of the consumers the competition here among these products may be said as desire competition as the primary task here is to fulfill the desire of the customers. The competition that satisfies a particular category desire then it is called generic competition.

iii) Marketing Intermediaries

The marketing intermediaries include middlemen such as agents and merchants that help the company find customers or close sales with them. The marketing intermediaries are vital links between the company and the final consumers.

iv) Financiers

The financiers are also important factors of internal environment. Along with financing capabilities of the company their policies and strategies, attitudes towards risk and ability to provide non-financial assistance etc. are very important.

v) Public

Public can be said as any group that has an actual or potential interest in or on an organization's ability to achieve its interest. Public include media and citizens. Growth of consumer public is an important development affecting business.

II. Macro Environment

Macro environment is also known as General environment and remote environment. Macro factors are generally more uncontrollable than micro environment factors. When the macro factors become uncontrollable, the success of company depends upon its adaptability to the environment. Some of the macro environment factors are discussed below:

1) Economic Environment

Economic environment refers to the aggregate of the nature of economic system of the country, business cycles, the socio-economic infrastructure etc. The successful businessman visualizes the external factors affecting the business; anticipating prospective market situations and makes suitable to get the maximum with minimize cost.

2) Social Environment

The social dimension or environment of a nation determines the value system of the society which, in turn affects the functioning of the business. Sociological factors such as costs structure, customs and conventions, mobility of labour etc. have far-reaching impact on the business. These factors determine the work culture and mobility of labour, work groups etc. The major factor influencing social environment is the buying and consumption habits of people, their language beliefs and values, education and colour.

3) Consumption habits of people: Examples: Nestle brews a very large variety of instant coffee to satisfy different national tastes. Vicks Vaporub, the popular pain balm is balm is used as mosquito repellent in some tropical countries.

Colour: Examples – Blue: Feminine and warm in Holland; but masculine and cold in Sweden. Green: Favorite in Muslim world; but represents illness in Malaysia. Red: Popular in communist countries; but represents disaster in Africa. White: Death and mourning in china and Korea; but it expresses happiness in some countries. Also it is the colour of bridal dress.

4) Political Environment

The political environment of a country is influenced by the political organizations such as philosophy of political parties, ideology of government or party in power, nature and extent of bureaucracy influence of primary groups etc. The political environment of the country influences the business to a great extent.

Example: In India, Advertisement of alcoholic product is prohibited.

5) Legal Environment

Legal environment includes flexibility and adaptability of law and other legal rules governing the business. It may include the exact rulings and decision of the courts. These affect the business and its managers to a great extent.

6) Technical Environment

The business in a country is greatly influenced by the technological development. The technology adopted by the industries determines the type and quality of goods and services to be produced and the type and quality of plant and equipment to be used. Technological environment influences the business in terms of investment in technology, consistent application of technology and the effects of technology on markets.

2.4 ENVIRONMENTAL SCANNING

Environmental scanning is one essential component of the global environmental analysis. Environmental monitoring, environmental forecasting and environmental assessment complete the global environmental analysis. The global environment refers to the macro environment which comprises industries, markets, companies, clients and competitors. Consequently, there exist corresponding analyses on the micro-level. Suppliers, customers and competitors representing the micro environment of a company are analyzed within the industry analysis.

Environmental scanning can be defined as 'the study and interpretation of the political, economic, social and technological events and trends which influence a business, an industry or even a total market'. The factors which need to be considered

for environmental scanning are events, trends, issues and expectations of the different interest groups. Issues are often forerunners of trend breaks. A trend break could be a value shift in society, a technological innovation that might be permanent or a paradigm change. Issues are less deep-seated and can be a temporary short-lived reaction to a social phenomenon. A trend can be defined as an environmental phenomenon that has adopted a structural character.

2.5 THE NEED AND IMPORTANCE OF ENVIRONMENTAL SCANNING

The following are the need and importance of environmental scanning:

2.5.1 Identification of strength

Strength of the business firm means capacity of the firm to gain advantage over its competitors. Analysis of internal business environment helps to identify strength of the firm. After identifying the strength, the firm must try to consolidate or maximise its strength by further improvement in its existing plans, policies and resources.

2.5.2 Identification of weakness

Weakness of the firm means limitations of the firm. Monitoring internal environment helps to identify not only the strength but also the weakness of the firm. A firm may be strong in certain areas but may be weak in some other areas. For further growth and expansion, the weakness should be identified so as to correct them as soon as possible.

2.5.3. Identification of opportunities

Environmental analyses helps to identify the opportunities in the market. The firm should make every possible effort to grab the opportunities as and when they come.

2.5. 4. Identification of threat:

Business is subject to threat from competitors and various factors. Environmental analyses help them to identify threat from the external environment. Early identification of threat is always beneficial as it helps to diffuse off some threat.

2.5.5. Optimum use of resources:

Proper environmental assessment helps to make optimum utilization of scare human, natural and capital resources. Systematic analyses of business environment helps the firm to reduce wastage and make optimum use of available resources, without understanding the internal and external environment resources cannot be used in an effective manner.

2.5.6. Survival and growth:

Systematic analyses of business environment help the firm to maximize their strength, minimize the weakness, grab the opportunities and diffuse threats. This enables the firm to survive and grow in the competitive business world.

2.5.7. To plan long-term business strategy:

A business organization has short term and long-term objectives. Proper analyses of environmental factors help the business firm to frame plans and policies that could help in easy accomplishment of those organizational objectives. Without undertaking environmental scanning, the firm cannot develop a strategy for business success.

2.5.8. Environmental scanning aids decision-making:

Decision-making is a process of selecting the best alternative from among various available alternatives. An environmental analysis is an extremely important tool in understanding and decision- making in all situation of the business. Success of the firm depends upon the precise decision making ability. Study of environmental analyses enables the firm to select the best option for the success and growth of the firm.

2.6 METHODS AND TECHNIQUES FOR ENVIRONMENTAL SCANNING

It involves two phase: Information gathering and Evaluation

1. Verbal Information: It includes, information obtained by direct talk with people, by attending seminars, meeting, etc. The verbal information is significant in several other situations. The situation might have changed after the documentation of the information, necessitating personally contacting knowledgeable people to get the latest information. Personal contacts will be helpful in getting more details of the written information. Personal contacts will also be useful in obtaining diverse views of different people.

There are indeed many matters on which written information is non – existent or scanty, these highlight the importance of verbal information in environmental analysis.

While using written information, several factors such as the purpose for which it was prepared, the methodology used for collection of the information, reliability of the sources of information, the ideology/orientation of the individual/organization that prepared the information etc. need to be evaluated. Such cautions should also be exercised while going in for verbal information.

Sources of verbal information also include electronic media, seminars, workshops etc.

2. Search and Scanning: This involves research for obtaining the required information. Search and scanning are, therefore, needed, many a time, to identify the sources of information and to manage the timely availability of the required information.

A number of organizations have clippings service which constantly scans newspapers, periodicals etc. and prepare clippings containing information required by different departments/executives the organization.

Many organizations have management information system for systematic gathering, processing, storing and disseminating information. An MIS is generally regarded as very useful.

3. Spying: Even though it is not considered as ethical, spying to get information about the competitor is not uncommon.

4. Techniques of environmental forecasting –

a) **Econometric techniques** – It involve casual models to predict major economic indicators. When there is a well established relationship between two or more variable, that casual relationship can be used to forecast the future. The econometric models may "Utilise complex simultaneous regression equations to relate economic occurrences to areas of corporate activity. They are especially useful when information is available on casual relationships and when large changes are anticipated". The most commonly used econometric environmental forecasting techniques are multiple regression analysis and time series regression models.

b) **Trend Extrapolation** – Time series models assume that the past is a prologue to the future and extrapolate the historical data to the future. The technique may use simple linear relationship or more complex non – linear relationships to forecast trends.

c) **Scenario Development**- It is a techniques used to forecast the occurrence of complex environmental events. It is particularly useful for forecasting events in which many variables play a role. A scenario is a detailed description of how certain events may occur in the future and their consequences for the organization.

d) **Judgment Models** – It involve the use of opinion of people who have intimate knowledge relevant factors. For example, Sales force opinion of the sales potential, competitive challenges customer behavior etc. Another method is juries' executive

opinion which "Combine estimating made by executives from marketing, production, finance, and purchasing and then average their views.

e) **Brain Storming** – Is a creative method of generating ideas and forecasts. Under this method a group of knowledgeable people are encouraged to generate ideas, discuss them and to make forecasts on the basis of that. Brain storming is a popular technique of technological forecasting.

f) **Delphi Method**- Which is also a common technique for technological forecasting is a more systematic technique than brain storming. This method uses a panel of experts on the subject from whom opinions are gathered, may be by using semi-structured questionnaire and / or interview. The opinions of the experts are documented and consolidated and circulated among the panel members, preferable anonymously, for their evaluation and comments. The experts are requested to review their opinion in the light of the feedback. This process may be continued until a consensus view is arrived at.

2.7 SUMMARY

This unit has concentrated on internal environment and external environment, scanning of the environment, importance, methods and techniques of environment scanning.

- The following are the features of Business environment: Totality of External forces, Specific and general forces and Dynamic Nature.
- The environmental factors may be classified into different types- internal environment and external environment. The internal environment is the environment that has a direct impact on the business. The important internal factors which have a bearing on the strategy and other decisions of internal organization are Value system, Mission and vision and objectives, Management structure and nature, internal power relationships and Human resource. External environment refers to the environment that has an indirect influence on the business. The factors are uncontrollable by the business.
- There are two types of external environment - Micro Environment and Macro Environment. The micro environment is also known as the task environment and operating environment because the micro environmental forces have a direct bearing on the operations of the firm. The micro environmental factors are suppliers, customers, marketing intermediaries, financiers and public. Macro environment is

also known as General environment and remote environment. Macro factors are generally more uncontrollable than micro environment factors. Some of the macro environment factors are Economic, social, Political, Legal and technical.

- Environmental scanning is one essential component of the global environmental analysis. Environmental monitoring, environmental forecasting and environmental assessment complete the global environmental analysis.
- The following is the need and importance of environmental scanning: Identification of strength, Identification of weakness, Identification of opportunities, Identification of threat, Optimum use of resources, Survival and growth, To plan long-term business strategy and Environmental scanning aids decision-making.
- The following are the Methods and techniques for environmental scanning: Verbal Information, Search and Scanning, Spying and Techniques of environmental forecasting.

2.8 KEY WORDS

Vision : It says what you want to become

Mission: It states what is our business

Financiers : those who supply funds

Suppliers : those who supply raw material / goods

2.8 SELF ASSESSMENT QUESTIONS

1. State the features of Business environment.
2. Explain the classification of the environmental factors.
3. Distinguish between the internal and external environment.
4. What is environmental scanning? State the Important Needs and Importance of Environmental Scanning.
5. Discuss the methods and techniques of environmental scanning.

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UNIT – 3 : IMPACT OF SOCIAL, LEGAL AND POLITICAL ENVIRONMENT ON BUSINESS

STRUCTURE

3.0 OBJECTIVES

After studying this unit, you should be able to :

- define the PEST.
- discuss the advantages and disadvantages of PEST analysis
- define the culture, impact and approaches to the study of culture
- explain the four key Factors of the political environment which affects on business
- discuss the legal environment factors affecting business.

3.1 DEFINITION OF PEST

The term PEST has been used regularly in the last 10 years and its true history is difficult to establish. The earliest known reference to tools and techniques for 'scanning the business environment' is by Francis J. Aguilar who discusses 'ETPS'- a mnemonic for the four sectors of his taxonomy of the environment: Economic, Technical, Political and Social. Over the years this has become known as PEST with the additional letters are: Ecological factors, Legislative requirements, and Industry analysis. PESTELI is known as a trends analysis. The external environment of an organization, partnership, community etc. can be assessed by breaking it down into what is happening at **Political, Economic, Social, Technological, Environmental, Legal** and **Industry** levels. The same checklist can also be applied inside an organization.

Initially the acronym PEST was devised, which stands for:

Political factors - both big and small 'p' political forces and influences that may affect the performance of or the options open to the organization

Economic influences - the nature of the competition faced by the organization or its services, and financial resources available within the economy

Sociological trends - demographic changes, trends in the way people live, work, and think

Technological innovations - new approaches to doing new and old things, and tackling new and old problems; these do not necessarily involve technical equipment - they can be novel ways of thinking or of organizing.

The expanded **PESTELI** also includes:

Ecological factors - definition of the wider ecological system of which the organization is a part and consideration of how the organization interacts with it

Legislative requirements - originally included under 'political', relevant legislation now requires a heading of its own

Industry analysis - a review of the attractiveness of the industry of which the organization forms a part.

To be useful as an analysis tool, these environmental factors have to be linked to the organization's mission: which are helpful or which make it more difficult to accomplish that mission.

3.2 ADVANTAGES OF USING A PEST (ELI) ANALYSIS

The following are the advantages of PEST (ELI) analysis

- Simple framework.
- Facilitates an understanding of the wider business environment.
- Encourages the development of external and strategic thinking.
- Can enable an organization to anticipate future business threats and take action to avoid or minimize their impact.
- Can enable an organization to spot business opportunities and exploit them fully
- By taking advantage of change, you are much more likely to be successful than if your activities oppose it;
- Avoids taking action that is doomed to failure from the outset, for reasons beyond your control.

3.3 DISADVANTAGES OF USING A PEST (ELI) ANALYSIS

The following are the Disadvantages of PEST (ELI) analysis:

- Some users over simplify the amount of data used for decisions. It is easy to use scant data.
- To be effective this process needs to be undertaken on a regular basis.
- The best reviews require different people being involved each having a different perspective.
- Access to quality external data sources, this can be time consuming and costly.

- The pace of change makes it increasingly difficult to anticipate developments that may affect an organisation in the future.
- The risk of capturing too much data is that it may make it difficult to see the wood for the trees and lead to 'paralysis by analysis'.
- The data used in the analysis may be based on assumptions that subsequently prove to be unfounded (good and bad).

3.4 DEFINITION OF CULTURE

Business must have a social purpose; business concern must discharge social responsibility and social obligations and have social commitment. Otherwise business cannot enjoy social sanction. We may identify the critical elements of the sociological environment of business. Social and cultural aspects of a society form its very nature.

Terpstran has defined culture as follows: "The integrated sum total of learned behavioral traits that is manifest and shared by members of society"

3.5 APPROACHES TO THE STUDY OF CULTURE

Keegan (1989) suggested a number of approaches to the study of culture including the anthropological approach, Maslow's approach, the Self- Reference Criterion (SRC) and diffusion theory. There are briefly reviewed here.

3.5.1 Anthropological approach

Culture can be deep seated and, to the untrained can appear bizarre. The Muslim culture of covering the female form may be alien, to those cultures which openly flaunt the female form. The anthropologist, though a time consuming process, considers behavior in the light of experiencing it at first hand. In order to understand beliefs, motives and values, the anthropologist studies the country in question anthropology and unearths the reasons for what, apparently, appears bizarre.

3.5.2 Maslow approach

In searching for culture universals, Maslow's (1964) hierarchy of needs gives a useful analytical framework. Maslow hypothesized that people's desires can be arranged into a hierarchy of needs of relative potency. As soon as the "lower" needs are filled, other and higher needs emerge immediately to dominate the individual. When these higher needs are fulfilled, other new and still higher needs emerge.

3.5.3 Maslow hierarchy of needs

Physiological needs are at the bottom of the hierarchy. These are basic needs to be satisfied like food, water, air, comfort. The next need is safety - a feeling of well being. Social needs are those related to developing love and relationships. Once these lower needs are fulfilled "higher" needs emerge like esteem - self respect - and the need for status improving goods. The highest order is self actualization where one can now afford to express oneself as all other needs have been met.

Whilst the hypothesis is simplistic it does give an insight into universal truisms. In Africa, for example, in food marketing, emphasis may be laid on the three lower level needs, whereas in the developed countries, whilst still applicable, food may be bought to meet higher needs. For example, the purchase of champagne or caviar may relate to esteem needs.

3.5.4 The self reference criterion (SRC)

Perception of market needs can be blocked by one's own cultural experience. Lee (1965) suggested a way, whereby one could systematically reduce this perception. He suggested a four point approach.

a) Define the problem or goal in terms of home country traits, habits and norms.

b) Define the problem or goal in terms of the foreign culture traits, habits and norms.

c) Isolate the SRC influence in the problem and examine it carefully to see how it complicates the pattern.

d) Redefine the problem without the SRC influence and solve for the foreign market situation.

The problem with this approach is that, as stated earlier, culture may be hidden or non apparent. Unearthering the factors in b) may, therefore, be difficult. Nonetheless, the approach gives useful guidelines on the extent for the need of standardization or adaption in marketing planning.

3.5.5. Diffusion theory

Many studies have been made since the 1930's to assess how new innovations are diffused in a society. One of the most prolific writers was Everett Rogers. In his book, "Diffusion of Innovations" (1962) he suggested that adoption was a social phenomenon, characterized by a normal distribution.

3.6 IMPACT OF CULTURE ON BUSINESS

The interface between business and culture is brought out in the following paragraphs

i) Culture creates People: The concept of culture is of great significance to business because it is the culture which generally determines the ethos of the people. It trains people along particular lines, tending to put a personality stamp upon them. Thus we have Indians, Japanese, Americans, Germans, and British and so on. It is not that all people are alike in a particular culture. There are subcultures within a culture. People have their own idiosyncrasies and are a blend of heredity, cultural experience, family experience, and unique personal experience.

When people with different cultural backgrounds promote, own and manage organizations, organizations themselves tend to acquire distinct cultures. Thus, the culture of the Tata group of companies is different from that of the enterprises owned by the Birla's.

ii) Culture and Globalization: As business unit go international, the need for understanding and appreciating cultural differences across various countries are essential. Work motivation, profit motivation, business goals, negotiating styles, attitudes towards the development of business relationships, gift – giving customs, greetings, significance of body gestures, meaning of colors and numbers, and the like vary from country to country.

iii) Culture Determines goods and Services: Culture broadly determines the types of goods and services a business should produce. The type of food people eat, the clothes they wear, the beverages they drink and building materials they use to construct dwelling houses vary culture to culture and from time to time within the same culture. Business should realize these cultural differences and bring out products accordingly.

iv) Language and culture: Language reflects the nature and values of society. There may be many sub-cultural languages like dialects which may have to be accounted for. Some countries have two or three languages. In Zimbabwe there are three languages - English, Shona and Ndebele with numerous dialects. In Nigeria, some linguistic groups have engaged in hostile activities. Language can cause communication problems - especially in the use of media or written material. It is best to learn the language or engage someone who understands it well.

The world's languages can be classified, based on whether the message conveyed is explicit or implicit, into two groups. Language in which people state things directly and explicitly are called low context. The words provide the meaning. There is no need to interpret the situation to understand the import of the words. Language in which people state things indirectly and implicitly are called high context. In the high context language, communications have multiple meanings that can be interpreted only by reading the situation in which they occur.

Most Northern European languages, including German, English and the Scandinavian languages, are low context. People use explicit words to communicate direct meaning. In contrast, Asian, and Arabic languages are high context.

Attitudes: Attitudes are positive or negative evaluations, feelings and tendencies which make an individual behave in a particular way towards people or object. Attitudes include many things including opinion about individual freedom, democracy, truth and honesty, role of sexes, justices, love, marriage and sex. Of particular interest to us in this context are ones attitude towards work, attitude towards business, and attitude towards time and the future.

Attitude toward work is important as it has significant impact on motivation, morale, job satisfaction, productivity and other aspects of human resource management. Positive attitude ones work, also called work ethic, makes a worker a more productive and a more satisfied employee.

The culture of the land determines its people's attitude towards business. Business systems are a product of beliefs, morals and customs of the society in which they exist. In fact, their vary existence depends upon social philosophies which conduct and support various kinds of business functions. Business people must have some basic set of philosophies to guide their actions. Beliefs and value systems concerning what is right and what is wrong are basic to all business activities and serve as a justification for doing or not doing something in a particular value system by which actins of business persons and other groups are judged.

People attitudes towards time depend on culture. Most western and capitalist societies believe that time is money. To waste time is to waste money. For most westerns punctuality is a must. Being late for a meeting or appointment is not only considered rude but also offensive. Every business activity is times in terms of hours, minutes, days, months, and years. Long term strategic plans are prepared to ensure targets are met in time. Time seems to control every aspect to human Endeavour. Pay and productivity

are measured in terms of the time it takes to complete a given task. But in some other society's time is viewed as something not to be taken seriously.

Ambitious: An individual ambition to grow or remain complacent depends on his cultural ethos. An ambitious individual is highly motivated, is wealth acquisitive, has a strong urge to excel, is prepared to change organizations and even take risks. Economy becomes vibrant if a large proportion of the population comprises ambitious people.

Family: The family is recognized as the institution responsible for procreation and child – rearing. In civilized societies, especially, the process of child socialization has come to have tremendous significance. Gone are the days when the children should be seen but not heard; on the contrary the importance of childhood and the effects of home life on personality and character formation have been widely recognized. In fact, as the basic primary group, the family probably has more to do with the child's ultimate behavioral pattern than does any other single environment factor , and it is on this assumption, that a loose home life is so often associated with delinquency.

The family, through the husband – wife relationship, is also a recognized institution for the fulfillment of sexual needs. The sex urge is a powerful one and most societies have set – up rather elaborate safeguards to ensure that sexuality is kept within bounds. In a very real sense, the family is answer to man's sex problems.

The family is also one of the chief agencies of social life. This was not always so, and in some societies, it is not the case today. In different cultures, for example, men and women have tended to socialize in same sex – groupings. Yet over the years, wherever women have been accorded a relatively equal status, the husband wife relationship has taken on an added meaning in terms of companionship, shared activities, satisfaction of emotional needs and other manifestations of primary group association.

Education: Education refers to the transmission of skills, ideas and attitudes as well as training in particular disciplines. Education can transmit cultural ideas or be used for change, for example the local university can build up an economy's performance.

Education has considerable business implications. Economic progress of a country depends on the education of its citizens. This being a broad statement, specific economic implications is as follows:

a) Countries rich in educational facilities vastly attract high wage industries. By investing in education, a country can attract the kind of high wage industries that are often called "brain power" industries.

b) The market potential of a country depends on education. Educationally advanced countries such as England, France and Germany are more likely to be markets for computers and high – tech equipment than are less educated countries such as Poland and Romania. It is also likely that MNCs doing business in these countries will find it easier to hire and train local managers in Western Europe than in Eastern Europe.

c) The level of literacy and educational attainment determines the nature of advertising, packaging, quality of marketing research, and distribution system.

Material culture

Material culture refers to tools, artifacts and technology. Before marketing in a foreign culture it is important to assess the material culture like transportation, power, and communications and so on. Input-output tables may be useful in assessing this. All aspects of marketing are affected by material culture like sources of power for products, media availability and distribution.

Aesthetics

Aesthetics refer to the ideas in a culture concerning beauty and good taste as expressed in the arts -music, art, drama and dancing and the particular appreciation of colour and form. African music is different in form to Western music. Aesthetic differences affect design, colours, packaging, brand names and media messages.

Religion

Religion provides the best insight into a society's behavior and helps answer the question why people behave rather than how they behave. Religion refers to a specific and institutionalized set of beliefs and practices generally agreed upon by a number of persons or sects. There are nearly 100,000 religions across the globe, but the major ones among them are Hinduism, Christianity, Islam and Buddhism. Each has its own distinct characteristics and followers.

Religion has considerable impact on one's life, irrespective of the country to which he or she belongs. People go any extent and practice abnormal activities in the name of religion. Animals and human beings are scarified to propitiate god, heads and tonsured, cheeks and tongues are pierced, sex and food are given up for days, dip in rivers and roll over around places of worship – all in the name of religion. People are compelled to change their religious faiths, places of worship are destroyed and pillaged, people are beheaded and battles are fought over religious matters.

Social organization

Refers to the way people relate to each other, for example, extended families, units, kinship. In some countries kinship may be a tribe and so segmentation may have to be based on this. Other forms of groups may be religious or political, age, caste and so on. All these groups may affect the marketer in his planning.

There are other aspects of culture, but the above covers the main ingredients. In one form or another have to be taken account of when marketing internationally.

3.7 DEFINING THE POLITICAL ENVIRONMENT

The political environment is one of the less predictable elements in an organization's business environment. The fact that democratic governments have to seek re-election every few years has contributed towards a cyclical political environment. The political environment in its widest sense includes the effects of pressure groups who seek to change government policies.

3.8 THE IMPORTANCE OF MONITORING THE POLITICAL ENVIRONMENT

It is important for organizations to monitor their political environment, because change in this environment can impact on business strategy and operations in a number of ways:

- The stability of the political system affects the attractiveness of a particular national market.
- Governments pass legislation that directly affects the relationship between the firm and its customers, its suppliers and other firms.
- Governments see business organizations as an important vehicle for social reform.
- The government is additionally responsible for protecting the public interest at large.
- The economic environment is influenced by the actions of government.
- Government is itself a major consumer of goods and services.
- Government policies can influence the dominant social and cultural values of a country.

3.9 FOUR KEY FACTORS OF THE POLITICAL ENVIRONMENT WHICH AFFECTS ON BUSINESS ORGANIZATIONS

The following are the four key factors of the political environment which affects on business organizations:

i) Impact on the Economy

The political environment in a country affects its economic environment. The economic environment, in turn, affects the performance of a business organization. In the United States, for instance, there are significant differences in Democratic and Republican policies. This has implications for factors such as taxes and government spending, which in turn affect the country's economy. A higher level of government spending tends to stimulate the economy, for instance.

ii) Changes in Regulations:

Governments could change their rules and regulations, and this could have an effect on a business. For instance, after the accounting scandals of the early twenty-first century, the United States Securities and Exchange Commission became more focused on corporate compliance and the government introduced the Sarbanes-Oxley compliance regulations of 2002. This was a response to the social environment that called for such change to make public companies more accountable.

iii) Political Stability:

Particularly for businesses that operate internationally, a lack of political stability in any country has an effect on its operations. A hostile takeover could overthrow a government, for instance. This could lead to rioting and looting and general disorder in the environment. All this disrupts the operations of a business. Such disruptions have occurred in Sri Lanka, which went through a protracted civil war, and in Egypt and Syria, which have been subject to disturbances as people agitate for certain rights.

iv) Mitigation of Risk:

One way to manage political risk is to buy political risk insurance. Organizations that have international operations use this type of insurance to mitigate their risk exposure as a result of political instability. There are indices that provide an idea of the risk exposure an organization has in certain countries. For instance, an index of economic freedom ranks countries based on how political interference impacts business decisions in each country

3.10 LEGAL ENVIRONMENT

Legal environment includes flexibility and adaptability of law and other legal rules governing the business. It may include the exact rulings and decision of the courts. These affect the business and its managers to a great extent.

3.11 LEGAL ENVIRONMENT FACTORS AFFECTING BUSINESS

Governments control the business activities is many ways both direct and indirect. However, government can control business activities in a more direct way. These are as follows:

1) Controlling what to produce

In order to safeguard the interest of the community government may ban or limit the production of certain goods and services. For example, selling of guns, explosive and dangerous drugs are illegal in many countries. Moreover, Goods which harm the environment are also totally banned or strictly controlled in many countries, e.g. aerosol cans that use CFCs which has been banned because of their damaging effect on the ozone layer.

2) Employees Protection legislations

Government may pass laws to protect the interest of employees such as Laws against unfair discrimination at work and when applying for jobs. There is no unfair discrimination on the basis of Race, religion, sex, age, or colour.

3) Legislations for health and Safety at work

The following are the legislations for health and safety at work

- To protect the workers from the dangerous machinery.
- Workers should be provided with proper safety equipments and clothing.
- A reasonable workforce temperature is maintained for workers.
- Proper hygienic conditions and washing facilities are provided.
- Workers get adequate breaks between shifts.

4) Protect employees against unfair dismissal

Business can not dismiss the workers because they have joined a trade union or for being pregnant. There should be proper warning before dismissing a worker otherwise it will be treated as unfair dismissal.

5) Ensure fair wages for the employees

In many countries, government makes it mandatory to have a written contract of employment. It contains the details of the wage rate; working hours, deductions (if any) and other necessary details regarding working conditions. Minimum wages paid to different types of workers are also determined by the government.

6) Consumer Protection legislations

Most of the countries have consumer protection laws aimed at making sure that businesses act fairly towards their consumers: A few examples are

7) Weight and Measures Act:

Goods sold should not be underweight. Standard weighting equipments should be used to measure goods.

8) Trade Description Act:

Deliberately giving misleading impression about the product is illegal.

9) Consumer Credit Act:

According to this act consumers should be given a copy of the credit agreement and should be aware of the interest rates, length of loan while taking a loan.

10) Sale of Goods Act:

It is illegal to sell products with serious flaws or problems and goods sold should conform to the description provided.

3.12 SUMMARY

This unit has concentrated on the impact of social, legal and political environment on business.

The term PEST can expands Economic, Technical, Political and Social. We have discussed the advantages and disadvantages of the PEST.

Terpstran has defined culture as follows: "The integrated sum total of learned behavioral traits that is manifest and shared by members of society.

Keegan (1989) suggested a number of approaches to the study of culture including the anthropological approach, Maslow's approach, the Self- Reference Criterion (SRC) and diffusion theory.

The following are the impact of culture on business - Culture creates People, Culture and Globalization, Culture Determines goods and Services, Language and culture, Attitudes, Ambitious, Education, Material culture, Aesthetics, Religion and Social organization.

The political environment is one of the less predictable elements in an organization's business environment. The following are the four key factors of the political environment which affects on business organizations: Impact on the Economy, Changes in Regulations, Political Stability and Mitigation of Risk**.**

Legal environment includes flexibility and adaptability of law and other legal rules governing the business. Government can control business activities in a more direct way. These are as follows: Controlling what to produce, Employees Protection legislations, Legislations for health and Safety at work, Protect employees against unfair dismissal, ensure fair wages for the employees, Consumer Protection legislations.

3.13 KEY WORDS

Culture : the Customs , ideas and social behaviour of particular society.

Anthropology : A study of human societies and cultures and their development.

Legal : environment relating to law or legal aspects of business

3.13 SELF ASSESSMENT QUESTIONS

1. Define the PEST.
2. State the advantages and disadvantages of PEST.
3. Define the culture.
4. Discuss the approaches of culture.
5. Explain the impact of culture on business.
6. Discuss the four key effects of the Political Environment on Business Organizations.
7. State the importance of monitoring the political environment.
8. Define the Political Environment.
9. Discuss the legal environment factors affecting business

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UNIT - 4 : IMPACT OF DEMOGRAPHIC, ECONOMIC AND TECHNOLOGICAL ENVIRONMENT ON BUSINESS

STRUCTURE

4.0 OBJECTIVES

After studying this unit, you should be able to:

- define the demographic environment and its factors affecting on business.
- discuss the advantages and disadvantages of a demographic environment.
- explains the economic environment factors affecting the business.
- discuss the technological factors affecting business and their environment.

4.1 DEFINITION OF DEMOGRAPHIC ENVIRONMENT

This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services.

For example a country where population rate is high and children constitute a large section of population, and then there is more demand for baby products. Similarly the demand of the people of cities and towns are different from the people of rural areas. The rapid growth of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skill labour in certain areas motivates the firms to set up their units in such area.

4.2 THE DEMOGRAPHIC ENVIRONMENT FACTORS AFFECTING BUSINESS

Demography studies how populations changes overtime, in terms of size and structure. The demographic variables that affect business are:

4.2.1 Size of the population:

Number of people within a certain population normally grows over time, according to birth and death rate as well as net migration (which counts emigrants and immigrants). The size of a population can have important implication both for the demand and supply side of goods and services.

The population changes overtime according to:

i) **Birth rate**: Number of live births for thousand of the population every year. In many Western countries birth rate is showing a falling trend, as a result of a raising in the trend of smaller families, increased accessibility to contraception, later marriages and childbearing, declining fertility rate and a changing attitude towards women at work.

ii) **Death rate**: Measured on thousand for population per year. This is falling in developed countries as a result of rising living standards, development in medical technology, better education and improved working conditions.

iii) **Net migration**: Balance between people leaving and those who enter a country over a given period of time. This parameter combined with birth and death rate, determines the changes in the population size.

Changes in size and structure of the population can impact business in several ways, either in the short or long term. For example, a growing population means a rising trend for the demand of primary goods such as housing, energy, food or durable goods in general. At the same time this means a higher availability of workforce. An ageing population leads to a rising demand for public and private health-care and pension. Declining birth rate may influence the demand for education or other goods such as toys and childcare.

4.2.2 Age and sex of the population:

This includes the balance between males and females as well as how the population is divided into groups of age. Younger people under 35 are often the first consumers to purchase high-tech products like cell phones, electronic books and video games. Certain buying groups also have more buying power than others. For example, there are about 76 million baby boomers in the United States, according to "Entrepreneur" online. This is the single largest population segment. These people were born between 1946 and 1964, according to "Elderly Journal" online. Baby Boomers spent $400 billion more than any other age group, according to a June 2009 report by "Entrepreneur." Small business owners have much to gain by selling products to this population.

Recent trends show how all the Western countries are going toward an ageing population as the group of people over 65 years has outnumbered the young people under 16 years. This can have important implications both on private and public businesses.

4.2.3 Income

Income is one demographic variable that can affect businesses. A company's products usually appeal to certain income groups. For example, premium products such as high-end women's' clothing usually appeal to women with higher incomes. Conversely, people with comparatively lower incomes are more sensitive to price and, therefore, may prefer purchasing discount products. People with lower incomes have less disposable income. Value is a major determinant in the products they purchase. Hence, a company

may best reach lower-income people through discount retailers and wholesalers and attract higher-income buyers in specialty retail shops.

4.2.4 Ethnicity:

This focuses the attention on the various ethnic groups living within a population and tries to identify their peculiar structure. Again, this is really important for business to interpret the possible demand coming from the different ethnic groups and understand how this impact on the supply demands with reference in particular to the workforce.

4.2.5 Geographic Region

People's buying preferences also vary by geographic region, which is another type of demographic. Those who meet buyers' needs and requirements in certain geographic regions can earn higher sales and profits. For example, people often prefer certain food and drink flavors in certain markets. Companies that sell the flavors consumer's desire in various areas are more likely to profit. Those who do not offer these flavors may risk losing customers to other competitors.

4.3 OBTAINING DEMOGRAPHIC INFORMATION

One of the best ways to collect consumer demographic data is through market research surveys. These surveys can be conducted by phone, mail, Internet or in person. The key is collecting as much demographic information as possible. Other demographic variables, besides age, income and geography, include household size, education, occupation, gender, race and employment status. Most marketing research professionals include demographic questions at the end of their surveys. Warranty cards are another way to collect this information from customers.

4.4 ADVANTAGES OF A DEMOGRAPHIC ENVIRONMENT

The following are the advantages of a Demographic environment

i) Focus

When a company looks at a demographic environment, it focuses its attention on the people who are most likely to buy a product. This is good from the marketing standpoint because it means the company does not waste money trying to get people to buy who have no interest in the product.

ii) Branding and Strategy

Demography provides very specific information about different populations. Once a company has this data, the company can develop well-defined strategies about how to reach each population — that is, it tells companies exactly how to market and develop their brands so people in the demographic environment will respond. For instance, if people in the demographic environment tend to be busy, young workers, then a company might promote the quick use and convenience available with the product.

iii) Trending and Comparison

When companies examine demographic environments, they usually do so under the same lenses, such as age or gender. By collecting demographic data over extended periods of time and comparing information from different points, companies can identify trends within the population. This lets them forecast what might happen with sales in the future and make some decisions about upcoming production or offered services.

4.5 DISADVANTAGES OF A DEMOGRAPHIC ENVIRONMENT

The following are the disadvantages of a Demographic environment

1) Assumption and Culture

Perhaps the largest problem with a demographic environment in terms of marketing is that even though marketers use accurate data to make predictions about what will happen with consumers, there is no guarantee that what the company predicts actually will come to pass. In other words, much of marketing with demographic data is based on assumptions. Additionally, those assumptions are based largely on the cultural norms surrounding the company. Demographic information has little meaning unless marketers examine it with this in mind, as culture has such a large influence on what those in the demographic environment do.

2) Change

Population are never constant. People migrate from place to place, and people pass away and are born. Subsequently, marketers cannot simply collect demographic data one time. They have to collect the information constantly in order to have a realistic picture of what is happening at any given point. This requires a great deal of effort and means a constant expense to a business.

3) Customer Loss

Focusing marketing based on demographic information means that a company may lose potential customers who do not fit the general demographic mold because the company does not concentrate on attracting those customers. This includes the loss of sales from people who might buy the product or service for someone else, as those people might not be aware the company offers the product or service.

4.6 ECONOMIC ENVIRONMENT

The **economic environment** consists of external factors in a business' market and the broader economy that can influence a business. We can divide the economic environment into the microeconomic environment, which affects business decision-making such as individual actions of firms and consumers, and the macroeconomic environment, which affects an entire economy and all of its participants. Many economic factors act as external constraints on your business, which means that you have little, if any, control over them.

Let's take a look at both of these broad factors in more detail

♦ Macroeconomic influences are broad economic factors that either directly or indirectly affect the entire economy and all of its participants, including your business. These factors include such things as:

- Interest rates
- Taxes
- Inflation
- Currency exchange rates
- Consumer discretionary income
- Savings rates
- Consumer confidence levels
- Unemployment rate
- Recession
- Depression

♦ Microeconomic factors influence how your business will make decisions. Unlike macroeconomic factors, these factors are far less broad in scope and do not necessarily

affect the entire economy as a whole. Microeconomic factors influencing a business include:

- Market size
- Demand
- Supply
- Competitors
- Suppliers
- Distribution chain - such as retailer stores

4.7 THE ECONOMIC ENVIRONMENT FACTORS AFFECTING THE BUSINESS

These are some of the economic environment factors which affect business

i) At what stage of the business cycle is the economy

If the economy is going through a recession it is obvious that businesses generally will not be doing well due to low aggregate demand in the economy. On the other hand, a boom period will lead to higher business profits and revenue for most of the businesses in the economy.

ii) Inflation rate

High rate of inflation leads to lower purchasing power for consumers resulting in lower demand for goods and services. Moreover, a higher inflation rate will make business uncompetitive in the international market leading to lower sales for the business.

iii) Prevailing interest rates

Higher Interest rates will lead to a fall in the aggregate demand in the economy thus leading to difficulty for business to find customers willing to buy its product. Lower interest rates will lead to a increase in demand in the economy.

iv) Unemployment level

High level of unemployment in the country can also adversely affect a business. People will not have enough money to purchase a firm's product.

v) Labor costs

High labor cost will result higher production costs. This will make a firm's product more expensive as compared to other firms affecting its sales and profit margin.

vi) Levels of disposable income and income distribution

High level of disposable income is good for business producing luxury goods. A large disparity in income distribution will promote businesses dealing in luxury goods as well as inferior goods.

vii) Taxes

High level of taxes will lead to low disposable income and contraction of demand in the economy. Business will find it difficult to attract consumers.

viii) Tariffs

Tariffs are taxes and imposed on imported goods. If the tariffs are low the domestic market may be flooded with cheap imported goods and the local businesses will have tough time selling their products.

4.8 DEFINITION OF TECHNOLOGY:

Among all the segments of macro environment, technological environment exerts considerable influence on business. Technology is one of the important determinants of success of a firm as well as the economy and social development of a nation. Technology includes the tools – both machines (hard technology) and ways of thinking (soft technology) – available to solve problems and promote progress between, among and between societies".

J.K Galbraith defines technology as a "Systematic application of scientific or other organized knowledge to practical tasks".

Technology is the most dramatic force shaping the destiny of people all over the world. Some of the technological inventions the man feels are wonders, some others are horrors, and yet others have mixed blessings. Automobiles and television, for example, have evoked mixed reactions. Hydrogen bomb, nerve gas and sub marine guns have proved to be horrors. Open heart surgery and birth control ipills are wonders.

4.9 THE TECHNOLOGICAL FACTORS AFFECTING BUSINESSES AND THEIR ENVIRONMENT

The following are the technological factors affecting the business

1) **Organizational change**

It is usually quite difficult especially when a high number of people are involved as routines will be modified. It is recommended to inform employees in advance and keep them up to date encouraging feedback when making such change.

2) **Business processes**

It is an integrating modern technology solicits identifying the business requirements and evaluating the business processes according to its objectives and goals. These changes should benefit the company and the consumers.

3) **Sustainable Competitive Advantage (SCA)**

It is looking at technology from a positive perspective instead of a 'necessary evil'. Traditional models are changing and advantages can be achieved by investing in modern technology but just purchasing technology for the sake of having it is not enough, implementing a strategic plan is the key in order to succeed.

4) **Costs involved**

It is a necessary expense in today's emerging environment. However, it's understandable that some organizations are hesitant to invest due to systems being outdated quite often, but the ones who view this investment as an opportunity to gain competitive advantage and have a well-developed strategy attached, could benefit immensely.

5) **Efficiency**

It is productivity, reducing manual labour costs, cost-effective overall factor as it can simplify, speed up and enhance accuracy (or e.g. departments can interact or check a particular issue or status of an order/delivery/service from different locations in the value chain.

6) **Information Security/Contingency Planning**

Technology provides a lot of advantages but we should also take into consideration the responsibilities that come with it. Businesses should take into account the rise in data breaching and various cyber-crime elements and must invest in effective ways of preventing or combating these factors. Imagine if an important process becomes unavailable suddenly or a system is hacked. Businesses must have these contingency plans in place in order to protect their valuable assets.

7) **Improving Communication**

Business technology can help small businesses improve their communication processes. Emails, texting, websites and personal digital products applications, known as "apps," can help companies improve communication with consumers. Using several types of information technology communication methods allow companies to saturate the economic market with their message.

Companies may also receive more consumer feedback through these electronic communication methods. These methods also allow companies to reach consumers through mobile devices in a real-time format.

Social networking affects the business environment. Employees are connected to social networks. This can be a double-edged sword, however. An employee might post something about the business publicly which should not be shared. In addition, employees need to understand what gets posted for the public to see can have an impact on the work environment, especially if the employee is posting negative comments about the work environment or other employees. On the flip side, businesses can use social networks to monitor customer satisfaction. For example, if a customer is not happy with a product and he posts his feelings online, the company can contact the customer and try to resolve any problems. Since social networks have links to friends and family, seeing the company work hard to make things right with the customer might turn the potential loss of a customer into the chance to gain new customers.

Technology has had a large impact on the business environment in terms of telecommuting. With broadband access and computers today, as well as smart phones, employees can work out of their homes, saving the company money by not needing as physically large a space to operate. With video conferencing, business meetings no longer need to be face-to-face, saving on air fare and hotel reservations.

8) **Potential Increase in Business**

Technology allows small businesses to reach new economic markets. Rather than just selling consumer goods or services in the local market, small businesses can reach regional, national and international markets. Retail websites are the most common way small businesses sell products in several different economic markets.

Websites represent a low-cost option that consumers can access 24/7 when needing to purchase goods or services. Small business owners can also use Internet advertising to reach new markets and customers through carefully placed web banners or ads.

9) **Considerations**

Business technology allows companies to outsource business function to other businesses in the national and international business environment. Outsourcing can help company's lower costs and focus on completing the business function they do best. Technical support and customer service are two common function companies outsource.

Small business owners may consider outsourcing function if they do not have the proper facilities or available manpower. Technology allows businesses to outsource function to the cheapest areas possible, including foreign countries.

The society as we know it is going through a radical makeover, thanks to constant connectivity everywhere. This is creating a need for a digital makeover of everything – from retail to our postal system. It is changing our infrastructure needs and it is also increasing the velocity of business. To stay ahead of the game business owners must also change the traditional way of operating their day-to-day business.

4.10 SUMMARY

This unit has concentrated on the impact of demographic, economic and Technical environment on business.

Demographic environment refers to the size, density, distribution and growth rate of population. The demographic variables that affect business are **Size of the population**, **Age and sex of the population,** Income, **Ethnicity** and Geographic Region.

The advantages of Demographic environment are branding and strategy, trending and comparison. The disadvantages of demographic environment are assumption and culture, change and customer loss.

The economic environment consists of external factors in a business' market and the broader economy that can influence a business. Economic environment factors which affect business are at what stage of the business cycle is the economy, Inflation rate, Prevailing interest rates, Unemployment level, Labor costs, Levels of disposable income and income distribution, Taxes and Tariffs.

Technology is one of the important determinants of success of a firm as well as the economy and social development of a nation. Technology includes the tools – both machines (hard technology) and ways of thinking (soft technology) – available to solve problems and promote progress between, among and between societies". The technological factors affecting the business are Organizational change, Business

processes, SCA (Sustainable Competitive Advantage), Costs involved, Efficiency, Information Security/Contingency Planning, **Improving Communication and Potential Increase in Business.**

4.11 KEY WORDS

Income : Money that an individual or business receives in exchange for providing a goods or service or through investment

Ethnicity : The fact or state of belonging to a social group that has common national or cultural tradition

Inflation : A general increase in prices and fall in purchasing value of money

Taxes : a compulsory contribution to state revenue, levied by the government

4.11 SELF ASSESSMENT QUESTIONS

1. Define Demographic environment.
2. Discuss the demographic factors influencing the business.
3. What are the advantages and disadvantages of Demographic environment?
4. Define Economic environment.
5. Explain the economic environment factors affecting the business.
6. What is technology?
7. Discuss the technological factors affecting the business.

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DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

M.B.A I Semester

COURSE - 6

BUSINESS ENVIRONMENT

BLOCK

2

ECONOMIC ENVIRONMENT OF BUSINESS

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BLOCK -2 : ECONOMIC ENVIRONMENT OF BUSINESS

The primary motive of a business concern is maximisation of wealth. A manager of a firm should have better understanding of all economic aspects which influence on a firm. The block deals with economic environment of bussiness. This block has 4 units.

Unit- 5 deals with economic environment, at the outset the unit focusses on types of business environment. The unit the explains economic and non economic environment. Also discussed recent developments in Indian economy and their implications to bussiness.

Unit- 6 focuses on economic development. The macroeconomic factors have greater influence on the business of a country's economic development and the factors which indicate economic development have very much relevance in business decisions. Hence, a manager needs to understand these factors. The unit discuses the economic development of India, then explains the basic indicators of economic development. Also discussed synergy between government and business, role of government towards performance of Indian economy.

Unit -7 deals with monetary policy. A countries central bank control monetary policy which has greater influence in the money flows into the economy. Thus managers needs to know the monetary policy changes and their influence in business. The unit at the outset discusses the meaning, odjectives and instruments of monetary policy. Further, the unit evaluate monetary policy explains the limitations and recent changes in RBI's monetary policy.

The unit- 8 concerned with fiscal policy. The government budget decides or set road for its overall economic growth, which decides the role of business in the country's economic growth . The unit at the outset discussed objectives, types of fiscal policy. It also explains differences between monetary policy and fiscal policy. Further, the unit discussed budget deficit, the deficit and debt.

UNIT – 5 : MEANING, NATURE AND SCOPE OF BUSINESS ENVIRONMENT

STRUCTURE

5.0 OBJECTIVES

After reading this unit, you will be able to:

- discuss types of business environment
- explain Nature and importance of economic environment
- identify different economic systems prevailing at present
- elaborate developments in Indian Economy.

5.1 INTRODUCTION

Business depends on the economic environment for all the needed inputs and to sell the finished goods. Business fortunes and strategies are influenced by the economic characteristics and economic policy dimensions. Next to the political environment, it is probably the economic environment which has a considerable influence on business. The economic environment includes the nature and structure of the economy, the stages relating to the economic development, standard of living, economic resources, income and assets distribution, economic linkage with global environment and so on. Economic system of country provides its broadest economic environment.

5.2 TYPES OF BUSINESS ENVIRONMENT

Confining business environment to uncontrollable external factors, it may be classified as

(a) Economic environment; and

(b) Non-economic environment.

The economic environment includes economic conditions, economic policies and economic system of the country.

Non-economic environment comprises social, political, legal, technological, demographic and natural environment. All these have a bearing on the strategies adopted by the firms and any change in these is likely to have a far-reaching impact on their operations.

Among all the environmental factors, business and its strategies are mainly influenced by the economic environmental factors. As a business is an economic unit in a market system, almost all the decisions taken in a business are directly or indirectly

economic in nature and hence, reflect economic environment. Economic environment is discussed in detail below.

5.3 ECONOMIC ENVIRONMENT

Economic environment refers to all those economic factors which have a bearing on the functioning of a business unit. Business depends on the economic environment for all the needed inputs. It also depends on the economic environment to sell the finished goods. Naturally, the dependence of business on the economic environment is total and it is not surprising because, as it is rightly said, business is one unit of the total economy.

The survival and success of each and every business enterprise depends fully on its economic environment. The main factors that affect the economic environment are:

(a) Economic Conditions:

The economic conditions of a nation refer to a set of economic factors that have great influence on business organisations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.

(b) Economic Policies:

All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are:

(i) Industrial policy

(ii) Fiscal policy

(iii) Monetary policy

(iv) Foreign investment policy

(v) Export –Import policy (EXIM policy)

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein.

Important Economic Policies are discussed below:

a. Industrial policy:

The Industrial policy of the government covers all those principles, policies, rules, regulations and procedures, which direct and control the industrial enterprises of the country and shape the pattern of industrial development.

b. Fiscal policy:

It includes government policy in respect of public expenditure, taxation and public debt.

c. Monetary policy:

It includes all those activities and interventions that aim at smooth supply of credit to the business and a boost to trade and industry.

d. Foreign investment policy:

This policy aims at regulating the inflow of foreign investment in various sectors for speeding up industrial development and take advantage of the modern technology.

e. Export–Import policy (EXIM policy):

It aims at increasing exports and bridges the gap between expert and import. Through this policy, the government announces various duties/levies. The focus now-a-days lies on removing barriers and controls and lowering the custom duties.

c. Economic System:

The world economy is primarily governed by three types of economic systems, viz., (i) Capitalist economy; (ii) Socialist economy; and (iii) Mixed economy. India has adopted the mixed economy system which implies co-existence of public sector and private sector. Economic system plays a major role in economy which is explained later in this unit.

5.3.1 NATURE OF ECONOMIC ENVIRONMENT

The economic environment of business is very complex as the business has to have economic relations with the Government, customers, capital markets and the international markets, increased competition has added to the complexity of economic environment.

The government is the key factor which dominates, directs, regulates and controls the economic environment through its policies and legislations. It influences the savings, investment and consumption of the households besides the capital market and

international trade. Through economic planning, it determines the flow of capital and other resources towards different sectors of the economy.

The agricultural sector also plays a significant role in determining the economic environment of an economy. Many industrial units depend on agricultural sector for their raw materials and also for marketing their final products.

The customers by expressing their preferences encourage the business to advance in a particular direction. The global environment and the government regulations determine the nature and extent of international trade. The level of income of the people in an economy determines the nature and volume of goods consumed. If the average per capita income is low, then the overall demand would also be at low level and is dominated by demand for necessities.

The resources present in an economy are a part of economic environment. The availability of minerals, oils etc., would influence the economic environment. Many Arab countries are well developed just because of oil resource and nothing else.

The level of technology available influences the production methods, cost effectiveness and competitiveness of the industrial sector. The extent of competitiveness is important both in the local markets and in international markets. The level of industrial development is contingent on technological factors and capacity to use the technology to self advantage. Hence, technology is also a part of economic environment.

The economic environment is also conditioned by the socio-cultural factors. The business units will have to offer their products considering the tastes, preferences and customs of the people. Thus, economic environment is a complex combination of various factors.

5.3.2 ECONOMIC SYSTEM

Economic system denotes the devices by which the preference of purpose of economic activity is determined and by which individual activities are coordinated for the achievement of this purpose. The economic philosophy decides the economic objectives. The economic philosophy is derived by customs, and institutions of society. The central problem of an economic system is the allocation of resources. In this context one should accept that national differences exist in world's nations. It is a known fact that India has embraced mixed economic system consisting good features of socialist, communistic, capitalistic economic philosophy. In the following section all the above mentioned economic systems are briefed below:

1. Capitalist Economic system

An economic system in which productive resources are predominantly owned by private individuals and production is carried out primarily for sale, is called Capitalism.

The motive of private owner is to earn profit from the use of productive assets. Profit motive, the institution of inheritance and the law of contract provide the source of drive to capitalism.

According to G.D.H.Cole, Capitalism is that profit oriented system which is characterised by private ownership of objects of labour, instruments of labour and means of labour. Production is mainly carried out with the help of labour services rendered by the working class in returns for wages and the class of capitalists has the right to whatever output is produced within the system.

Features of the Capitalist System

a. Economic Sovereignty

In a capitalist economy, producers are free to use their capital in the production of any commodity. Workers are free to acquire any type of skills and choose any occupation. Similarly, consumers are free to purchase any commodity and in any amount they like. These freedoms are also referred to as producers' sovereignty and consumer sovereignty in the capitalist system.

b. Right of Private Property

In a capitalist economy every individual has the right to hold and use of property and the means of production such as farms, factories, mines, transport and so on. After the death of the owner, his property is inherited by his legal heirs. In this way the right of property perpetuates in the economy.

c. Labour power as a commodity

An important feature of the capitalist system is that under it the labour power of man becomes a commodity and can be bought and sold just like any other commodity. In a capitalist economy the majority of the people own only one thing viz., their capacity to work or their labour power. Whatever the nature of the economy, man has always possesses his labour power. Labour power just like any other commodity commands a price which is equivalent to the cost of those commodities which are essential for the maintenance of the labourers and their family members.

d. Private ownership of means of Production

Under capitalism the means of production such as farms, factories, mines, transport, etc., are owned by private individuals or firms and they use these means of production for their private benefit.

e. Production for the market

One of the main features of capitalist economy is that under capitalism business firms produce mainly with the aim of selling the output in the market. The producers forms follow division to undertake the production of different commodities. The development of the factory system renders the division of labour even more complex. As long as the tools required in the process of production were possessed by everybody it was normal practice for all to produce just everything which they needed. It is only when the means of production get concentrated in a few hands that the capitalist system based on commodity production starts emerging.

f. Price Mechanism

The working of a capitalist economy is regulated by the functioning of price mechanism. The decisions of producers to produce particular commodities depend on price, demand and costs of production of different commodities. Producers produce such commodities that are priced high, and engage such factors of production that are priced low and contribute relatively mere to output. Households' purchasers are also influenced by prices of different commodities. Households prefer to buy more of such commodities that are priced low and yield greater amount of satisfaction. Thus price mechanism helps producers and consumers to take decisions about production and consumption.

g. Exploitation of labour

Workers are exploited under capitalism. Very often due to the freedom granted to the workers at a formal level, many people are wrongly given to believe that the workers by bargaining in the free market are able to get a fair price in return for their labour power. But this is not true, according to Marx, businessmen exploit workers and pay less wages than the goods produce by them.

h. Growing wealth of the capitalist

In a capitalist economy the wealth of the capitalist class increases in a sustained manner. Under capitalism to earn more profit, generally every firm makes the utmost effort to eliminate every often firm. A firm which losses out in the competition leave

the market and its share is captured by successful firm. In this way only a handful of firms manage to survive in every industry and with them large wealth is concentrated. Another may by which wealth is accumulated is the exploitation of workers.

i. Class Contradiction

The capitalist system rests fundamental on class distinctions. As capitalism develops, the society gets divided into two mutually hostile classes. On the one hand are the handful of capitalists with whom wealth as well as power in concentrated. In spite of the enormous power vested in the capitalist class it cannot do without the class of workers. Machines are not self operative. Therefore the labour power is indispensable for the survival of the capitalists. The workers who through their hard labour create immense wealth themselves remain poor and exploited throughout their lives, while the capitalists by laying a claim to the entire output become richer over time. The class of interests of capitalists they are offered all possible help in their suppression of workers by the government agencies like the police.

j. Emergence of the working class

The working class in capitalism is totally dependent on the capitalist for its livelihood. Under capitalism the increasing use of machinery lads to widespread unemployment and an increase in the rate of exploitation of workers which implies a decline in the share of workers in the income over time.

2. SOCIALISM

Socialism was in fashion till the breakup of USSR. Though its popularity has declined sharply, still it is approved by most of the economists, social reformers, politicians etc. socialism is used by different persons in a different way. Socialism is a economic system where private sector does not have any kind of control over production and distribution and all major economic activities including production distribution and consumption are controlled by the state or state established agencies.

There is no universal definition of socialism. The concept of socialism has conceived in different ways by different thinkers. Therefore it becomes necessary on our part to study a few definitions of socialism. According to Paul M.Sweegy, “Socialism is a complete social system which differs from capitalism not only in the absence of private ownership of the means of production but also in its basic structure and mode of functioning”.

According to Prof.H.D.Dicknson, "Socialism is an economic organisation of society in which the material means of production are owned by the whole community and operated by organs representative of and responsible to the community according to a general economic plan, all members of the community being entitled to benefit from the results of such socialised planned production on the basis of equal rights".

FEATURES OF SOCIALISM

a. State ownership

In socialist economy, there is a social or state ownership of the means of production. Because of social ownership, there is no profit motive to produce goods and services. The production is guided by social and other economic motives.

b. Equality of opportunity

Every individual should have equal opportunity to rise in life whether he is born in the poor family or the rich one. One must get equal opportunity to get education and training so that he should enter occupation of his choice. Under socialism steps are taken to ensure that every child whatever his birth and whatsoever his parental background is provided sufficient opportunities to develop fully his talents and potentialities. Health services and free education upto a certain standard and or level should be made for all.

c. Equality of income

In socialist economy there is perfect equality of income but each person is paid according to work, performance and needs. Thus, the gulf between the rich and the poor is low.

d. Social welfare motive

An important feature of socialism is that it is the motive of social welfare rather than private profit which guides production. Under capitalism, luxury goods are produced for their rich as they ensure greater profits while poor go even without necessaries as their production does not bring adequate profits to the producers. Under capitalism profit motive is the driving force of the economy. But under socialism the welfare of the society as a whole is the driving force of all economic activities. The place of impersonal forces of market which work under capitalism is taken by a central authority or the planning commission which takes decisions about all important issues.

e. Economic planning

Economic planning has been most closely associated with socialism. Effective planning cannot be adopted under capitalism because under capitalism means of production are owned and controlled by private individuals and production of goods and allocation of resources are directed by price mechanism. Planning ensures rapid economic development along desired. It guarantees efficient and optimum allocating of resources in under developed countries where the level of national income and wealth is very low.

f. Classless of society

Socialism believes in a classless society. In a socialist state everybody irrespective of his caste, class, need and religion is provided with equal opportunity in all fit fields of life. A truly socialist state is a secular state. The two main classes of labour and capitalist no longer exist under socialism. Zamindars and capitalists are not allowed to remain under socialism because ownership of private property is strictly restricted and everybody is rewarded according to his work and merit. Thus class struggle which is the chief feature of capitalism comes to an end under socialism.

DIFFERENT TYPES OF SOCIALISM

1. Collectivism

Collectivism economy is one in which the authority sets the aims for the economy as a whole and which sees that these are achieved. There may be total control, regulation or planning for the purpose of achieving, predetermined aims relating to the satisfaction of communal demand, full employment, factor allocation, income distribution, capital formation, economic development etc.

2. Authoritarian Private Enterprise system (Fascism)

This system exists when temporary war time controls are made permanent for the achievement of collective purposes during peace time. If viewed superficially, it gives an impression that all the important characteristics of the private enterprise system like private property, income distribution, consumers' sovereignty and freedom of enterprise are maintained. But the real fact is that a totalitarian collective plan with social aims set by a dictator takes precedence over the private ends of individuals. The achievement of these aims necessitates the establishment of a system of controls which ultimately destroy private enterprise.

3. Central planning

It constitutes an important characteristic feature of a socialist economy. Central planning is found in all collectivist economies, undertaken by a central planning authority

which sets objectives and which allocates the resources for achieving the objectives. Socialists consider central planning as a device for preventing the economic system from deteriorating into that of a private enterprise economy.

4. Liberal Socialism

Liberal or democratic socialism is an economic system which has public ownership of strategically important material means of production, free choice of occupation and consumers' sovereignty. It aims at removing the evils of private enterprise and at attaining a greater degree of equality in the distribution of income.

5. Authoritarian Socialism (communism)

This is another type of socialism which has-

a. The state of ownership of all the means of production;

b. The central authority determines the aims of the economy, formulates a central plan according to which all production and distribution are regulated; and

c. All economic freedoms enjoyed by the people in the liberal socialist economy are abolished. The system is one in which the consumers have to take what is produced and the workers have to work where the planning authority requires their services.

In short, under authoritarian socialism, constant changes in the production plan to accommodate the changes in the wishes of the consumers are not permitted as under the private enterprise economy or a liberal socialist economy.

3. MIXED ECONOMY

A mixed economy represents a mixture of features of the two types of economies capitalism and socialism.

Under this form of economic system, the ownership of means of production is partly in the hands of private individuals and partly owned by the society. The public authority usually own public utility services like supply of water and electricity, roadways and railways, shipping and air services, hospitals, schools and colleges, defence industries. As regards the distribution the Government tries to remove disparities and inequalities in the income distribution by various measures such as taxes and their levies and through public expenditure.

According to Samuelson, a mixed economy is characterised by the existence of both public and private institutions exercising economic controls. In this economy price

mechanism and partial planning both plays an important role. India is perhaps the best example of such an economy and can legitimately be called a mixed economy.

FEATURES OF MIXED ECONOMY

a. Coexistence of the Private and Public sectors

The concept of mixed economy presupposes the existence of two or three sectors. In the public or state sector the entire system of production and distribution is managed, owned, controlled and financed by the state itself. Private individuals are not permitted to undertake any economic activity in this sphere. The public sector performs three functions:

i. It is to provide/create social heads,

ii. It has to create industrial climate; and

iii. It has to create a sound industrial base in the economy.

b. Price Mechanism and Government Control and Regulation work together

A mixed economy contains the goods features of both socialism and capitalism. Every possible effort is made to make the best possible use of available economic resources. The price mechanism and the profit motive and all kinds of freedoms result in the efficient allocation and utilisation of the available resources. As a result shortages and surpluses are easily avoided and business fluctuations are eliminated.

c. Economic freedom and control

In mixed economy freedom of expenditure, production, occupation, investment, to hold property and have property by inheritance is present. But these freedoms are not granted to people in unlimited way these freedoms are restricted or controlled by the state in the public interest.

d. Economic welfare

The system is adopted to overcome the evils of capitalism. Exploitation of the poor by the rich is one of the chief evils of capitalism. The conflict between the labourers and the capitalists is avoided. The state posses labour laws and fix minimum wages, working hours etc., and provide social security benefits.

e. Economic planning and General Balance

Economic planning is an important feature of a mixed economy. It derives all the benefits of planned socialist economy. It maintains a general balance between the public sector and the private sector. The two sectors are not rivals of each other, they cooperate with each other.

5.3.3 COMPARISON BETWEEN CAPITALISM, SOCIALISM AND MIXED ECONOMY

Sl. No.	Capitalism	Socialism	Mixed Economy
1	Freedom to compete with the right to invest	Limited competition with state-owned industries	Absence of competition with state-owned markets and industries
2	Profits and wages in relation to one's ability and willingness to work	Profits recognised. Wages fairly in relation to efforts.	Profits not allowed. Workers urged to work for the glory of the state.
3	Capital invested by owners who may also borrow on credit. Capital may be reinvested form profits. Depreciation is legal	Obtained from owners and from state issued bonds for state owned industries. Depreciation permitted	State provides all resources to start business owned by the state. No depreciation.
4	Workers are free to select and employer and occupation	Workers are allowed to select occupation. State planning encourages employment	The state determines one's employer and employment
5	Managers are selected on the basis of ability. Managers have freedom	Managers in state owned industries are answerable to the state. Non monetary	Key managers must be party members. Absence of freedom to take
	to make decisions.	rewards emphasised	decisions.
6	Individuals have the right to own a business and to contract with others.	State owns the basic industries. Other businesses may exist.	State owns all productive capacity including communes.
7	Losses assumed by owners. May transfer business risks to other businesses through insurance	People assume risks of state owned industries. Losses taken from taxes.	Economic production owned by the state. Risks assumed by the state. Losses reduce standard of living.

5.3.4 INDIAN ECONOMIC ENVIRONMENT

India is a mixed economy. In fact, India has a very complex economic system. Let us elaborate this further.

Firstly, a simple mixed economic system is characterised by the existence of the private and public sectors. India has a multiplicity of sectors: Private (dominant undertakings, foreign companies, etc.), public, joint, co-operative sectors and also tiny sector. India is a complex vector of sectors.

Secondly, a simple mixed economy is characterised by complementarily between central planning and pricing. India has a multiplicity of mechanisms at work: five year plans, annual plans during plan holidays, pointed economic reform and reconstruction programmes during and after plan vacations, ideas of rolling plans; an elaborate system of controls and regulatory measures, attempts towards streaming and simplification of procedures, private traders and public distributors for some products and hence a retention prices, procurement prices, levy prices, and free market prices and so on. In India, there is a complex system of liberal rules, strict regulations, control mechanisms, planning and host of price regulations.

Finally, a simple mixed economy is expected to reach a target level of social welfare, and for this task, the profit policies are to be designed according to social purpose. The social welfare function in India is defined by multiplicity of objectives, which are sometimes conflict in nature. For example, in terms of five year plans, India is aiming at efficiency, justice and stability. Productive efficiency in static sense refers to the optimum allocation of the given resources. Productive efficiency in its dynamic sense refers to economic growth. The fruits of economic growth have to be distributed, fairly among the masses; social justice is to be so attained so as not to endanger stability of prices, incomes, balance of payments and so on. The Indian plans have always emphasized objectives like full employment of labour, full capacity utilization of plant and equipment and self sufficiency. In the long run, these objectives may be compatible with each other, but operationally these objectives come in conflict with each other. For example, in order to promote a higher rate of growth, heavy industrialisation and large investments are undertaken. Such investments increase the flow of money faster than the flow of output. This generates inflationary forces. Thus, price stability comes in conflict with economic growth. Similarly, economic growth comes in conflict with social justice.

Thus, the mixed economic system of India gives the impression of a mixed up economic system that is characterised by a multiplicity of sectors, a multiplicity of instruments, a multiplicity of objectives, and a multiplicity of adjustments to resolve the conflict between various sectors, between instruments and between objectives.

5.4 NON-ECONOMIC ENVIRONMENT

The various elements of non-economic environment are as follows:

(a) Social Environment

The social environment of business includes social factors like customs, traditions, values, beliefs, poverty, literacy, life expectancy rate etc. The social structure and the values that a society cherishes have a considerable influence on the functioning of business firms. For example, during festive seasons there is an increase in the demand for new clothes, sweets, fruits, flower, etc. Due to increase in literacy rate the consumers are becoming more conscious of the quality of the products. Due to change in family composition, more nuclear families with single child concepts have come up. This increases the demand for the different types of household goods. It may be noted that the consumption patterns, the dressing and living styles of people belonging to different social structures and culture vary significantly.

(b) Political Environment

This includes the political system, the government policies and attitude towards the business community and the unionism. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. Further, ideology of the political party also influences the business organisation and its operations. You may be aware that Coca-Cola, a cold drink widely used even now, had to wind up operations in India in late seventies. Again the trade union activities also influence the operation of business enterprises. Most of the labour unions in India are affiliated to various political parties. Strikes, lockouts and labour disputes etc. also adversely affect the business operations. However, with the competitive business environment, trade unions are now showing great maturity and started contributing positively to the success of the business organisation and its operations through workers participation in management.

(c) Legal Environment

This refers to set of laws, regulations, which influence the business organisations and their operations. Every business organisation has to obey, and work within the framework of the law. The important legislations that concern the business enterprises include:

(i) Companies Act, 2013

(ii) Foreign Exchange Management Act, 1999

(iii) The Factories Act, 1948

(iv) Industrial Disputes Act, 1972

(v) Payment of Gratuity Act, 1972

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

(vii) Prevention of Food Adulteration Act, 1954

(viii) Essential Commodities Act, 2002

(ix) The Standards of Weights and Measures Act, 1956

(x) Monopolies and Restrictive Trade Practices Act, 1969

(xi) Trade Marks Act, 1999

(d) Technological Environment

Technological environment include the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. For example, in USA and many other countries electrical appliances are designed for 110 volts. But when these are made for India, they have to be of 220 volts. In the modern competitive age, the pace of technological changes is very fast. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organisations. Now a days in fact, no firm can afford to persist with the outdated technologies.

(e) Demographic Environment

This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services. For example a country where population rate is high and children constitute a large section of population, and then there is more demand for baby products. Similarly the demand of the people of cities and towns are different than the people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skill labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorsteps.

(f) Natural Environment

The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. Business is greatly influenced by the nature of natural environment. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish manufacturing unit near the sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector.

5.5 RECENT DEVELOPMENTS IN INDIAN ECONOMY

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership on certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts resulted a mixed response. There was growth in net national product, per capita income and development of capital goods sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign exchange crisis during eighties. As a result, the government of India introduced a radical change in

economic policies in 1991. This policy abolished industrial licensing in most of the cases, allowed private participation in most industries, disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channelize foreign capital investment in India. Let us discuss the developments under three heads, viz., (a) Liberalisation, (b) Privatisation, and (c) Globalisation.

(A) LIBERALISATION

Liberalisation refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises. It includes:

(i) Abolishing industrial licensing requirement in most of the industries;

(ii) Freedom in deciding the scale of business activities;.

(iii) Freedom in fixing prices of goods and services;

(iv) Simplifying the procedure for imports and exports;

(v) Reduction in tax rates; and

(vi) Simplified policies to attract foreign capital and technology to India.

Through this liberalisation process, Indian Economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organisations in India. This has further resulted in stiff competition and efficiency. Ultimately, liberalisation has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

(B) PRIVATISATION

Privatisation refers to reducing the role of public sector by involving the private sectors in most activities. Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the post liberalised period. The issues of privatisation include: (i) Reduction in the number of industries reserved for the public sector from 17 to 8 (reduced further to 3 later on) and the introduction of selective competition in the reserved area;

(ii) Disinvestment of shares of selected public sector industrial enterprises in order to raise. Resources and to encourage wider participation of general public and workers in the ownership in business;

(i) Improvement in performance through an MOU system by which managements are to be granted greater autonomy but held accountable for specified results.

In India, as a result of these steps, the post liberalisation phase has witnessed massive expansion of the private sector business in India. You can have an idea of their expansion from the fact that the total capital employed in top 500 private sector companies rose from Rs. 1,39,806 crores in 1992-93 to Rs. 2, 34, 751 crores in 1994-95 (an expansion of 68% in just two years).

(C) GLOBALISATION

Globalisation means 'integrating' the economy of a country with the world economy. This implies free flow of goods and services, capital, technology and labour across national boundaries. To achieve these objectives of globalisation, the government has adopted various measures such as reduction in custom duties, removal of quantitative restrictions or quotas on exports and imports, facilitating foreign investment and encouragement of foreign technology. These measures are expected to achieve a higher rate of growth, enlargement of employment potential, and reduction of regional disparities.

5.6 SUMMARY

India is a country of land and people. It has a huge customer base as well as world's most powerful brains. It is rich in its natural resources and is highly adaptive to changing business environment. In some areas like technology and political stability, it requires some wise steps. With all these virtues India has become a favourite destination of other countries to expand their business. India is expanding domestically as well as globally to compete with other powerful business nations so as to get its desired share of world economic growth.

Business enterprise is a part of society and the business environment has direct relationship with the policy of the enterprise. The environment may impose several constraints on the enterprise. The enterprise on the other hand, has very little control over its environment. Therefore, the success of an enterprise depends to a very large extent on its adaptability to the environment, i.e., its ability to identify itself with the environment and fit in with the environmental framework. According to Hicks, "The firm can adjust to the environment, or if it has ability, change the environment."

5.7 KEY WORDS

Fiscal

Sovereignty

Capitalist

Liberalisation

Privatization

5.8 SELF ASSESSMENT QUESTIONS

1. Mention the different types of business environment.
2. What is economic environment? Explain the nature of economic environment.
3. What do you mean by economic system?
4. Mention the different economic systems.
5. Define Capitalism.
6. Explain the features of capitalism.
7. What do you mean by socialism? Explain the features of socialism.
8. Explain the different types of Socialism.
9. What do you mean by mixed economy? Explain its features.

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UNIT-6 : ECONOMIC DEVELOPMENT

Structure:

6.0 OBJECTIVES

After reading this unit, you should be able to:

- explain Economic Development of India
- discuss the basic indicators of economic development
- write Synergy between Government and business
- discribe Role of Government towards Business
- analyse Role of Business towards Government
- define Role of Government towards Performance Of Indian Economy

6.1 INTRODUCTION

Indian economic policy after independence, influenced by the colonial experience, which was seen by Indian leaders as exploitative in nature, and by their exposure to Fabian socialism, became protectionist in nature. The early policy makers formulated a policy of import substitution, industrialization, state intervention in labour and financial markets, a large public sector, overt regulation of business, and central planning. This led to a low overall average growth rates upto 1980.

The economic reforms that surged economic growth in India after 1980 can be attributed to two stages of reforms. The pro-business reform of 1980 initiated by Indira Gandhi and carried on by Rajiv Gandhi, eased restrictions on capacity expansion for incumbents, removed price controls and reduced corporate taxes. The economic liberalization of 1991, initiated by then Indian prime minister P. V. Narasimha Rao and his finance minister Manmohan Singh in response to a macroeconomic crisis did away with the *Licence Raj* (investment, industrial and import licensing) and ended public sector monopoly in many sectors, thereby allowing automatic approval of Foreign Direct Investment (FDI) in many sectors .

With the increasing importance of the economy of India, which is now well above the one billion mark in population, monitoring Indian economic cycles is now of more interest. Dua and Banerji established the dates of Indian business cycles and growth rate cycles, with the help of a coincident index created for the purpose. However, the more interesting question is that of whether there exists a set of *leading index*, a composite of several *indicators*: designed to peak and trough earlier than the coincident indicators, to collectively predict future economic activity. Such an index of leading indicators will

be an important and useful forecasting and planning tool for policymakers, financial analysts, financial investors and businesses.

6.2 ECONOMIC DEVELOPMENT

Economic development is concerned with the sustained, concerted actions of policy makers and communities that promote the standard of living and economic health of a specific area. Economic development can also be referred to as the quantitative and qualitative changes in the economy. Such actions can involve multiple areas including development of human capital, critical infrastructure, regional competitiveness, environmental sustainability, social inclusion, health, safety, literacy, and other initiatives. Economic development differs from economic growth. Whereas economic development is a policy intervention endeavor with aims of economic and social well-being of people, economic growth is a phenomenon of market productivity and rise in GDP. Consequently, as economist Amartya Sen points out: "economic growth is one aspect of the process of economic development."

6.3 ECONOMIC DEVELOPMENT OF INDIA

The economic development of India was dominated by socialist-influenced policies, state-owned sectors, and red tape & extensive regulations, collectively known as "License Raj". It led the country and its economy isolated from the world economy. However the scenario started changing from the mid-1980s, when India began opening up its market slowly through economic liberalization. The policy played a huge impact on the economic development of India. The Indian economic development got a boost through its economic reform in 1991 and again through its renewal in the 2000s. Since then, the face of economic development of India has changed completely.

The economic reform of 1991 played a pivotal role in the economic development of India. Reaping its benefit, the growth of the country reached around 7.5% in the late 2000s. It is also expected to double the average income within a decade. According to the analysts, if India can push more fundamental market reforms, it will be able to sustain the rate and can even achieve higher growth.

6.4 BASIC INDICATORS OF ECONOMIC DEVELOPMENT

Following are the basic indicators of economic development:

1. Real GDP (Gross Domestic Product)

The real GDP is the market value of all goods and services produced in a nation during a specific time period. Real GDP measures a society's wealth by indicating how fast profits may grow and the expected return on capital. It is labelled "real" because each year's data is adjusted to account for changes in year-to-year prices. The real GDP is a comprehensive way to gauge the health and well-being of an economy.

2. M2 (Money Supply)

M2 money supply represents the aggregate total of all money a country has in circulation. It takes into account all physical currency such as bills and coins; demand deposit savings and checking accounts; traveller's checks; assets in retail money market accounts and small money market mutual funds, (i.e., less than $100,000); individual time deposits and savings deposits, such as certificates of deposits; in addition to some repurchase agreements and Eurodollar holdings. It does not include institutional money fund assets, large denominated (more than $100,000) time deposits, or any special reserves banks are required to maintain.

The Federal Reserve uses this data to assess current economic and financial conditions, and to help alter its monetary policy, which includes raising and lowering interest rates. The Fed's actions are aimed at bolstering or reducing the money supply.

Economists and others also use M2 data to predict cyclical economic recessions and recoveries and expected changes in stock prices— not to mention expected changes in the Fed's monetary policy.

Some economists believe that M2's relevancy has waned over the past 20 years. For many years this monetary measurement had closely paralleled the growth or contraction of the U.S. economy and overall changes in prices. But over the past two decades, a bevy of changes— such as the introduction of new depository products, the movement of consumer funds from bank deposits to investment accounts and the internationalization of the economy—have caused the money supply data to fall out of sync with other economic indicators.

3. Consumer Price Index (CPI)

The CPI measures changes in the prices paid for goods and services by urban consumers for the specified month. The CPI is essentially a measure of individuals' cost of living changes and provides a gauge of the inflation rate related to purchasing those goods and services.

The CPI does not include every item an individual may buy, but instead takes a sampling of several hundred goods and services across 200 item categories. Data is collected through phone calls and personal visits in 87 urban areas across the country.

The CPI does not include income, Social Security taxes, or investments in stocks, bonds or life insurance. But it does include all sales taxes associated with the purchases of those goods and services.

This statistic is the best indicator of inflation that we have to rely on. It is particularly closely scrutinized by financial economists now since it shows inflation to be at a 16-year low. Changes in inflation can spur the Fed to take action to change its monetary policy.

The U.S. Department of Labor's Bureau of Labor Statistics releases the national CPI—an average of all areas sampled, monthly, during the second or third week after the end of the measured month. CPIs for three specific metropolitan areas are also published monthly, while CPIs for other specific metropolitan regions are published every other month.

4. Producer Price Index (PPI)

The PPI is a group of indexes that measures the changes in the selling price of goods and services received by U.S. producers over a period of time. The PPI captures price movements at the wholesale level, before price changes have bubbled up to the retail level.

The PPI tracks price changes in virtually all goods-producing sectors, including agriculture, forestry, fisheries, mining and manufacturing. The PPI also tracks price changes for a growing portion of the non goods-producing sectors of the economy as new PPIs are introduced. Prices from 25,000 establishments are tracked monthly.

This report measures prices for goods at three stages of production: finished goods, intermediate goods and crude goods. This was called the Wholesale Price Index from 1902 until 1978.

This index is timely because it is the first inflation measure available in the month. In addition, by watching crude prices, which are first in the chain of production trends, one can sometimes spot inflation in the pipeline, before it shows up in the CPI.

The U.S. Department of Labor's Bureau of Labor Statistics releases the data monthly, during the second full week of the month following the reporting month.

5. Consumer Confidence Survey

A gauge of the public's confidence about the health of the U.S. economy that reflects the public's optimism/pessimism and the nation's mood.

This statistic is a leading indicator of consumer spending—consumers are more inclined to spend money when they are feeling confident about their financial and employment prospects.

6. Current Employment Statistics (CES)

CES provides comprehensive data on national employment, unemployment and wages and earnings data across all non-agriculture industries, including all civilian government workers. Information is disseminated in many different ways—for example, employment/unemployment rates among men and women, varied ethnic groups and teens.

This is the earliest indicator of economic trends released each month. Employment rates indicate the well-being of the economy and labour force. Changes in wages point to earnings trends and related labour costs. Economists focus on the monthly change in total non-farm payrolls and in which sectors jobs were gained or lost.

7. Retail Trade Sales and Food Services Sales

This data tracks monthly U.S. retail and food service sales, details changes from previous periods, and identifies in which sectors sales increased and/or decreased.

The numbers measure consumers' personal consumption across retail industries and track growth or deceleration of personal consumption spending, which makes up approximately two-thirds of the annual U.S. GDP. Analysts use the data to help track consumer spending trends and forecast the direction and magnitude of future spending. Automobile sales are separated from the data because of their volatility, which can sometimes obscure the underlying pattern of spending.

8. Manufacturing and Trade Inventories and Sales

This data represents the combined value of trade sales and shipments by manufacturers in a specific month, as well as the combined values of inventories in the

wholesale and retail business sectors and manufacturing. The current and most recent past month's inventory/ sales ratios are also provided. Information is provided across 17,000 manufacturing, retail and wholesale companies within 160 industries.

This data set is the primary source of information on the state of business inventories and business sales. Inventory rates often provide clues about the growth or contraction of the economy. A growth in business inventories may mean sales are slow and the economy's rate of growth is also slowing. If sales are slowing, businesses may be forced to cut production of goods, and that can eventually translate into inventory reductions.

9. S&P 500 Stock Index (the S&P 500)

The Standard & Poor's 500 is a market-value-weighted index of 500 publicly owned stocks that are combined into one equity basket. This basket of stocks has become the industry standard and benchmark for the overall performance of the U.S. equity markets.

The S&P Index Committee choose the indexed stocks based upon market size, liquidity and industry group representation. Component companies are periodically replaced. Companies are most often removed because of a merger with another company, financial operating failure or restructuring. Prospective companies are placed in an index "replacement pool" and vacancies are filled from that pool.

The index is designed to measure changes in the stock prices of component companies. It is used as a measure of the nation's stock of capital, as well as a gauge of future business and consumer confidence levels. Growth of the S&P 500 index can translate into growth of business investment. It can also be a clue to higher future consumer spending. A declining S&P 500 index can signal a tightening of belts for both businesses and consumers.

Economists tend to look for long term trends rather than short-term fluctuations in the S&P 500 index. The S&P 500's 10-year total return, for example, has become a common indicator of longer-term trends.

10. National debt

National debt is the total outstanding borrowing of a country's government (usually including national and local government). It is often described as a burden, although public debt may have economic benefits. Certainly, debt incurred by one generation may become a heavy burden for later generations, especially if the money borrowed is not

invested wisely. The national debt is a total of all the money ever raised by a government that has yet to be paid off; this is very different from an annual public-sector budget deficit. In 1999, the American government celebrated a huge budget surplus, yet the country still had a national debt equal to nearly half its GDP.

11. Trade balance

The balance of trade (or net exports, sometimes symbolized as NX) is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports. A positive or favourable balance of trade is known as a trade surplus if it consists of exporting more than is imported; a negative or unfavourable balance is referred to as a trade deficit or, informally, a trade gap. The balance of trade is sometimes divided into a goods and a services balance.

Measuring the balance of trade can be problematic because of problems with recording and collecting data. As an illustration of this problem, when official data for the entire world's countries are added up, exports exceed imports by a few percent; it appears the world is running a positive balance of trade with itself. This cannot be true, because all transactions involve an equal credit or debit in the account of each nation. The discrepancy is widely believed to be explained by transactions intended to launder money or evade taxes, smuggling and other visibility problems. However, especially for developed countries, accuracy is likely.

12. Credit rating

A credit rating estimates the credit worthiness of an individual, corporation, or even a country. It is an evaluation made by credit bureaus of a borrower's overall credit history. A credit rating is also known as an evaluation of a potential borrower's ability to repay debt, prepared by a credit bureau at the request of the lender.

Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan. However, in recent years, credit ratings have also been used to adjust insurance premiums, determine employment eligibility, and establish the amount of a utility or leasing deposit. A poor credit rating indicates a high risk of defaulting on a loan, and thus leads to high interest rates, or the refusal of a loan by the creditor.

13. Physical quality of life index - PQLI

This is non-income indicator of economic development because this uses physical quality of life as the indicator. This method of measuring economic development is based on the following three things. They are:–

(a) Life expectancy

(b) Infant mortality

(c) Literacy.

The scale of all these things measured is between zero (0) and hundred (100) shows the lowest level and 100 shows the highest level. If in any country life expectancy measured is maximum, i.e. 100 and the other two indicators are measured minimum i.e., zero then giving equal weightage to each indicator a competitive index is prepared from the average of all three. Likewise index of a country with high literacy rate will be 100. Countries having low life expectancy, low literacy rate and high infant mortality will have low index (i.e. 0). If in any country PQLI is increasing then it indicates the increase in the physical quality of the life of people:

Increase in per-capita income does not necessarily indicate the increase in the facilities like healthy food, health, situation, education, etc. Therefore PQLI method is taken to be better indicator than per-capita income method.

14. Human development index - HDI

Human development index is new and modern indicator of economic development. This indicator was for the first time developed by United Nations Development Program (UNDP) in the year 1990 AD. This indicator is based on three things; They are as follows:

(a) Income for decent living

(b) Education

(e) Life expectancy.

As PQLI, HDI also divides all nations of the world in the scale of 0 to 1 on the basis of three objectives of development. In this method minimum of 0 and maximum of 1 value is given. This method has classified all nations of the world in three different classes. Low human development is from 0 to 0.50. Medium human development in from 0.51 to 0.79 and high human development is from 0.80 to 1.0. Since this method measures the relative level of human development, this focuses on life expectancy,

education and physical choice. This takes per-capita income as an indicator the change in monetary value is adjusted in GNP. This is measured on the basis of the unofficial education and middle age of school going population. In this method on the basis of the development of skill of all the adults and infant mortality and the nutritious food they get. When all three indicators are included an important indicator of human HDI is measured development will be obtained. On the basis of this, human development index (HDI) of different countries is obtained.

6.5 SYNERGY BETWEEN GOVERNMENT AND BUSINESS

Government and business institutions in a country in many ways are interrelated and interdependent on each other. In today's global economy, its businessmen and entrepreneurs are the driving forces of the economy. In planned economy or even in market economy government holds control of shaping the business activates of a country. For maintaining a steady and upward economic growth the Government must try to make the environment for business organizations suitable. And the organizations must follow the laws of governments' to run the businesses smoothly and making sure there is a level playing field. The main goal of businesses is to make profit and governments' goal is to ensure economic stability and growth. Both of them are different but very co-dependent. For this the government and organizations or businesses always tries to influence and persuade each other in many ways for various matters. A balanced relationship between the government and businesses is required for the welfare of the economy and the nation.

6.6 ROLE OF GOVERNMENT TOWARDS BUSINESS

There was a time when the role of government was just to maintain law and order. Trade, Commerce and Industry were not within the purview of government. But after the great depression of 1929, government realized that economic activities cannot be luft unregulated and the need of state intervention was realized. After independence, our government has been playing significant role in regulating business activities. In the pre reform period, our government was very strict in regulating private sector, and Foreign enterprises. It was giving great importance to public sector and it was actively participating in setting public enterprises. It was also protecting domestic sector from foreign competition. There were many restrictions on entry of foreign companies in India. In post reform period (after 1991) government has been following the policy of liberalization, privatization and globalization. Government has relaxed controls, encouraged private sector and changed its approach towards foreign capital. In the present

scenario, the nature of role of government has changed. The role and responsibility of government towards business is as follows:

1. To pass and execute proper laws

The behaviour of the people in society can be effectively controlled with the help of laws. The government has to pass laws which would create a friendly and helpful atmosphere for the business to grow. At the same time the laws should be capable of controlling the dishonest businessmen and prevent and punish their unfair practices.

In India the government has passed several laws such as Companies Regulation Act, The factory Act, The labor Laws, the social security laws, the foreign exchange management act etc. Though passing of proper laws is important, an efficient implementation of the law is more important. If a good law is implemented in a bad way it produces harmful effects. It encourages dishonesty on the part of the people.

2. Maintenance of law and order

It is the responsibility of the government to maintain law and order and peace in the community. Any business can exist and prosper if there is law and order in the country. Periods of disturbance are harmful to the existence of business and much more to the progress of the business. The government has to maintain law and order for attracting foreign investment.

3. Providing Money and Credit

Every business requires credit. It is like blood circulation in the body of the economy. Finance is provided to business by the money market and the capital market. The government has to regulate them in such a way that they are able to attract more capital and direct it to the business. It is the responsibility of the government to maintain the financial institutions in sound health so that they can mobilize more finances.

The government, through the central bank of the country has to maintain a stable and appropriate rate of exchange which is helpful in attracting more foreign investment

4. Building Infrastructure

All productive activities require infrastructure by way of means of transport and communications, supply of energy and credit, providing appropriate information about the openings for different businesses etc. If the government is successful in building efficient infrastructure, business can expand at a fast rate.

5. Basic Research

Innovation is the watchword of modern business. Introduction of proper innovations at proper time requires extensive research. It is of 2 types: a: Basic research and b: commercial research.

6. Providing information

The government collects information on several issues such as the growth of population, changes in the demographic features, trends in migration etc. This information is highly useful to business in formulating its policies. The government can keep that information open to business

7. Controlling the growth of monopolies and preserving competition

A free market economy has an inherent tendency to give birth to monopolies. They are economically and socially harmful. They result into concentration of economic and political power. They are also instrumental in increasing inequalities. The government can pass appropriate laws and can take timely action for preventing the growth of monopolies and encourage competition.

8. Reservation of fields of production

The government reserves certain fields of production for the public sector. The remaining part is kept open to the private sector. In India several fields of production were reserved for the small scale and cottage industries. The sphere was contracted after we adopted the policy of globalization.

9. Awarding patent rights and copy rights

Progress in any field requires research inventions and innovations. The job of patent rights and copyrights is to give protection to those who invest in research and arrive at inventions and innovations. Every country has its patent rights. After the establishment of the WTO the member countries have adopted the rules and regulations prepared by WTO in respect of patent rights, copy rights and allied matters

10. Protections

The industries belonging to the developing countries are not able to compete with the industries belonging to the developed countries. It is the responsibility of the government to give them protection by using tariff and if necessary, non-tariff barriers. At the same time the industries should not get undue protection which would develop complacency. After the establishment of the WTO, protection is slowly on the decline.

6.7 ROLE OF BUSINESS TOWARDS THE GOVERNMENT

Government tries to preserve the community and improve its conditions. In that respect the business has to extend its co-operation to the government. If the business discharges its responsibilities the government sincerely and effectively, the government can function more efficiently. This is in the interest of the whole community and indirectly in the interest of the business. The prospects of the business depend upon the status of the community. The development of business depends upon the development of the community; hence business has got to be very particular about discharging its obligations towards the government.

The prominent responsibilities of the business towards the government can be described as follows:

1. To obey Laws

The laws reflect the wishes of the community, they show what the community wants the member to do and what the community wants the member to avoid. The laws control the behaviour of the individuals with each other and with the community. If business obeys laws the society can function smoothly and business can prosper only when the society is functioning smoothly but if laws are oppressive or obstructing the path of business, they can be opposed in constitutional manner. The business can take the help of constitution or the judiciary to oppose the laws and get them repealed. The Maharashtra government banned the sale of gutkha in Maharashtra state. The producers of gutkha approached the court which repealed the order of the government of Maharashtra on the ground that tobacco is in the jurisdiction of the central government.

2. **Payment of taxes**

The expenditure of a modern government is heavy and is fast increasing. The main source of income for the government is the different type of taxes imposed by it. The business pays taxes on goods produced by them, taxes on goods imported by them, taxes on own income and taxes on the incomes of the employees. The bulk of the tax revenue is collected from business. If business pays the taxes honestly and on time the government can fulfill its responsibilities efficiently. If taxes are evaded by one group, the burden of taxation increases on some other group. Non payment of a tax is a political offence and also a social dishonesty.

3. Social responsibility

In addition to the legal and political responsibilities, the business has to take up several moral responsibilities towards the society. Thus, the business has to provide training facilities for the unemployed persons so that they can get absorbed in some occupation or can setup self employment units. Several business houses established educational institutions, hospitals, libraries, recreation halls, playgrounds etc. for the community. This is helpful in winning them sympathy from the community. It is like an investment made by the business.

4. Providing inputs to the government

Often the government requires inputs of technical economic financial or political importance for framing appropriate policies. The business has contacts in different sections of the community. They can be used for collecting the required information and providing it to the government. Any action based upon accurate inputs has greater chances of achieving a higher success. For eg: before imposing a tax on commodity the government likes to know the elasticity of demand for that commodity. Other things remaining the same the government prefers to impose a tax on a commodity which enjoys relatively less elastic demand.

5. Government Contracts

The government has to take up several works such as construction of roads, bridges, flyovers, airports etc. Sometimes these works are undertaken by the government departments but a more common method of undertaking that work is to invite tenders and give contracts to business. It is the responsibility of the business to complete the work in time and maintain a high level of quality of the work.

6. Government Services

The business offers services of its leaders to the government to work on different committees. The business leaders have practical experience of a particular type of business. A committee appointed for doing something in respect of that business is highly benefited if some prominent person from that field is appointed as the chairman of that committee or commission.

7. Active participation in politics

Sometimes the businessmen try to participate actively in politics. A member of the TATA family contested election to the Lok sabha. Sometimes the leaders of the business are nominated to the Rajya Sabha so that the government gets the benefit of

their practical experience of that field, but often the businessmen try to keep themselves away from active politics.

6.8 ROLE OF GOVERNMENT TOWARDS PERFORMANCE OF INDIAN ECONOMY

Government plays four important economic roles, viz., regulatory, promotional, entrepreneurial and planning roles. These are discussed below.

I. Regulatory Role

In this role, government regulates the economic activities by direct and indirect control.

a. Direct control

Direct controls can be applied selectively from firm to firm, industry to industry at the discretion of the government; like reservation of certain products for small enterprise, reservation of industries for public enterprises, licensing, imposing restrictions on imports, exports, etc.

b. Indirect control

These are applicable to all types of business units; these are not selective in nature. For example, restrictions on inter-corporate investments, multiple directors, inter-locking of directors, regulation of promotional activities, limit on managerial remuneration, etc. in addition to above, there are various types of other controls by government to regulate business units; like tax measures, monetary policy measures, measures to check concentration of economic power, measures to regulate foreign investment, etc.

II. Promotional Role

The promotional role of government is very important for the economic development of the nation. For promoting economic development, government provides infrastructure, social overhead capital, etc. promotional role of government includes:

a. Generation and distribution of power and energy (electrical, coal, petroleum products, natural gas, etc.)

b. Development of transport and communication facilities.

c. Development of social overhead capital like health, education, training institutes, etc.

d. Developments of money and credit systems like banks, stock exchanges, etc.

e. Providing incentives in the form of tax concessions, subsidies, concessional loans, etc for development of industries which are of strategic importance and for industries located in backward regions.

III. Entrepreneurial /Participative Role

In this role, government directly participates in economic activities by setting up public enterprises. Indian government has set up various public sector enterprises like railways, power generation plants, steel plants; enterprises producing engineering goods, heavy machinery, etc. in developing countries like India. This role is of special importance as all economic activities cannot be left to the private sector due to the following reasons:

a. To promote social welfare by providing essential items at a price even below cost of production.

b. To promote areas where private sector has no interest, because these areas are less profitable and require huge capital.

c. To protect customers form the monopoly like situation created by private sector.

d. To take over sick private sector units in the interest of employees.

IV. Planning Role

The government plays an important role as a planner. Many developing countries adopt economic planning for achieving growth and economic development. Planning is an integral part of the development. The common arguments in favour of government planning are:

a. In many developing countries, market forces fail to allocate efficient resources due to various reasons. Hence, governments adopt planning for obtaining efficient allocation of resources.

b. Government in developing countries follow planning for removing differences between social benefit and private benefit that is considered to be necessary to obtain optimum allocation of resources.

c. India lacks in capital, skilled man power, and foreign exchange. Planning mechanism helps in employing capital, skilled man power and other necessary resources required for the economic development.

6.9 SUMMARY

Economic development is a process whereby an economy's real national income as well as per capita income increases over a long period of time. Here, the process implies the impact of certain forces which operate over a long period and embody changes in dynamic elements. It contains changes in resource supplies, in the rate of capital formation, in demographic composition, in technology, skills and efficiency, in institutional and organisational set-up. It also implies respective changes in the structure of demand for goods, in the level and pattern of income distribution, in size and composition of population, in consumption habits and living standards, and in the pattern of social relationships and religious dogmas, ideas and institutions. In short, economic development is a process consisting of a long chain of inter-related changes in fundamental factors of supply and in the structure of demand, leading to a rise in the net national product of a country in the long run.

Economic development is also the increase in the amount of people in a nation's population with sustained growth from a simple, low-income economy to a modern, high-income economy. The scope of economic development includes the process and policies by which a nation improves the economic, political, and social well-being of its people. Economic development, as it is now generally understood, includes the development of agriculture, industry, trade, transport, means of irrigation, power resources, etc. It, thus, indicates a process of development. The sectoral improvement is the part of the process of development which refers to the economic development.

Economic development differs from economic growth. Economic development is a policy intervention endeavour with aims of economic and social well being of people; economic growth is a phenomenon of market productivity and rise in GDP. Consequently, as economist Amartya Sen points out: "economic growth is one aspect of the process of economic development".

Economic indicators are those often-voluminous statistics put out by government agencies, non-profit organizations and even private companies. They provide measurements for evaluating the health of our economy, the latest business cycles and how consumers are spending and generally faring.

6.10 KEY WORDS

Synergy

Debt

Controcts

Promotion

Planning

6.11 SELF ASSESSMENT QUESTIONS

1. What do you mean by economic development?
2. Explain the basic indicators of economic development.
3. Explain the role of government towards business.
4. Explain the role of business towards government.
5. Explain the role of government towards economy.

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UNIT - 7 : MONETARY POLICY

Structure:

7.0 OBJECTIVES

After reading this unit, you will be able to:

- define of monetary policy
- describe Instruments of monetary policy
- explain Monetary Policy in India
- analyse Limitations of monetary Policy
- write a note Recent Changes in RBI's monetary Policy

7.1 INTRODUCTION

The monetary policy is assuming greater relevance nowadays because the government has now shifted from physical control cover output, capacity utilisation and licensing to non-physical controls like monetary policy in order to regulate business activities. Two reasons are quoted in support of this shift. One is that the changes in the quantum of saving and its characteristics are reasons enough for considering the Indian economy to be ready for indirect management through financial controls. It is argued that the physical management of the economy through controls and licenses, which had been an unavoidable necessity during the earlier phase of the development of the Indian economy is no longer necessary and, indeed, may turn out to be counter-productive when the economy is poised for a higher level of performance and growth as shown by the higher rate of saving (from 10 percent of GDP in 1950-51 to 26 percent in 1978-79 and 20.7 percent during 1985-92.

The second reason which is claimed to favour the indirect management of the economy through financial controls is the findings of the Planning commission that in recent years, especially during the sixth Plan period of high growth rate, there has been a perceptible fall in the incidence of poverty. (In 1983, the percentage of population below the poverty line declined from 48.3 to 37.4 and further came down to 26 percent in 1999-2000). The commission's reasoning is that reduction in the incidence of poverty is being brought about by the accelerated rate of growth of the economy and what the economy needs in the decade ahead is growth which can be achieved through appropriate macro-policies based primarily on fiscal, monetary and credit policies.

7.2 MEANING AND DEFINITION OF MONETARY POLICY

Many economists have given different definitions, prominent among them are as follows:

According to Prof.Harry Johnson "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".

In the words of A.G.Hart "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".

According to Prof.Ann Lark Monetary policy is the policy statement, traditionally bi-annual through which the Reserve Bank of India (RBI) targets a key set of indicators to ensure price stability in the economy. These factors include:

a. Money supply commonly referred to as M3.

b. Interest rates

c. Inflation

From the above definitions, it is clear that a monetary policy is related to the availability and cost of money supply in the economy in order to attain certain broad objectives. The Central Bank of a nation keeps control on the supply of money to attain the objectives of its monetary policy.

7.3 OBJECTIVES OF MONETARY POLICY

The monetary policy of a nation is only a part of its overall economic policy. Therefore, the objectives of monetary policy are generally derived from the objective of economic policy. However, some of the objectives of monetary policy are as follows:

1. A Rational price system
2. Exchange rate stability
3. Attainment of full employment
4. Rapid economic growth
5. Social justice
6. Regulation Of NBFIs
7. External Stability

8. Encouraging Savings and Investments
9. Neutrality of Money

1. A Rational Price System

The monetary authority could have any of the following objectives with regard to prices in the economy:

a) Price-stability
b) Gradual increase in prices
c) Fall in prices

a) Price-stability

In normal circumstances usually economies prefer to have stable prices. This is because, both inflation and deflation have ill effects on the economy. A positive stable price policy is one which ensures changes in the supply of money in such a way that the needs of the economic system are adequately met and prices are not allowed to fluctuate widely. However, it is very difficult task to attain prices stability in the economy because prices and credit in the economy do not depend only on the central bank. Prices and credit level in the economy is also largely affected by a number of commercial banks and also a vast unorganised money market. The activities of commercial banks may be controlled but the activities of unorganised money market are difficult to control. Moreover, prices are influenced by many economic and non economic factors some of which may be totally out of the realm of monetary policy and hence difficult to control.

b) Gradual Price-Increase

A modest rise in price is good for the economic growth of a country. This is because increasing price level stimulates investment, employment and output in the economy. An economy could strive for mild rate of inflation and thus develop its monetary policy in such a way that prices are followed to rise gradually.

c) Fall in Prices

Prices if allowed to increase uncontrollably may inhibit growth. Therefore, under such circumstances, the Central Bank may pursue a policy of bringing down prices. For this, it may use appropriate measures such as increasing Bank rate, selling securities in the open market, raising CRR and SLR etc. However, it should be remembered that such a policy will slow down employment in the economy and may lead to depression.

2. Exchange-Rate Stability

Apart from maintaining internal price stability, stability in th external value of currency could also be one of the aims of monetary policy. For this, it ensures that there are no wide fluctuations in exports, imports or capital movements.

3. Attainment of Full Employment

These days, the most important objective of monetary policy is attainment of full employment without inflation. The objectives of price and exchange rate stability have been given a secondary importance these days. The policy of full employment can be pursued through monetary measures as they can help in achieving and maintaining the rates of savings and investment at a level, which would ensure full employment. For this, monetary policy may help in raising the aggregate rate of savings and proper channelization of savings into desirable directions of investment. Several monetary measures can be adopted for raising the level of savings. The rates of interest may be increased and banking facilities may be expanded. Similarly, for boosting investment, bank credit may be offered for investment. Besides, monetary instruments may be used to ensure that the banking system contributes to financing the planned public investment. For example, in India SLR is used to ensure that a good part of the savings mobilized by the banking system are invested in Government securities and approved securities for financing vital investment projects.

4. Rapid Economic Growth

The economic growth refers to increase in real national output of an economy. Economic growth can be accelerated by increasing the rate of savings and investment in the economy. Therefore, a monetary policy aiming at the objective of rapid economic growth should employ measures to increase savings (such as raising interest rate, promoting and expanding banking services, maintaining price stability etc.) and investments (such as offering bank credit at reasonable terms, financing planned public investment etc.) and ensuring adequate flow of money into desirable channels such as infrastructural facilities, basic and key industries.

5. Social Justice

Monetary policy also aims at social justice in the economy. For this certain selective credit control measures come handy. For example, if the authorities want to restrict wasteful expenditure on consumer goods, they may use variable interest rates or may increase the down payments while reducing the number of instalments for repaying the debt. Similarly, they may provide concessional credit to agricultural and small scale

units for promoting economic equality. They may increase the margin requirements in respect of loans against the securities of certain sensitive commodities or may force the banks to reduce their lending against commodities of mass consumption.

6. Regulation Of NBFIs

Non – Banking Financial Institutions (NBFIs), like UTI, IDBI, IFCI plays an important role in deployment of credit and mobilization of savings. RBI does not have any direct control on the functioning of such institutions. However it can indirectly affects the policies and functions of NBFIs through its monetary policy.

7. External Stability

With the growth of imports and exports India's linkages with global economy are getting stronger. Earlier, RBI controlled foreign exchange market by determining exchange rate. Now, RBI has only indirect control over external stability through the mechanism of 'managed Flexibility', where it influences exchange rate by buying and selling foreign currencies in open market.

8. Encouraging Savings and Investments

RBI by offering attractive interest rates encourages savings in the economy. A high rate of saving promotes investment. Thus the monetary management by influencing rates of interest can influence saving mobilization in the country.

9. Neutrality of Money

Economist such as Wicksted, Robertson have always considered money as a passive factor. According to them, money should play only a role of medium of exchange and not more 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 criticised on the ground that if money supply is kept constant then it would be difficult to attain price stability.

7.4 INSTRUMENTS OF MONETARY POLICY

Unlimited expansion of money and credit results in hyper-inflation, which hits all sections of society, particularly the poor. The Reserve Bank has a responsibility to ensure that money supply is within manageable limits and inflation is not too harsh. For this purpose, the Reserve Bank has been using different control measures, popularly

called ‘credit control measures’. These control measures can be broadly classified into two categories

I. General or Quantitative Control

II. Selective or Qualitative Control

I. GENERAL CREDIT CONTROLS

The general controls affect the total quantity of credit and the economy generally. General controls include:

a) Bank Rate

b) Open Market Operations

c) Cash Reserve Requirements

d) Statutory Liquidity Requirements

e) Refinance Policy

f) Repo And Reverse Repo Rates

a) Bank Rate

Commercial banks, when they need cash, can borrow from the central Bank. The latter offers to them the facility of rediscounting bills of exchange or advancing loans on approved securities. For this, it charges from them a rate, which is called the Bank Rate. A change in the Bank rate is usually followed by a corresponding change in the rates of interest charged by the commercial banks and other financial institutions. Thus, through manipulation of the bank rate the Central bank can initiate a considerable chain of repercussion throughout the banking system, which influences the supply of money. When the bank rate is raised by the central Bank, banks also raise their lending rates. Thus borrowing becomes costly and credit is tightened. This discourages investment which in turn affects production and employment. Ultimately, the income of the people is reduced and price level is brought under control. On the contrary, a fall in the bank rate causes increased production, which in turn results in higher income and purchasing power of the people and pushes the prices up. If a country allows free flow of funds in and out of the country, the changes in the bank rate will also have an effect on the external sector. For example, when the bank rate is raised all interest rates in the market would generally rise. This will encourage funds from the banks to the other countries or vice versa.

It is to be noted that the bank rate changes affects the credit creation by banks by changing the cost of credit. Changes in the cost of credit affect borrowings by commercial banks from the Central bank and also affect the borrowings by businessmen from the commercial banks.

Limitations of Bank Rate Policy

The limitations of Bank Rate Policy are as follows:

a. All the other rates should follow the bank rate in its movement so that credit should contract or expand as the case may be. If, for example, commercial banks have enough reserves at their disposal, their dependence on the Central Bank for getting their bills discounted will be low. Thus, their cost of borrowings may not get affected and eventually the cost of borrowing from baks may not get much affected.

b. For successful operation of this policy, it is necessary that there is a well organised money market. In most of the developing economies including India, indigenous bankers who remain outside the realm of Bank rate policy constitute a good part of the money market. This reduces the importance of bank rate policy, as changes in the bank rate are not followed by the appropriate changes in the lending rates charged by all lending institutions.

c. The structure of the economy should be elastic so that changes in credit should lead to corresponding changes in interest rates, investment, production, wage-rate; employment, income and prices, etc. In simply words, businessmen and investors should respond in the expected way to changes in the bank rate. Thus, they should reduce the borrowing when the bank rate is raised and increase the borrowings for investment when the bank rate is reduced. But generally it is found that businessmen do not go by the rates of interest only, they look into other economic factors for deciding whether to invest or not. Thus, during depression they may not feel motivated to invest, however-low interest rates may be. Bank rate is thus, not a very effective tool for recovering an economy from recession although it may be effective to control inflation. Moreover, this tool is useful only when it is used in conjunction with other tools. Bank rate in India was 11 percent in April 97; it was reduced to 7 percent in April 2000.

b) Open Market Operations

These imply the sale or purchase of approved securities by the Central Bank in the open market. When the Central Bank sells securities, the individuals or institutions that purchase them drew money from their respective banks. There is thus a reduction in the deposit of commercial banks and consequently in their cash balance. With the

reduction in cash balance, the commercial banks have to reduce their lending. Thus credit contracts, purchase of securities by the Central Bank leads to an increase in the supply of money through a sequence of opposite kind.

The method of open market operations is sometimes adapted to make the Bank rate policy effective. If banks are flushed with funds they do not increase rates following the increase in the bank rate and the Central bank may sell securities in the market and force the commercial banks to buy them and thus it may wipe away surplus funds available with the banks.

Advantages of open market Operations

i) Open market operations can be used to support the Bank Rate Policy. For example, during boom, a higher bank rate may be accompanied by sale of securities by the Central bank.

ii) Open market operations can be used for stabilising the prices of government securities. This can be done by buying them at a time when their prices are low and selling them at a time when their prices are high.

iii) Similarly, these operations can be used for evening out seasonal shocks. This can be done by buying them during busy season and selling them during slack season.

Limitations of Open market Operations

The limitations of Open Market Operations are as follows:

i) When the Central Bank purchases securities, the quantity of money in circulation as well as cash reserves of commercial banks will increase and when it sells securities, the quantity of money in circulation and the cash reserves of commercial banks will decrease.

This, however, may not happen. The sale of securities may be offset by return of notes from circulation and boards. The purchase on the other hand, may come along with withdrawal of notes for increased currency requirement or for hoarding.

ii) Another limitation is that commercial banks will seek to increase or decrease their loans and investment more or less in accordance with the increase or decrease in their cash reserves. But there are many circumstances-monetary, economic or political-which may deter a bank from using increase cash reserves fully, or from contracting credit when its reserves are reduced.

iii) Commercial banks cash resources increase, the demand for loans and advances should increase too and vice versa. But this may not happen always. Du to economic or political uncertainty, even cheap money rates may not attract borrowers. Similarly when trade prospects are good even high rates may not deter the borrowers from borrowings.

Open market operations in developed economies have proved to be quite successful as an instrument of monetary policy. This is mainly because when the central bank purchases securities or sells securities, the reserves of commercial banks automatically, expand or contract. This affects their capacity to lend. Secondly, these operations can be manipulated in a way that cash reserves of banks increase or decrease to the desired extent. In India, however, due to small market for Government securities, these operations have not been very successful. In India, open market operations are not conducted as instrument of monetary control but to maintain desired yield on government Securities.

c) Cash Reserve Ratio(CRR)

Under the RBI Act, 1935, every commercial bank has to keep a certain minimum cash reserve with the RBI. The RBI is empowered to vary with the CRR between 3 percent and 15 percent of demand and time deposits. Like the bank rate, CRR was changed several times. In 1973, it was 7 percent, in 1984, 9 percent, increased by 0.5 percent with effect from February 28, 1987, and subsequently hiked to 10 percent. CRR was further hiked to 15 percent in 1991 but brought down to 14 percent from May 14, 1994 with a view to inject a measure of liquidity in the banking system, CRR was cut down to 10 percent with effect from Jan, 1997. It is 4.5 percent since June 2003. CRR is a powerful weapon. An increase in the CRR would reduce the available funds for bank credit and a reduction would have the opposite effect.

d) Statutory Liquidity Ratio(SLR)

In addition to CRR, every commercial bank should keep a certain percentage of its total demand and time deposits with the RBI in the form of liquid assets like cash, gold or unencumbered approved securities. Maintenance of adequate liquid assets is a basic principle of sound banking. Hence, commercial banks have been required by the Banking Regulation Act, 1949, to maintain a minimum ration of liquid assets. The RBI has been empowered to change the ration. Accordingly, it raised the SLR from 25 percent to 30 percent in 1972, to 32 percent in 1973, to 35 percent in 1981, to 36 percent in 1984 and to 37.5 percent in 1987. This was raised to 38.5 percent in 1991 and subsequently reduced to 25 percent.

The Narasimhan Committee recommended a gradual reduction of SLR to 25 percent over a period of five years. Consequently, the SLR was reduced to 30 percent on incremental basis in April 1992, and a further reduction of 0.75 percent was announced in October 1992. It has been reduced to 25 percent with effect from October 16, 1993. Further reduction in SLR would be planned taking into account the evolving monetary situation

e) Refinance Policy

This system of refinance provided by the RBI to commercial banks affects on credit. The system is changed periodically to allow or disallow certain flows by banks. The scope of refinance as an instrument of credit control depends on the liquidity position of the commercial banks. Over the years, the commercial banks' dependence on the RBI for refinance has come down except in the case of subsidised refinance of agricultural and rural credit. The effectiveness of refinance policy has, therefore, come down.

f) Repo and Reverse Repo Rates

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

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

II. SELECTIVE CREDIT CONTROL

The methods of controlling credit discussed above are known as quantitative or general methods because they control the availability of credit in general. They affect all sectors of the economy indiscriminately. As against these, selective credit controls are supposed to regulate the flow of credit for specific purposes. These controls seek to distinguish between essential and non essential uses of bank credit and seek to divert bank credit from inessential and non priority sectors to essential and priority sectors. The selective credit controls are used in the following forms:

a. Rationing of Credit

Credit rationing means limiting the amount available to each applicant as credit. Rationing of credit is normally undertaken by the Central Bank at the time of monetary stringency. Credit rationing may also be undertaken by (a) putting an overall ceiling on loans and advances for every bank (b) fixing ceilings for specific classes of loans and advances.

b. Changes in the margin requirement against security

Margin is the difference between the value of security offered and amount borrowed against this security. This system is particularly intended in controlling the volume of credit used for speculative purposes. Under this system, the Central Bank is empowered to fix the margin requirements, the Central Bank can ensure that credit moves to socially desirable channels.

c. Regulation of Consumer Credit

This instrument intends to regulate credit for the purchase of consumer goods. This includes, banning (or allowing) credit for the purchase of certain consumer goods, limiting (or extending) the time for repayment, raising (or lowering) the limit of down payment and decreasing (or increasing) the number of instalments for repayment.

d. Direct action

If commercial banks persist on pursuing a policy which is in conflict with the declared policy of the central Bank, the Central Bank may take direct action. Direct action may take the form of (i) refusal to discount the bills of erring bank, (ii) charging penal rate of interest from such a bank.

e. Moral Suasion

Direct action may often be avoided by the Central Bank. It may try to exert discreet or indirect influence over the loan policy of a member bank by what is called Moral Suasion. The use of moral persuasion makes it easier for the Central Bank to secure the willing and active co-operation of commercial banks in letter and spirit.

In addition to the above measures, the Central bank use methods such as prohibiting the discounting of bills involving sale of certain commodities, charging varying interest rates etc.

7.5 AN EVALUATION OF MONETARY POLICY

Monetary policy has become a target of severe criticism. RBI's monetary policy has been characterised as one of controlled expansion. It is said that the RBI has failed both in expansion and control of money and credit in our economy. With regard to the expansion of credit, it is said that the major component of the increase in money supply was the Reserve Bank credit to the Central Government. The inability of the Reserve Bank to deny or regulate credit to the central Government due to both legal and practical considerations has been interpreted by the Committee (Sukhamoy Chakravarty Committee) as an important factor in the Reserve Bank's helplessness in controlling the rise in money supply.

With regard to the role of the RBI in controlling inflation, criticism is equally strong. It is said that the monetary policy operated by the RBI did not play any effective role in containing inflation in the economy. The growth of money supply in recent years was much higher than the growth in output. The average annual growth in output (net national product at factor cost at 1970-71 prices) between 1970-71 and 1983-84 was 3.7 percent per annum. The increase in money supply on an average annual basis between March 1971 and March 1984 was as high as 17.2 percent. There had a growth rate of 4 percent per year and money supply of over 17 percent. It is this divergence between the two key factors governing the health of the economy which led to the average annual rise of prices nearly 10 percent during this period.

The reasons for the failure to formulate an effective monetary policy should, perhaps, be found elsewhere and not with the RBI. The Sukhamoy Chakravarty Committee has strongly indicated the central Government for living beyond its means and making the central banking authority important in discharging its responsibility in maintaining the value of the currency. The report has clearly shown that the indiscipline of the fiscal policy has made the monetary policy an exercise in futility. The central Government has opened the flood gates of monetary growth and asked the Reserve Bank of India to plug the small leaks. In simple words, the report conveys that the emperor of monetary policy has no clothes on.

Another argument to prove the reserve Bank's helplessness is that the powers and weapons of the bank cover only the commercial banks. To the extent inflationary pressure is the result of bank finance, the Reserve Bank's general and selective credit controls will have effect. But if inflationary pressure is really brought about by deficit financing and shortage of goods, the Reserve Bank's control may not have any effect at all. Besides,

the apex bank has no power over non-banking financial institutions and indigenous bankers who continue to play a considerable role in financing trade and industry.

7.6 LIMITATIONS OF MONETARY POLICY

Though the monetary policy is useful in attaining many goals of economic policy, it is not free from certain limitations. Its scope is limited by certain peculiarities, in developing countries. Some of the limitations of monetary policy are given below:

1. It has been pointed out that monetary policy is ineffective in tackling the complex situation of present day business. For example, the success of the bank rate depends upon the amounts by which it is manipulated. A small change will hardly be noticed by the economic system in general. But a sharp and sudden change may totally shake the public confidence.

2. It has been generally noticed that people's attitude to consumption and savings depends much upon their income and upon the institutional channels through which they save and much less on the interest which their savings get. That is why very few would notice 1-2 percentage change in the bank rate as to change their rate of consumption

3. Similarly, investment decisions are affected by many other considerations that the rate of interest such as future uncertainties and risks of business, the economic scene in the country, etc. Interest cost is only one factor in investment decisions. Moreover, this can be easily passed on to the consumers. It is very difficult to induce investment through easy credit during the times when business prospects are poor and no investment looks profitable. Similarly, it is difficult to squeeze investments by putting restrictions on credit when business conditions are bright.

4. Selective credit controls are also ineffective because bank credit is not the only source of fund available to business in the present era. There are other sources as well-insurance companies, extended trade credit, indigenous money lenders etc.

5. Most of the developing economies have underdeveloped money markets including the banking system. In such conditions, the use of orthodox monetary policy as an instrument of economic policy has very limited possibility of success.

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

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

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

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

10. In order to attain a maximum of the above objectives it is necessary that both the fiscal and monetary policies should go hand in hand. As both these policies are prepared and implemented by two different authorities, there is a possibility of non coordination between these two policies. This can harm the interest of the overall economic policy.

11. In rapidly growing economy the deposit base of many commercial banks is expanded. This creates excess liquidity in the system. Under this circumstances even if the monetary policy increases the CRR or SLR, it does not deter commercial banks from credit creation. So the existence of excess liquidity due to high deposit base is a hindrance in the way of successful monetary policy.

These are major obstacles in implementation of monetary policy. If these factors are controlled or kept within limit, then the monetary policy can give expected results. Thus though the monetary policy suffers from these limitations, still it has an immense significance in influencing the process of economic growth and development.

7.7 RECENT CHANGES IN RBI's MONETARY POLICY

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

1. Multiple Indicator Approach

Upto late 1990s, RBI used the 'Monetary targeting approach' to its monetary policy. Monetary targeting refers to a monetary policy strategy aimed at maintaining price stability by focusing on changes in growth of money supply. After 1991 reforms

this approach became difficult to follow. So RBI adopted Multiple indicator Approach in which it looks at a variety of economic indicators and monitor their impact on inflation and economic growth.

2. Selective Methods Being Phased Out

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

3. Reduction In Reserve Requirements

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

4. Deregulation Of Administered Interest Rate System

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

5. Delinking Of Monetary Policy From Budget Deficit

In1994 government phased out the use of adhoc treasury Bills. These bills were used by government to borrow from RBI to finance fiscal deficit. With phasing out of Bills, RBI would no longer lend to government to meet fiscal deficit.

6. Liquidity Adjustment Facility (LAF)

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

7. Provision Of Micro Finance

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

8. External Sector

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

9. Expectation as a Channel Of Monetary Transmission

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

7.8 STRUCTURAL ADJUSTMENTS AND MONETARY POLICY

In tune with the ongoing structural adjustment programme, objectives and instruments of the monetary policy have been redefined. The major considerations which underline the monetary policy in recent years have been: (a) bringing about a deceleration in monetary expansion with a view to containing inflation without hampering the revival of economy; (b) reducing the monetised deficit, i.e., printing of new currency consistent with the government's objective of bringing down gross fiscal deficit and (c) boosting exports in order to alleviate the problem of external payments deficit.

To achieve these objectives, the following instruments of monetary policy have been employed:

1. The stipulation of a minimum lending rate for advances of over Rs.2 lakh has been discontinued and banks would be free to fix their own prime rates.
2. SLR has been reduced to 25 percent, sharply shrinking the captive market for government securities.
3. State governments too would have to go to market for loans.
4. Automatic monetisation of the budget deficit would cease and has been replaced by a system of ways and means advances under which temporary accommodation provided to the Central Government would have to be liquidated by the end of financial year.
5. The RBI would endeavour to develop an active market in securities for which it would undertake to develop institutions and instruments as well as an appropriate structure of market determined rates of interest on securities.

6. A close linkage would be established between monetary policy and exchange rate policy.
7. The RBI is prepared to accept that the bank's choice of asset holdings would be determined not by statutory prescriptions but by risk reward perceptions.
8. Guidelines have been issued for the promotion of market makers in major stock exchanges and for the grant of bank advances for the purpose, without any ceiling and without applying the 50 percent margin applicable to advance against shares.

7.9 SUMMARY

Monetary policy is concerned with measures taken to regulate the supply of money for the realisation of general economic goals by the central Bank of the country. However, in developing countries like India, monetary policy cannot remain confined only to regulating the supply of money. It has to play a positive role in helping the economy to meet its specific goals. That is why the Reserve Bank of India's monetary policy has been designed in such a manner that it, besides regulating the supply of money, ensures that the legitimate credit requirements of industry and trade are met. In addition, it ensures that the credit is not used for speculative purposes. Its policy is thus a policy of controlled expansion of money and credit in the economy.

7.10 KEY WORDS

Stability,

Interest,

Liquidity

Refinance

7.10 SELF ASSESSMENT QUESTIONS

1. Define Monetary Policy.
2. Explain the objectives of Monetary Policy.
3. Explain Credit control measures of RBI in brief.
4. Explain Selective Control Measures of RBI in brief.
5. What are the limitations of monetary policy?
6. Explain the recent changes in RBIs Monetary Policy.

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UNIT - 8 : FISCAL POLICY

Structure

8.0 OBJECTIVES

After reading this unit, you will be able to:

- The give meaning of fiscal Policy
- discuss Instruments of Fiscal Policy
- define budget
- expalin canses Budget deficits

8.1 INTRODUCTION

Fiscal policy is playing an important role on the economic and social front of a country. Traditionally, fiscal policy was concerned with the determination of state income and expenditure policy. But with the passage of time, the importance of fiscal policy has been increasing continuously for attaining rapid economic growth. Accordingly, it has included public borrowing and deficit financing as a part of fiscal policy of the country. An effective fiscal policy is composed of policy decisions relating to entire financial structure of the government including tax revenue, public expenditure, loans, transfers, debt management, and budgetary deficit and so on. The policy also tries to attain proper balance between these aforesaid units so as to achieve the best possible results in terms of economic goals.

8.2 MEANING AND DEFINITION OF FISCAL POLICY

The word fiscal is derived from the old French Word Fisc, which means the money basket or the treasury. Thus fiscal means pertaining to treasury or government finance.

Some of the definitions given by different economists are as follows:

According to Arthur Smith, "Fiscal policy refers to a policy under which government uses its expenditure and revenue programmes to produce desirable effects on national income, production and employment".

According to A.G.Buchler, "By fiscal policy it means the use of public finance expenditure, taxes, borrowing and financial administration".

Harvey and Joanson, M., defined fiscal policy as "changes in government expenditure and taxation designed to influence the pattern and level of activity".

According to G.K.Shaw, "We define fiscal policy to include any design to change the price level, composition or timing of government expenditure or to vary the burden, structure of frequency of the tax payment".

Otto Eckstein defined fiscal policy as "changes in taxes and expenditure which aim at short run goals of full employment price level and stability."

Thus it can be said that fiscal policy refers to the policy of the government regarding taxation, public expenditure and public debt. Fiscal policy plays an important role in determining the stability of an economy because it affects the level of income and employment in a country.

8.3 OBJECTIVES OF FISCAL POLICY

The objectives of fiscal policy differ from country to country as they basically depend upon the economic policy of the country. In a socialist economy, the main aim could be equitable distribution of income and wealth. For this, the fiscal policy will be employed in such a way that there is a transfer of income from rich to poor. In a developing country the main aim is to accelerate economic development; for this the fiscal policy will be employed in such a manner that its instruments i.e., taxation, public expenditure and borrowing all lead to accelerating the growth of the economy.

These objectives of fiscal policy may come in conflict with one another. For example, the objective of high rate of economic growth may come in conflict with the distributive objective of the fiscal policy. Likewise, equitable distribution of income and wealth may adversely affect the inducement to produce more and thus retard the rate of economic growth. Thus, reconciliation has to be achieved between these conflicting objectives of fiscal policy. The main objectives of fiscal policy in a developing economy may be summarized as follows:

1. Mobilisation of Resources

Most of the developing countries are caught in the 'vicious circle of poverty.' Prof. Higgins remarks that "the road to the growth of developing economies is paved with vicious circles." Vicious circle of poverty refers to the circular constellation of forces, tending to act and react in such a way as to keep a poor country in a state of poverty. The most important objective of fiscal policy in a developing country should be to break this vicious circle of poverty. In order to achieve the above objective it is of utmost importance to increase the rate of investment and capital formation to accelerate the rate of growth. The government may resort to voluntary and forced saving to collect

enough resources for investment. 'Incremental saving 'ratio', i.e. the marginal propensity to save, can be maximized by a number of methods which may include direct physical controls, increase in the rates of existing taxes, imposition of new taxes, operating surplus of the public enterprises, public borrowings, deficit financing, etc.

2. Acceleration of Economic Growth

The aim of fiscal policy in a developing country is to accelerate the rate of growth so that the real national income of the country may increase in the long run. The government, through its taxation policy, public borrowings, deficit financing, etc., can provide incentives for saving and investment. The revenue resources collected through taxes should be invested in productive activities. Public expenditure should be diverted towards new and more useful development activities. The government may also grant tax relief and subsidies to the entrepreneurial class to boost the investment activities. Expansion of investment opportunities will certainly have a favourable effect on the level of business activities and rate of economic growth.

3. To Minimise the Inequalities of Income and Wealth

To maintain the equality of income and wealth is not only an objective of economic growth, but a precondition to it. The government, therefore, should formulate its fiscal policy in such a manner so that it may reduce the inequalities of income and wealth. A mere increase in national income does not necessarily promote economic growth. It is all the more essential to reduce the existing inequalities of income and wealth. Extreme inequalities create political and social discontentment and generate instability in the economy. The following measures can be taken to reduce the inequalities of income and wealth:

(i) Progressive taxes may be imposed on the rich people so that the unnecessary consumption expenditure is curtailed.

(ii) The poorer section of the society should be exempted from taxes.

(iii) Luxury goods should be highly taxed and the proceeds so collected are diverted to productive investment activities.

(iv) The government must spend more on the social services or on the items which benefit the poor people most.

(v) The fiscal policy must discourage unearned income.

In brief, the problem of reducing inequalities of income and wealth may be solved through redistributive public expenditure and redistributive tax policy.

4. To Increase Employment Opportunities

One of the important objectives of fiscal policy in a developing country is to increase the employment Prof. Lewis is of the opinion that without providing full employment to the available manpower, the objective of economic growth will remain incomplete. The government through fiscal policy can help in creating and promoting an atmosphere where people may get employment opportunities.

5. Equilibrium in Balance of payment

The position of balance of payment of a country has close relation with the overall economic situation of a country. If the value of total imports exceeds the value of total exports there will be disequilibrium in the balance of payments. This disequilibrium in balance of payments can be corrected with the help of a fiscal policy. Government can use fiscal policy to promote the exports and reduce imports. It can do so by increasing the import duties and reducing the export duties along with providing various subsidies to the exporters.

Some of the other objectives of Fiscal Policy are as follows:

1. To raise the rate of savings and investment for increasing the rate of capital information.
2. To promote necessary development in the private sector through fiscal incentive.
3. To arrange an optimum utilisation of resources.
4. To control the inflationary pressures in economy in order to attain economic stability.
5. To attain the growth of public sector for attaining the objective of socialistic pattern of society.
6. To reduce regional disparities.

8.4 TYPES OF FISCAL POLICY

There are two types of fiscal policy:

1. Automatic stabilizers fiscal policy-Built in the system automatically without deliberate action of the government. There are two automatic stabilizers viz.,
    a. Changes in tax revenues
    b. Unemployment compensation and welfare payments

2. Discretionary Fiscal Policy- It implies deliberate changes undertaken by the government of a country in the tax rates and planned expenditures in an effort to stabilize the economy.

8.5 STANCES OF FISCAL POLICY

The three possible stances of fiscal policy are as follows:

a. A Neutral Stance

A Neutral Stance of fiscal policy implies a balanced economy. This results in large tax revenue. Government spending is fully funded by tax revenue and overall the budget outcome has a neutral effect on the level of economic activity.

b. An Expansionary Stance

An Expansionary Stance of fiscal policy involves government spending exceeding tax revenue.

c. A Contractionary Fiscal Policy

A Contractionary Fiscal policy occurs when government spending is lower than tax revenue.

8.6 INSTRUMENTS OF FISCAL POLICY

The various instruments of fiscal policy are as follows:

1. Public Expenditure
2. Public Revenue
3. Public Debt
4. Deficit Financing

1. Public Expenditure

Public expenditure is playing an important role in the economic development of a country like India. With the increase in responsibilities of the government and with the increasing participation of government in economic activities of the country, the volume of public expenditure in a highly populated country like India is increasing at a galloping rate. In 1992-93, the public expenditure as percentage of GDP was around 30 percent.

Types of Public Expenditure

The main types of Public Expenditure are as follows:

i. Revenue Expenditure and Capital Expenditure

Revenue expenditure is a current expenditure which is incurred on civil administration (consisting of police, judiciary etc.) defence forces, public health and education. This expenditure is of recurring type and is incurred year after year.

On the other hand, capital expenditure is incurred on building multi-purpose projects, buying capital equipment, machinery, etc. These expenses are non recurring type and are incurred once in several years.

ii. Productive Expenditure and Non-Productive Expenditure

Productive expenditure is that expenditure, which helps in improving the productive capacity of the economy. As such, expenditure on capital stock and tangible goods is considered productive. Expenditure which does not improve productive capacity of the economy is considered non productive expenditure. As such, expenditure on administration, defence, justice law and order, and maintenance of the state is considered non productive expenditure. However, it may be noted that a precise distinction between productive expenditure and non productive public expenditure is a difficult task. For example, expenditure on defence services, research administration, etc., is non-productive, but indirectly such expenditure adds to the efficiency of the economy and hence is indirectly productive. It is, therefore, necessary to judge each case on its own merits. It is to be noted that a modern counterpart of the distinction between productive expenditure and non productive expenditure is development expenditure and non development expenditure.

iii. Transfer Expenditure and Non Transfer Expenditure

Transfer expenditure is one against which there is no corresponding transfer of real resources to the government. For example, expenditure incurred on unemployment allowances, sickness benefits, old age-pensions, etc., is transfer expenditure as the Government does not get any return in the form of goods or services against them. Non transfer expenditure is one against which there is a corresponding transfer of real resources to the Government. For example, expenditure on defence, education, and health is non transfer expenditure as the government gets the services of defence personnel, teachers, doctors, etc., in return for such expenditure.

iv. Plan Expenditure and Non-Plan Expenditure

The expenditure for which provision is specifically made in the budget is called planned expenditure. The non-planned expenditure is one for which no specific provisions

are made in the budget. It is to be noted that the distinction between plan and non plan expenditure does not correspond to that between developmental and non developmental ones. This is because both plan and non plan expenditure may contain developmental as well as non developmental items. In Indian budgets, for example, once a plan is fully operative or the plan project is completed, its maintenance and operational expenses are shifted to non plan budget.

Effects of Public Expenditure

The following are the effects of Public Expenditure:

1. Public expenditure can help an economy to achieve higher levels of production and growth. The effects of public expenditure on production may be different in the case of a developed economy from that of a developing economy. A developed economy may face depression or recession due to a lack of effective demand. Under such circumstance, the increase in Government expenditure on public works or any other type of investment or expenditure will lead to increase in effective demand. This increase in demand will cause fuller utilization of existing productive capacity and unemployed manpower and result in increasing production, employment and national income. But once fuller employment of resources is attained, increase in production may not be attained by increasing aggregate demand. If however, the Government spends judiciously like spending on investment projects or projects for capital formation (railways, infrastructural facilities, etc.) or on research and development, it will result in increase in productivity and ultimately increase in production in the long run.

2. Public expenditure helps in stabilising and maintaining stable rate of growth in a developed economy. In a developing economy, it can contribute to economic growth by developing social overheads, creating of infrastructure in the form of transport and communication, education and training, growth of capital goods, basic and key industries research and development, etc., and stimulating saving and capital accumulation.

3. Public expenditure may be geared in such a manner that it helps in attaining an equitable distribution of income and wealth. For this a number of welfare measures like free education, health, water and other facilities may be given top priority. Various social security schemes may be adopted where people are entitled to old age pension, unemployment relief, sickness allowance and so on. The products of mass consumption like food can be subsidized and production of those which are in short supply can be taken up in the public sector. Public expenditure through direct purchases, public

production or subsidies can ensure that the supply of essential goods is there to the desired extent. Similarly, public expenditure, through appropriate subsidies and other such policies can encourage labour intensive techniques of production which reduce unemployment and improve income distribution.

Guiding Principles of Public Expenditure

1. While spending public money, the Government should be careful that there is no wasteful usage of public money. It should have a scientific approach while evaluating projects for public expenditure.

2. No public money can be used without proper sanction from the competent authority and once the funds have been sanctioned, they must only be used for the purpose for which they have been sanctioned.

3. The public expenditure must be incurred only when it is beneficial to the society. The various items of public expenditure should result in maximum social advantages. Public expenditure must ensure that its benefits are availed of by the largest sections of the society.

4. The state should manage public funds in a manner that there are moderate surplus to meet the contingencies.

2. Public Revenue

In order to meet public expenditure, a state needs funds. Such funds called public revenue are raised from various sources. The common sources of public revenue are taxes, borrowing from public and banks, profits of public undertakings deficit financing and Foreign aid.

Taxes are the most important source of public revenue. A tax is a compulsory levy or payment levied to meet the expenditure incurred for the common benefit of the people of a country. Two important points emerge here: (i) A tax is a mandatory payment and thus no one can refuse to pay it (ii) Taxes so collected are used for the common benefit of the public purpose and, as such a taxpayer does not receive a definite and direct quid pro quo from the Government. This implies that a person cannot demand that the Government should render him a particular service in return for the tax paid by him. This does not, however, mean that the Government does not do anything for the people who pay taxes. In fact, the government spends the tax proceeds for the general benefit of the society rather than providing any special benefit to a particular taxpayer.

Main objectives of taxation policy in India are as follows:

a) Mobilization of Resources:

Taxes are the major sources of government revenue. Taxrevenue in India has been rising every year. Government mobilizes resources through taxation for economic development.

b) To promote savings:

One of the important objectives of taxation policy is to promote savings. For this purpose various tax concessions, tax deductions are given on savings e.g., savings in provident funds, savings in national saving certificate, etc.

c) To promote Investment:

To promote investment in remote and backward areas, rural areas, various tax rebates, tax concessions, tax deductions are given for investment in these areas.

d) To bring Equality of Income and Wealth:

To achieve this objective different kinds of progressive direct taxes are levied e.g., income tax, wealth tax, etc., rate of tax is increase with the increase in income.

3. Public Debt

When the State finds it difficult to match its inflows (i.e., public revenue) with outflows (i.e., public expenditure), it resorts to public debt. Public debt may also be resorted to in the event of a sudden spurt in the state expenditure (may be because of war, natural calamity, etc.)

Public debt may be internal or external, when the Government borrows from its own people in the country, it is called internal debt. On the other hand, when the Government borrows from outsources, the debt is called external debt.

Public debt takes two forms: (1) Market loans (2) Small savings

In the case of market loans, the Government sells to the public negotiable Government securities of varying denominations and duration and treasury bills. For financing capital projects, long term capital bonds are floated and for meeting short term Government expenditure, treasury bills are issued.

The small savings represent public borrowings, which are not negotiable and are not bought and sold in the market. In India, for mobilizing small savings various types of schemes are introduced e.g., National Savings Certificates, National Development Certificates, etc.

Advantages of Public debts

a. It is the quickest mode of raising funds.

b. Public debt does not involve social burden if it is used for productive works. The lenders are able to get remunerative investment outlets and the Government gets funds for its projects and can repay from the income yielded by investment.

c. Public debt is anti inflationary since it helps in mopping up the surplus purchasing power from the people.

d. Public debt helps in accelerating economic development. Thus funds raised through public borrowings can be used for building up infrastructure, and for strengthening agricultural and industrial base of the economy.

Difficulties Involved in mobilization of public borrowings

a. In many countries, especially the developing and under-developed countries, there are no well organised money and capital markets.

b. The government and the private sector may compete for the funds and may raise the rate of interest. This will act as a disincentive for the private sector.

c. It may not be easy to check the diversion of funds into unproductive investment.

4. Deficit Financing

When the Government expenditure exceeds the Government revenue from taxes, profits of public undertaking, borrowing from the public and so on, it resorts to deficit financing. Deficit financing involves either drawing down of cash balances of the Government held in the Central Bank or by borrowing from the Central bank. When the government borrows from the Central Bank, the Central bank issues notes and gives them to the government against government securities. In any developing economy, the need for raising resources for development far exceeds the resources raised through taxation, borrowing, etc. This gap has to be met by deficit financing.

Deficit financing is very useful resource. It helps in fuller exploitation of unused resources. The unutilized human and non human resources can be utilized for productive purposes with the help of deficit financing.

Generally, deficit financing has inflationary potential. But if the supply of goods increases with additional increase in purchasing power (generated through deficit financing), there will not be much inflation. Deficit financing will lead to inflation only when it is not accompanied by corresponding increase in output of goods in the economy.

In fact, deficit financing during depression in an advanced country may help in increasing effective demand and moving the economy out of depression. In developing economies, however, deficit financing may be inflationary in nature because such economies use deficit financing to invest in long term projects such as building of big dams, steel plants, machine making industry etc., which create additional demand but do not add to supply of goods immediately. Thus, in the short run, such economies may face high inflation due to deficit financing.

8.7 MERITS OF FISCAL POLICY

The following are some of the important merits of fiscal policy:

a. Fiscal policy of the country has been playing an important role in raising the rate of capital formation in the country both in private and public sector. The gross capital formation as percent of GDP in India has increased from 10.2 percent in 1950-51 to 22.9 percent in 1980-81 and then to 24.8 percent in 1997-98. Therefore, it has created a favourable impact on the public and private sector investment of the country.

b. Fiscal policy of the country has been helping to mobilise considerable amount of resources through taxation, public debt etc., for financing its various developmental projects. The extent of internal resources mobilisation for financing plan has increased considerably from 70 percent in 1965-66 to around 90 percent in 1997-98.

c. The fiscal policy of the country has been providing various incentives to raise the savings rate both in household and corporate sector through various budgetary policy changes, viz., tax exemption, tax concession etc. accordingly, the saving rate has increased from a mere 10.4 percent in 1950-51 to 23.1 percent in 1997-98.

d. Private sector of the country has been getting necessary inducement from the fiscal policy of the country to expand its activities. Tax concessions, tax exemptions, subsidies etc., incorporated in the budgets have been providing adequate incentives to the private sector units engaged in industry, infrastructure and export sector of the country.

e. Fiscal policy of the country has been making constant endeavour to reduce the inequality in the distribution of income and wealth. Progressive taxes on income and wealth tax exemption, subsidies, grant etc., are making a consolidated effort to reduce such inequality. Moreover, the fiscal policy is also trying to reduce the regional disparities through its various budgetary policies.

f. The Fiscal policy of the government has been making constant endeavour to promote export through its various budgetary policy in the form of concessions, subsidies etc. As a result, the growth rate of export has increased from a mere 4.6 percent in 1960-61 to 10.4 percent in 1996-97.

g. Another important merit of Indian fiscal policy is that it is making constant effort to alleviate poverty and unemployment problem through its various poverty eradication and employment generation programmes like IRDP, JRY, PMRY, SJSRY, EAS etc.

8.8 DEMERITS OF FISCAL POLICY

The following are the main shortcomings of the fiscal policy of the country:

a. Fiscal policy of the country has failed to attain stability on various fronts. Growing volume of deficit financing has created the problem of inflationary rise in price level. Disequilibrium in its balance of payments has also affected the external stability of the country.

b. Fiscal policy has also failed to provide a suitable tax structure for the country. Tax structure has failed to raise the productivity of direct taxes and the country has been relying much on indirect taxes. Therefore, the tax structure has become burdensome to the poor.

c. Fiscal policy of the country has failed to contain the inflationary rise in price level. Increasing volume of public expenditure on non developmental heads and deficit financing has resulted in demand pull inflation. Higher rate of indirect taxation has also resulted in cost-push inflation. Moreover, the direct taxes has failed to check the growth of black money which is again aggravating the inflationary spiral in the level of prices.

d. The negative return on capital invested in the public sector units has become a serious problem for the Government of India. Inspite of having a huge total investment to the extent of Rs.2,04,054 crore in 1998 on PSUs the return on investment has remained mostly negative. In order to maintain those PSUs, the Government has to keep huge amount of budgetary provisions, thereby creating a huge drainage of scarce resources of the country.

e. Fiscal policy of the country has failed to contain the growing inequality in the distribution of income and wealth throughout the country. Growing trend of tax evasion has made the tax machinery ineffective for the purpose. Growing reliance on indirect taxes has made the tax structure regressive.

8.9 RECENT FISCAL POLICY REFORMS

In the mean time, the Government of India has introduced various fiscal policy reforms which constitute the main basis of the stabilisation policy of the country. The following are some of the important measures of fiscal policy reforms adopted by the Government of India in recent years.

i) The peak rate of income tax was reduced to 30 percent in 1997-98 budgets. This has resulted an increase in the share of direct taxes in total revenue of the country from 19 percent in 1990-91 to around 30 percent in 1996-97.

ii) In recent years as per the recommendation of Raja Chelliah Reform committee, several steps have been taken to simplify the tax procedure in the successive budgets. The 1998-99 budget has introduced a series of tax simplification measures viz, "Saral", "Samadhan" and "samman", which is considered as an important step in right direction. The 2003-04 budget introduced filing of return through e-mail.

iii) Several measures were undertaken recently by the government. Accordingly, total expenditure of the government under various heads has been reduced. As a result,

total public expenditure as percent o GDP has declined from 19.7 percent of GDP in 1990-91 to 16.4 percent in 1996-97.

iv) Central government has been making huge payments in the form of subsidies, i.e., food subsidies, export subsidies etc. steps have been taken to reduce these subsidies phase-wise.

8.10 DIFFERENCE BETWEEN MONETARY POLICY AND FISCAL POLICY

The difference between monetary policy and Fiscal Policy are as follows:

Sl.No.	Monetary Policy	Fiscal Policy
1	Monetary policy involves changing the interest rate and influencing the money supply.	Fiscal policy involves the government changing tax rates and levels of government spending to influence aggregate demand in the economy.
2	Monetary policy is usually carried out by the Central Bank / Monetary authorities	Fiscal Policy is carried out by the government
3	Monetary policy relates to the supply of money, which is controlled via factors such as interest rates and reserve requirements (CRR) for banks.	Fiscal policy relates to government spending and revenue collection.
4	Monetary policy involves manipulating the supply of money to influence outcomes like economic growth, inflation, exchange rates with other currencies and unemployment.	Fiscal Policy involves manipulating the level of aggregate demand in the economy to achieve economic objectives of price stability, full employment, and economic growth.
5	Monetary policy tools includes interest rates; reserve requirements; currency peg; discount window; quantitative easing; open market operations; signalling.	Fiscal Policy tools include taxes; amount of government spending.

8.11 THE BUDGET

Fiscal policy operates through the budget. In fact, fiscal policy is also known as budgetary policy. The term 'budget' is derived from the French word 'Bougette', which means a leather bag or a wallet used to carry financial papers. The Chancellor of the Exchequer in England used to carry his papers in a leather bag to the House of Cammons. Thus, the word 'budget' has come to mean papers containing financial matters.

The budget simply means an estimate of revenue and expenditure. In its true sense, budget is not only "a plan of revenue and expenditure but the entire condition of material finances as disclosed in the ministerial statement placed before the legislature and orderly administration of the financial affairs for the government" (E.Shirras)

According to Philip V Taylor "Budget is a master financial plan of the government. It brings estimates of anticipated revenues and proposed expenditures, employing schedule of activities to be undertaken towards the direction of national objectives. It is a device for consolidating various interests, objectives, desires and needs of the people into a programme whereby they provide for their safety, convenience and comforts.

8.12 THE UNION BUDGET

Our constitution provides that: (i) No tax can be levied or collected except by the authority of law; (ii) No expenditure can be incurred from public funds except in the manner provided in the constitution, and (iii) The executive authorities must spend public money only in the manner sanctioned by the Parliament in the case of the Union and by the state legislature in a state.

The work of preparing the Union budget begins in the month of August every year and after finalisation, it is presented to the Parliament on the last day of February. The budget is generally presented by the Finance Minister in the name of the President of India. The budget speech of the Finance Minister is of great importance and is eagerly awaited by the finance and business circles as it contains information about fresh taxes

and proposals relating to expenditure. No discussion is allowed on the date of presentation of the budget. Discussion follows on later dates and then the budget demands are put to a vote. When the budget is passed by the Parliament, it goes to the President for his assent. The tax proposals of the budget are embodied in another Bill which is passed as the Finance Act of the year.

Occasionally, in times of financial crisis, an interim budget may be introduced later in the year to increase taxation and expenditure. Sometimes, there may be slight modifications of taxation and expenditure without the formality of introducing a revised budget.

The receipts and expenditure of the government are audited by the Comptroller and Auditor-General in order to ensure that the executive has spent the appropriated money in accordance with the wishes of the legislature. The office of the Comptroller and Auditor General came into being in 1913.

The budget is divided into two parts. They are:

a. Revenue budget

b. Capital budget

a. Revenue budget: The revenue budget deals with revenue receipts, which includes receipts from taxes, interest receipts and dividends and profits and revenue expenditure which is mainly on administration.

b. Capital budget: The capital budget is the statement of all capital expenditure and capital receipts which include market loans, external aid, deposits and provident funds.

8.13 BUDGET DEFICITS

In the early 20th century, few industrialized countries had large fiscal deficits. This changed during the First World War, a time in which governments borrowed heavily and depleted financial reserves. Industrialized countries reduced these deficits until the 1960s and 1970s despite years of steady economic growth.

Budget deficits as a percentage of GDP may decrease in times of economic prosperity, as increased tax revenue, lower unemployment and economic growth reduce the need for government programs such as unemployment insurance. If investors expect

higher inflation rates, which would reduce the real value of debt, they are likely to require higher interest rates on future loans to governments.

Countries can counter budget deficits by promoting economic growth, reducing government spending and increasing taxes. By reducing onerous regulations and simplifying tax regimes, a country can improve business confidence, thereby prompting improved economic conditions while increasing treasury inflows from taxes. Reducing government expenditures, including on social programs and defense, and reforming entitlement programs, such as state pensions, can result in less borrowing.

8.13.1 WHAT IS BUDGET DEFICIT?

A budget deficit is when a country's government spends more than it takes in from taxes or other forms of revenue. Although individuals, companies and other organizations can run deficits, the term usually applies to governments. That's because there are immediate penalties for most organizations that run persistent deficits. If an individual or family does so, their creditors stand calling. As the bills go unpaid, they lose a good credit score, which makes new credit more expensive. Eventually, they may have to declare bankruptcy. The same applies to companies who have ongoing budget deficits. Their bond rating is lowered, and they have to pay higher interest to get any loans at all.

However, most governments can run moderate deficits for years. That's because they are usually highly likely to repay their creditors. Government leaders retain popular support by providing services. If they want to continue being elected, they want to spend as much as possible while keeping their lenders happy.

Many countries, including the U.S., have the added benefit of being able to print their own currency. As bills come due, they simply create more credit and pay it off. This does lower the value of the currency as more supply is available. But, if the deficit is moderate, it doesn't hurt the economy. In fact, it can boost economic growth because government spending is a component of a nation's total output, known as Gross Domestic Product (GDP).

The consequences aren't immediate. Creditors are satisfied, because they know they will get paid. The nation's leaders don't have to decide who gets paid, and who doesn't, because the government has the ability to pay everyone. Elected officials just keep promising the voters in their district more and more benefits, military bases, and tax cuts. Telling voters that they will get less from the government would be political

suicide. To voters, elected officials, and creditors, the government's ability to run mild deficits means no pain, and all gain — year after year after year.

There are two questions which are often raised about budget deficits. They are:

(a) Are budget deficits inflationary?

(b) Do budget deficits 'crowd out' private investments?

Apparently these two are different questions, but answers to them are related.

First, deficit budgeting is not inflationary. Much would depend on how that deficit is financed. If a deficit in the budget is met by printing of more notes (i.e., money creation), there is a possibility of inflation from excess money supply. However, if budget deficit is kept within 'safe limit' or if new money printed is used in production ventures, such rate on increase in production matches with the excess demand on account of more money flowing in the system, then budget deficits need not be inflationary. We can, therefore, state that 'deficit budgeting' need not be always inflationary, though 'deficit financing' through money creation may be inflationary.

Secondly, what happens if the government finances the budget deficit by raising public loans rather than printing notes? If the government enters the market for loanable funds to borrow funds, the increase in demand for loanable funds, given the short run supply of funds, will end up raising interest rate. When the market rate of interest thus goes up, the quantity of funds borrowed by the private sector may drop. This is referred to as "crowding out effect". If private investment is thus crowded out, the total amount of capital in the economy will be smaller than otherwise.

Another effect of high interest rates induced by large budget deficits has been an increase in the value of domestic currency relative to other currencies; and this may depress the net exports of the country. Thus, budget deficits may cause trade deficits and payment deficits, typical of a high cost economy.

Finally under certain circumstances, some economists argue that budget deficits can increase, rather than decrease investment. This is known as the "crowding-in effect". The idea is that, if the economy is having considerable unemployment, public investment expenditure and its growing volume(which is at the root of budgetary deficits) may increase national output, national employment and national income as that may induce further investment through 'accelerator mechanism'. of course, much would depend on the interaction between the multiplier and accelerator effects and consequent capital stock adjustments in an economy.

8.13.2 CAUSES OF BUDGET DEFICIT

- The causes of a budget deficit are both simple and complex. At its most rudimentary level of analysis, a budget deficit is caused when a government spends more than it collects in taxes. Reducing tax rates may also cause a deficit if spending isn't reduced to account for the decrease in revenue. However, the world is more complex and a bit more than a mere rudimentary analysis is required.
- Periods of economic growth and economic decline can have a tremendous effect on the ability of a government to finance its spending. In fact, a budget deficit can occur even if a government doesn't increase its spending one per cent or lowers its tax rate one percent.
- Deficits can increase even more during economic downturns if the government attempts to stimulate economic growth with spending, as many economists recommend. This is what happened in the Great Depression with the New Deal. Of course, deficits explode in this type of situation because a government dramatically increases spending while revenues are dramatically declining.
- Unplanned expenses can also cause a deficit. National disasters such as droughts, floods and hurricanes not only destroy assets, but also impede or stop economic activities that will result in less taxable income from which to collect revenue. War is another example of a major unplanned event that is very costly. Even if a war is planned, it's often difficult to project an end date and the resources necessary to successfully prosecute it.

8.14 THE DEFICIT AND THE DEBT

Each year the deficit adds to a country's sovereign debt. As the debt grows, it increases the deficit in two ways. First, the interest on the debt must be paid each year. This increase spending will not provide any benefits. If the interest payments get high enough, it creates a drag on economic growth, as those funds could have been used to stimulate the economy.

Second, higher debt levels can make it more difficult for the government to raise funds. As the debt to GDP ratio is 77% or higher, creditors become concerned about a country's ability to repay its debt. When this happens, they demand higher interest rates rise to provide a greater return on this higher risk. This increases the deficit each year.

This becomes a self-defeating loop, as countries go deeper into debt to repay their debt. At some tipping point, interest rates on new debt can skyrocket, as it becomes ever more expensive for countries to roll over debt. If it continues, long enough, a country may default.

8.15 SUMMARY

Fiscal policy is one of the most important instruments of government intervention in the economy. Fiscal policy refers to the policy relating to taxation, expenditure and public debt. It has gained importance because of its immense potential in dealing with trade cycles and accelerating economic growth. For example, during a depression, fiscal policy instruments may help in increasing demand. For this, the Government can increase its public expenditure and start on various public works or it can subsidize mass consumption goods or it can lower tax rates so as to stimulate investment and production. This will help reducing unemployment and increase effective demand. On the other hand, if the economy is suffering from inflation, the government can reduce its expenditure and curb private spending by levying taxes to control it. Thus, fiscal policy is an effective economic policy tool in the hands of Government.

8.16 KEY WORDS

Budget,

Deficit,

Wealth,

Revenue

Expenditure

8.17 SELF ASSESSMENT QUESTIONS

1. What do you mean by Fiscal Policy?
2. Explain the main objectives of fiscal policy?
3. What are the different types of fiscal policy?
4. Explain the techniques of Fiscal Policy.
5. What are the recent fiscal policy reforms?
6. Differentiate between Monetary Policy and Fiscal Policy.

7. What do you mean by budget?
8. Write a note on 'budget deficit'.

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DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

M.B.A I Semester

COURSE - 6

BUSINESS ENVIRONMENT

BLOCK

3

NON-ECONOMIC ENVIRONMENTAL FACTORS

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BLOCK-3 : NON-ECONOMIC ENVIRONMENTAL FACTORS

A business organisation operates in a society, that needs to consider non-economic factors along with economic factors. The non economic factors influences directly or indirectly to the firm. Also, a firm should have obligation towards protection of social and non economic environment. The block deals with various non-economic environmental factors which influence a bussiness.

Unit- 9 deal with natural environment, the unit at out set focusses on natural resource, factor of natural resources, importance of nature resource, and also explain regulations relating to natural resources and compliance requirement.

Unit- 10 focused on environmental protection and sustainable development. The topic emerged as very crucial in recent time. In this view the unit discussed sustainable development, implications of sustainable development India. Also discusses the principles adopted under the sustainable development. Further, the unit focusses on environmental degarding causess for environmental degradation and environment pollution.

Unit- 11 deals with environmental legislation. The unit at the outset explains environment policy, instruments of environment policy. Then the unit explains environment audit, ecomark, environment assessment. The Unit explains global warming, green house gases, global warming imputs.

Unit- 12 deal with terrorism nuclear proliferation, natural disaster. These are the topics which occupied greater relevance in the recent times manager need have understanding on these issue to attain success in his bussiness.

UNIT -9 : NON-ECONOMIC AND NATURAL ENVIRONMENT

Structure

9.0 OBJECTIVES

After studying this unit you will be able to understand:

- explain factors affecting economic environment
- discuss influence of non-economic factors on business
- statehouse natural environment and its importance

9.1 INTRODUCTION

As you studied in the previous chapter business environment can be classified in to two broad categories as (a) Economic environment; and (b) Non-economic environment. The economic environment includes economic conditions, economic policies and economic system of the country. Non-economic environment comprises social, political, legal, technological, demographic and natural environment. All these have a bearing on the strategies adopted by the firms and any change in these areas is likely to have a far-reaching impact on their operations.

9.2 ECONOMIC ENVIRONMENT

The survival and success of each and every business enterprise depend fully on its economic environment. The main factors that affect the economic environment are:

9.2.1 Economic Conditions

The economic conditions of a nation refer to a set of economic factors that have great influence on business organisations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.

9.2.2 Economic Policies

All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are:

(i) Industrial policy

(ii) Fiscal policy

(iii) Monetary policy

(iv) Foreign investment policy

(v) Export -Import policy (EXIM policy)

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein.

9.3 NON-ECONOMIC ENVIRONMENTAL FACTORS

Non-economic environmental factors refer to social, political, legal, technological environment. The identification of the non-economic factors is particularly essential because of the fact that it influences and get influenced by the economic factors. In addition to these non-economic factors the natural environment also significantly impact business. Let us discuss how these factors influence the decisions of a business organization.

9.3.1 Social Environment

The social environment of business includes social factors like customs, practices, attitudes, education, culture, traditions, value system ,Religious beliefs and faiths, caste system, language, poverty, literacy, life expectancy rate etc. The social structure and the values that a society follows have a considerable influence on the functioning of business firms. For example, during festive seasons there is an increase in the demand for new clothes, sweets, fruits, flower, etc. Due to increase in income and awareness due education ,the consumers are becoming more conscious of the quality of the products. Due to change in family composition, more and more nuclear families are emerging and they are creating more demand for goods and services.

9.3.2 Political Environment

Today business activities are very much influenced by government policies and programmes. The role of the government especially in a democracy is very significant in order to bridge the gap between the aspirations and achievements of the society. The government has to ensure safety and security of the people at the same time work for the economic development of the country. The stability of the government to a great extent sends a signal of strength, confidence to various interest groups and investors. Further, ideology of the political parties also influences the business organization and its operations. The political ideologies many times influences the economic policies such as trade policy, monetary and fiscal policies.

9.3.3 Legal Environment

This refers to set of laws, regulations, which influence the business organizations and their operations. Every business organization has to obey, and work within the framework of the law. The important legislations that concern the business enterprises include:

(i) Companies Act, 2013

(ii) Foreign Exchange Management Act, 1999

(iii) The Factories Act, 1948

(iv) Industrial Disputes Act, 1972

(v) Payment of Gratuity Act, 1972

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

(vii) Prevention of Food Adulteration Act, 1954

(viii) Essential Commodities Act, 2002

(ix) The Standards of Weights and Measures Act, 1956

(x) Monopolies and Restrictive Trade Practices Act, 1969

(xi) Trade Marks Act, 1999

(xii) Bureau of Indian Standards Act, 1986

(xiii) Consumer Protection Act, 1986

(xiv) Environment Protection Act

(xv) Competition Act, 2002

Besides, the above legislations, the following are also form part of the legal environment of business.

(a) Provisions of the Constitution: The provisions of the Articles of the Indian

Constitution, particularly directive principles, rights and duties of citizens, legislative powers of the central and state government also influence the operation of business enterprises.

(b) Judicial Decisions:

The judiciary has to ensure that the legislature and the government function in the interest of the public and act within the boundaries of the constitution.The various

judgments given by the court in different matters relating to trade and industry also influence the business activities

9.3.4 Technological Environment

Technological environment include the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. In the modern competitive age, the pace of technological changes is very fast. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organisations. Infact, today, no firm can afford to persist with the outdated technologies.

9.4 NATURAL ENVIRONMENT

The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. Business is greatly influenced by the nature of natural environment. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish manufacturing unit near the sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector.

The **natural environment** encompasses all living and non-living things occurring naturally on Earth or some region thereof. It is an environment that encompasses the interaction of all living species. Natural resources occur naturally within environments that exist relatively undisturbed by humanity, in a natural form. A natural resource is often characterized by amounts of biodiversity and geodiversity existent in various ecosystems.

9.5 NATURAL RESOURCES

Natural resources are derived from the environment. Some of them are essential for our survival while most are used for satisfying our needs. Natural resources are materials and components (something that can be used) that can be found within the environment. Every man-made product is composed of natural resources (at its fundamental level). A natural resource may exist as a separate entity such as fresh water, and air, as well as a living organism such as a fish, or it may exist in an alternate form

which must be processed to obtain the resource such as metal ores, oil, and most forms of energy.

9.6 FACTORS OF NATURAL RESOURCES

There is much debate worldwide over natural resource allocations. This is partly due to increasing scarcity (depletion of resources) but also because the exportation of natural resources. Some natural resources such as sunlight and air can be found everywhere, and are known as ubiquitous resources. However, most resources only occur in small sporadic areas, and are referred to as localized resources. There are very few resources that are considered inexhaustible (will not run out in foreseeable future) – these are solar radiation, geothermal energy, and air (though access to clean air may not be). The vast majority of resources are exhaustible, which means they have a finite quantity, and can be depleted if not managed properly. In business, when these natural resources are used without any limit, natural environment changes. Global warming, floods, famines, etc., are its result. It is the duty of business to protect the natural environment. There is need avoid misuse of natural resources improperly.

Natural Environmental Factors That Affect Business

Companies in the industrial or manufacturing industry often work with different kinds of equipment, machinery and chemical-producing agents. In effect, a business' day-to-day operations can pose an on-going threat to the natural environment. To reduce the likelihood of damage to the environment, federal and state regulations require businesses consider certain natural environmental factors in their overall operations plans.

1) Environmental Regulations

Regulating business activities is one way government agencies protect the environment. Businesses must meet certain standards that help to reduce any adverse effects a company's activities have on the environment. As a result, natural environmental factors, such as clean water and clean air, dictate how companies conduct their day-to-day operations.

2) Permit Requirements

Companies involved in activities that impact their surrounding environment typically have to file for operating permits through a local, state or central government agency. Business permit requirements enable government agencies to regulate and keep track of business activities. These permits serve different purposes, some of which include setting minimal standards for any air emissions, dictating certain procedures for handling waste and hazardous materials and regulating how a company's day-to-day operations interact with nearby water

supplies. In effect, natural environmental factors determine the types of operations a company can engage in within a particular locale or region.

3) Compliance Requirements

Natural environmental factors affect a business' operations as well as its ability to expand or take on new operations. In effect, companies must comply with environmental regulations in all stages of a business' development. Companies considering purchasing a building should ensure the building conforms to environmental regulations or risk paying penalties for noncompliance. Building expansions must also meet regulatory requirements. Companies that have a record of noncompliance may risk having their operations shut down on a permanent basis. Ultimately, natural environmental factors affect a company's overall costs in terms of ensuring equipment and procedures meet regulatory requirements.

4) Environmental Contaminants

Businesses that work with hazardous materials on a regular basis have certain responsibilities when it comes to ensuring contaminants don't reach or affect the natural environment. Various Acts hold business owners liable for activities that contaminate surrounding air, soil or water supplies. This law even applies for new business owners who unknowingly purchase a contaminated site or purchase an operation that fails to meet compliance standards. Ultimately, owners, both old and new, must cover clean-up costs as well as the costs of restoring a property to required environmental standards.

9.7 IMPORTANCE OF NATURAL RESOURCES

Natural resources were historically an important condition of the successful development of countries. The disparity in the access to natural resources predetermined, to a significant extent, the socioeconomic disparity in the development of Northern countries and Southern ones. In fact, the economic and technological development of countries and the difference in their development was driven by the availability of natural resources, which stimulated the development of technology and, therefore, economic progress of those communities and countries, which benefited from the available natural resources and the backwardness of those countries and communities, which lacked natural resources. Even though today the process of globalization makes natural resources available worldwide, but the world economy still depends on natural resources and those countries, which have access to natural resources, especially fossil fuels, such as oil and gas, can keep progressing fast, while those, which have limited opportunities to use natural resources are doomed to backwardness.

Historically, natural resources played the role of the main driver of the economic development of nations. For example, coal mining and the availability of iron to Great Britain allowed the country to become one of the leaders in the world economy and conduct its industrial revolution successfully. Similarly the availability of natural resources became the major condition of the successful economic and technological development of other powers, including the US, France, Germany and others.

At the same time, the significant role of natural resources as the major driver of the economic development becomes obvious, when the availability of natural resources, their use and historical socioeconomic and technological development of countries is compared. In this regard, the disparity between North and South is particularly obvious. For example, early civilizations emerged in Northern hemisphere of the world basically due to the availability of natural resources, such as iron ore, for example, which allowed people to start making first tools as well as weapon. At this point, it is worth mentioning early civilizations in Egypt, Mesopotamia, Greece, India and China, which were all located in Northern hemisphere due to the available natural resources, such as iron ores. For example, the beginning of the early production of bronze boosted the technological and economic development of those civilizations. The further introduction of iron, steel and other materials based on the use of natural resources accelerated their economic and technological development even more. Moreover, even the early settlement of people were determined by their natural environment and availability of natural resources, such as water and fertile soil, which people used for their regular life and basic needs.

In the course of time, the role of natural resources increased even more because they became essential for the economic development of nations and fast technological progress. At this point, it is possible to return to the time of the industrial revolution once again since the industrial revolution would be impossible without rich natural resources available to leading nations, such as Great Britain, France, Germany and the US. The availability of such natural resources as coal and iron ore allowed them to boost their industrial production and develop transportation system, which, in its turn, accelerated trade within those countries as well as between those countries. At the same time, the rest of the world that had limited access to natural resources remained under-developed and suffered from technological and economic backwardness.

THE ECONOMIC SIGNIFICANCE OF NATURAL RESOURCES

The economic significance of natural resources depends upon the magnitude of two basic variables: current flows of income and potential future flows of income. The first is largely a function of production costs and market demand, and the second of

natural resource endowments and management planning. In order to understand the true importance of natural resources, both current and future flows of income must be taken into account. The former can be a deceptive indicator of how natural resources will contribute to economic development over time if income is derived from the depletion of the natural capital . Managing natural resources sustainably - in the case of renewable resources - and as sources of revenue for investment in future growth - in the case of non-renewable resource - allows resource rich countries to establish the foundation for long-term development and poverty alleviation.

i. Contribution towards fiscal revenue, income and poverty reduction

The wealth embodied in natural resources makes up a significant proportion of the wealth of most nations, often more than the wealth embodied in produced capital, therefore making natural resources management a key aspect of economic development. Many countries have seen significant rises in revenues from natural resources due to the rise in commodity prices. Natural resources such as oil, gas, minerals and timber are expected to continue to play a significant role in resource abundant economies, as demand from rapidly growing economies increases, and as supplies of non-renewable resources decline and renewable resource harvests approach maximum sustained yield levels. Not surprisingly, countries richly endowed with natural capital have the potential to derive significant current income from resources. In addition to providing revenues to resources rich countries, natural resources can play a central role in poverty reduction efforts. The poor generally depend upon natural resources directly for their livelihoods, especially the rural poor. Consequently, policies that improve natural resources management can have immediate and meaningful poverty reduction impacts.

Natural resources and intact, functioning ecosystems provide a ¯safety net for the poor, particularly in times of financial crisis, providing food in the form of plant and animal wildlife and fertile soils for subsistence agriculture, and fuel wood. In order to benefit be able to rely on such ¯safety nets the poor must have access to resources and should also be involved in resource management decision-making, thereby gaining a stake in using resources sustainably and avoiding tragedies of the commons. Moreover, the revenues from natural resources, can contribute to the development of human capital through investments in education and job training. Especially during times when commodity prices are high, countries have the opportunity to use a portion of the additional profits realized from the sale of natural resources to support propoor policies and investments.

ii. Employment and job creation potential

Policy makers must generally choose between competing values in designing policies for natural resources management. If jobs are the highest priority, allocating quotas or harvesting rights to a large number of small harvesters may be the preferred option. If maximizing exports are the highest priority, a strategy of maximum sustained yield with a smaller number of large firms may be preferable. This ¯trade-off often occurs with fisheries, where larger but fewer boats may be more efficient for harvesting fish for export, while a larger fleet of smaller boats will employ far more fishermen.

In such decisions, social considerations such as the value of communities and rural livelihoods must also be taken into consideration. Natural resources generally form the backbone of rural economies in low and middle income countries and, if managed wisely through sound policies and institutions, can be used to generate growth that benefits the most vulnerable parts of the population. Indeed, studies show that non-farm income from natural resources plays an important role in sustaining rural livelihoods in transition countries. Growth of rural economies can be promoted by governmental policies aimed at supporting small and medium sized enterprises, based in many cases on use of local natural resources.

A synthesis of objectives - growth, employment and long-term economic stability - can be found in adopting policies that put countries on the path towards green growth. Natural resources have the potential to provide a significant number of jobs.

9.8 REGULATING NATURAL RESOURCES

Regulating business activities is one way government agencies protect the environment. Businesses must meet certain standards that help to reduce any adverse effects a company's activities have on the environment. As a result, natural environmental factors, such as clean water and clean air, dictate how companies conduct their day-to-day operations.

Businesses involved in activities that impact their surrounding environment typically have to file for operating permits through a local or a government agency. Business permit requirements enable government agencies to regulate and keep track of business activities. These permits serve different purposes, some of which include setting minimal standards for any air emissions, dictating certain procedures for handling waste and hazardous materials and regulating how a company's day-to-day operations interact with nearby water supplies. In effect, natural environmental factors determine the types of operations a company can engage in within a particular locale or region.

9.9 COMPLIANCE REQUIREMENTS

Natural environmental factors affect a business' operations as well as its ability to expand or take on new operations. In effect, companies must comply with environmental regulations in all stages of a business' development. Companies considering purchasing a building should ensure the building conforms to environmental regulations or risk paying penalties for noncompliance. Building expansions must also meet regulatory requirements. Companies that have a record of noncompliance may risk having their operations shut down on a permanent basis. Ultimately, natural environmental factors affect a company's overall costs in terms of ensuring equipment and procedures meet regulatory requirements.

Environmental issues now loom large on the social, political, and business agenda. Over the past four decades, "corporate environmentalism" has emerged and been constantly redefined, from regulatory compliance to more recent management conceptions such as "pollution prevention", "total quality environmental management", "industrial ecology", "life cycle analysis", "environmental strategy", "environmental justice," and, most recently, "sustainable development are discussed at all forums to protect and sustain environment.

9.10 SUMMARY

The success and failure of any business depends on the environment in which it operates, the business environment can be classified into two broad categories; as a) Economic environment and b) Non- economic environment. The economic conditions and economic policies of the state are greatly influence the business. Apart from these economic conditions and policies of that state other non-economic environmental factors also affect the business such as social factors, political environmental factors (for example., political stability, agenda of major political parties) various laws, technology, and natural environmental factors such as availability of natural resources in the country. An entrepreneur has considered all these factors before he starts his business.

9.11 KEY WORDS

Industrial,

Constitution,

Technologies

Compliance

9.11 SELF ASSESSMENT QUESTIONS

1. What are non- economic environmental factors?
2. What is meant by natural environment?
3. What are natural resources?
4. What is meant by environmental protection?
5. Explain the economic factors that impact the business and their operations.
6. Discuss important economic policies impacting the business.
7. What does natural environment comprises of?
8. What are the important features of natural resources?
9. Explain the importance of natural resources to mankind.
10. Discuss natural resources compliance requirements?
11. What are the various environmental laws passed by the government from 1970?

9.12 REFFERENCES

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UNIT -10 : ENVIRONMENTAL PROTECTION, SUSTAINABLE DEVELOPMENT AND ENVIRONMENTAL DEGRADATION

Structure

10.0 OBJECTIVES

After studying this unit you will be able to:

- define sustainable development
- elaborate sustainable development in India
- explain the principles adopted under sustainable development
- discuss various ways of environmental pollutions

10.1 INTRODUCTION

Increasingly, environmental protection is being incorporated more broadly into all human actions and into the process of development. Meeting our needs while protecting the environment is called *sustainable development*.

Environmental protection has evolved from piecemeal local efforts to a much more comprehensive global strategy involving high levels of cooperation among states and nations covering a wide assortment of environmental problems. Although environmental policy and environmental protection efforts have evolved dramatically in the past three decades, most solutions dealt with symptoms. Efforts are now under way to address the root causes of the problems.

10.2 ENVIRONMENTAL PROTECTION: MEANING, IMPORTANCE, AND PROTECTIVE MEASURES

Meaning

Environmental protection refers to any measure that is taken to conserve, maintain or preserve the state of the environment. Protection of the environment can be done through reducing pollutants or anything that leads to its degradation.

Conservation of the environment aims at keeping it safe and healthy. It aims at the reduction of overusing the natural resources. It is the taking care of all the components that make up the environment.

Preserving is also used hand in hand with the term conserving. Environmental preservation refers practices that do not alter the environment. It aims at keeping the environment unchanged so as to leave it intact.

Protection of the environment can also mean that the environmental practices that the human race indulges in are sustainable to help avoid damaging or harming the ecosystem.

The animals are also part of the environment and when we talk about protection, animals are a key factor. For animals, it is more about conservation. It has to do with protecting the endangered species from extinction by discouraging activities such as poaching.

When the environment is protected it serves to benefit all those who rely on it. It serves in the maintenance of life for the plants, humans and animals.

Importance of environmental protection.

i. To protect/save our lives.

The environment supports the life of each and every living thing on earth. We rely on the environment for life. When it is protected we are assured of better health, food, quality air and so much more. As the popular saying goes "if we destroy the environment, the environment will destroy us." This is so true because it is the environment that sustains our life.

ii. The environment has suffered due to the scientific inventions.

A lot has been discovered over the years. Many of these inventions tend to be harmful to the environment, though it is a way of the human race trying to make their life better. Factories have been built in so many places around the world. The emission of harmful gases into the air is on the increase. The dredging of oil in the sea is also another case. Trees are being cut down to create space for more land. With all this going on, the environment remains at or mercy for protection.

iii. Discharge of carbon gases.

The first thing everyone with a good amount of money is thinking about is how to get a car. The purchase of cars has grown over the years. The worst part is that there are not many cars that are environment friendly. Most of them use fuel which when burnt, releases carbon into the air. Factories are also playing a role in this. Carbon gases are not in any way friendly to the environment and this is why we need to protect it.

iv. Use of low grade plastics.

The chemicals that go into making plastics is highly toxic and it poses serious threats to the environment. Burning of plastics during their production and even after

use releases toxic fumes into the air. The toxins can also leak into the soil and ground water causing contamination. This makes it difficult to grow plants and even pose a challenge to hormones in many living things.

v. Biodiversity is important.

For the environment to be a better place to live, biodiversity has to be a part of it. In science it is said that during the day, plants use carbon dioxide, while humans breathe in oxygen and breathe out carbon dioxide. This is a form of exchange plan. Plants help to reduce carbon dioxide in the air, which in turn benefits humans. Each living has a role to play in the environment. It makes the world a better place to live in.

vi. It is our moral obligation.

We owe our existence to the environment. It is our role to ensure that the environment supports us and other living species in a comfortable way. The only way we can pay it back is by protecting it in all ways possible.

v. Environmental hazards are dangerous.

When we look at our water bodies, they have become dumping grounds for dangerous chemicals. Most factories throw their waste into the lakes and oceans. These chemicals end up in the food web such as mercury in fish. These foods end up on our plates and the end result could be serious diseases. The air we breathe in and what our skin comes into contact with is crucial. When we have harmful gases in the air it is a threat to life.

10.3 SUSTAINABLE DEVELOPMENT

Sustainable development is a means of meeting present needs in ways that do not impair future generations – and other species – from meeting their needs. Because the environment is essential to satisfying the needs of present and future generations. Environmental protection is a key to its success. Sustainable development requires strategies that satisfy social, economic, and environmental goals simultaneously.

Society depends on the environment for countless goods and services that are essential to day-to-day living and the functioning of the economy. The renewable and non-renewable resources that support our lives have limitations. Living sustainably means finding ways of prospering within limits.

Building a sustainable society will require participation by governments, businesses, and individuals. Environmental protection and sustainable development will

require cooperation of all participants. To create a sustainable society, we must focus on strategies that address the root causes of environmental problems.

"Sustainable Development is a development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

Sustainable development focuses on improving the quality standards of all human being in the earth without compromising the excessive use of natural resources beyond the capacity of the environment to supply them indefinitely; it requires and understanding that, this action has its consequences and we must find out innovative ways to change the institutional structures and individual behaviour, in other words it's about taking action, changing policy and practice at all levels from the individual to international.

10.4 IMPLEMENTATION OF SUSTAINABLE DEVELOPMENT IN INDIA

There were various factors which led to and become the guiding factor to pass various laws relating to environment by the Indian Parliament. These factors cumulatively created an atmosphere to legislate on various aspects of environment including the umbrella legislation - the Environment Protection Act, 1986.

In June 1972, the First U.N (International) Conference on Human Environment was held in Stockholm declared that: 'to defend and improve the human environment for present and future generations has become an imperative goal for mankind.' Therefore, it called upon Government and people of the world to exert common efforts for the preservation and improvement of the human environment.. India is one of the signatories of this Conference and to preventing environmental degradation. It has passed various statutes to improve and to protect the environment. India has passed number of laws on environment, namely:

1. Water (Prevention and Control of Pollution) Act, 1974,
2. Air (Prevention and Control of Pollution) Act, 1981,
3. Environment (Protection) Act, 1986,
4. National Environment Tribunal Act, 1995,
5. National Green Tribunal Act, 2010.

10.5 SUSTAINABLEDEVELOPMENT: BASIC CONDITIONS AND PRINCIPLES

A. The Concept of Sustainable Development Restated

The concept of sustainable development implies, first, the integration of environmental issues with the imperatives of economic development in order to meet the immediate needs of populations today without undermining the aspirations of future generations. However, the definition of the term "sustainable development" has been expanded to include the ideas of fairness and interdependence, not only between generations, but between the countries and peoples of the Earth. Social, cultural, economic and natural environments, whose harmonious development is essential to the welfare of humanity and of nature, are also included in the concept.

Sustainable development can only be achieved in a long-term perspective. However, this cannot be done reactively, but rather through applying the principles of proactive and strategic planning and management. It is therefore essential to establish clear principles at all levels of participation and decision-making, together with clear objectives and measures that are part of a long-term approach and take into consideration the various countries' ability to act and to pay.

B. Basic Conditions of Sustainable Development

Although the purpose of sustainable development is to integrate social and environmental concerns into economic decisions, its achievement requires adherence to general principles that must be joined to the basic conditions for success. Those are nothing more or less than the five major principles governing life in society and relations between governments and nations. They have a number of underlying concepts, which are also considered essential to the attainment of sustainable development.

1. Democracy

Although they need not absolutely be linked, sustainable development can hardly be initiated or implemented in the absence of genuine democracy. It is hard to see just how to provide fairly for present needs, and without compromising the future of generations to come, without underlying mechanisms and institutions in which all can participate. To paraphrase the Brundt land Commission, which so aptly opened debate on the subject, isn't sustainable development everyone's business and everyone's future?

Thus, all human beings, no matter what their country of origin, may legitimately aspire to clean air and water, sufficient food, comfortable housing and satisfying work,

in an atmosphere of peace and respect for differences and diversity. At the same time, they must be able to ensure the protection and survival of their natural and cultural heritage. In short, all human beings enjoy a fundamental right to an environment that is of high quality and is healthful. By democracy, we must understand respect not only for individual rights, but also for collective rights and in particular the right of women and first peoples to participate actively and fully in the march toward sustainable development.

2. Autonomy

While sustainable development must be achieved in a democratic context, the autonomy of governments, peoples and ethnic groups in making their development choices must also be respected. This does not mean that governments must operate in isolation; on the contrary, they must adopt a global view of development and development planning by taking an active part in international forums and processes for determining major common objectives for sustainable development.

Nor does this exclude the establishment of common international environmental standards, although each government is free to adopt national standards consistent with these. It is important that governments adhere to the principle that, while protection of the environment is a joint responsibility, the development and implementation of environmental standards by less developed countries will take into account the limits and ability of those countries to act and pay the associated costs, as well as their responsibilities with respect to a particular environmental problem.

At the same time, it must be acknowledged that these countries have certain potential skills and practical knowledge that often remain underexploited in the absence of appropriate support structures. Thus a greater need for mutual assistance, cooperation and the transfer of knowledge and "clean technologies" arises directly from the interdependence of countries in the implementation of sustainable development.

3. Fairness

The concept of fairness is central to the entire issue of sustainable development, being based on recognition of the global and common nature of our environment and on the need for the planet's resources to be shared in a sustainable way. Achieving fairness in sustainable development must be addressed at three levels: (1) within populations or states, (2) between populations or states and (3) between generations.

Fairness within a single population or government essentially requires meeting the needs of all and improving the quality of life through a better distribution of wealth. Despite what is often thought, this objective does not apply solely to the poorest

countries, but also to Western societies, where disparities between people have tended to increase over the last decade.

At the next level, the harmful effects of underdevelopment and the obvious disparities between developed and less developed countries show that sustainable development cannot be achieved without reducing discrepancies between the rich and poor countries, that is, without a relentless struggle against poverty. It is for this reason that sustainable development cannot be viewed solely from an environmental standpoint, particularly in the countries of the South, where it must be achieved by accelerating development.

Lastly, one of the major challenges of sustainable development is beyond a doubt the objective of fairness between generations. As mentioned in *A Strategy for Sustainable Living*:

Each generation should leave to the future a world that is at least as diverse and productive as the one it inherited. Development of one society or generation should not limit the opportunities of other societies or generations.

Once again, at this level, making certain development choices will, in many instances, require new approaches and attitudes and different behaviour.

4. Interdependence

Interdependence, which derives from the notion of fairness, is another basic condition for sustainable development: the common interest can only be served through international cooperation. With industrialization, improved technological capabilities and the globalization of trade and commerce, has come increased interdependence, even at the local level. It brings with it its own set of problems, such as the loss of traditional rights to certain resources and increased commercial and industrial production, with an attendant reduction in the decision-making power of local communities and individuals. Interdependence extends beyond a local and regional framework, however; it is now global, particularly with respect to the environmental problems affecting the biosphere.

This interdependence of individuals and communities requires first that we acknowledge our common interest in the environment so that each decision is made and each action taken in full knowledge of the repercussions for the environment and the welfare of others. More than anything else, interdependence is based on the capability for mutual assistance and cooperation at all levels of action, from the local to the international. Although international cooperation in environmental matters has increased over the past decade, a number of aspects must still be reviewed and reoriented, taking sustainable development into account.

5. Responsibility and Accountability

Since it is in everyone's interest to preserve the environment and to use it in a sustainable way, all countries have a responsibility from the outset to preserve and restore the environment and to achieve development, without harming their own environment or that of others. Consequently, all countries must take an active part and show solidarity in this cause. Furthermore, the concept of fairness, as it applies to countries and nations or to generations and individuals, implies that the responsibilities of all involved may be different but complementary, depending on the needs of each, and may vary in proportion to the extent of damage to the environment and the abilities of each party to rectify this. Furthermore, in the context of globalized trade and environmental problems, it is vital for the economic benefits of a given business activity to be linked with its environmental repercussions, so that the responsibilities of each stakeholder are recognized; that is to say, so that all players are accountable for their own actions.

Some have argued that the question of accountability, and thus of every stakeholder's assumption of responsibility, may lead to a redistribution of profits so that compensation can be established, for example, for the use of natural resources or for environmental impacts. This proposal might be one way in which the richest countries can make a greater contribution to the sustainable development of poor countries and take an active part in solving environmental problems.

Collective and individual responsibility for managing the environment and natural resources in a sustainable manner must take into account both present and future generations. Making stakeholders responsible for their actions is at the same time encouraging the principle of stewardship, whereby a representative of both present and future generations acts as the "custodian" of natural resources and the environment.

C. General Principles of Sustainable Development

In addition to the five basic conditions necessary for ensuring sustainable development, five major principles underlie its implementation. These principles, to an even greater extent than the aforementioned conditions, are vital to the definition of sustainable development.

1. Environmental and Economic Integration

The environment and the economy are obviously very closely related. This link is more than a mere principle; it is a necessity for sustainable development. Various economic tools and policies may promote sustainable development, or at least lead to a more environmentally conscious use of resources. These tools or policies, such as the

polluter-payer or consumer-payer approach, may be applied equally to producers, consumers and taxpayers and to enable the market to determine the correct overall cost of using resources. In many instances, however, for the actual value of natural resources to be taken into account, producers and economic agents need to change their attitudes. As a result, tax incentives or other economic tools may be necessary to promote this coming together of the environment and the economy.

The integration of the environment and the economy is as advantageous for poorer countries as for rich ones because, if production models adhere to economic and environmental rules, there may be a better balance of comparative production advantages. The result could be a softening of world trade rules whereby poorer countries would be enabled to lay claim to greater economic development.

Certain traditional economic indicators may also assist in assessing the degree to which the economy and the environment are integrated. Particular examples are the gross domestic product and per capita income; global indicators that reflect social aspects (such as the Human Development Index, which includes longevity, education and income); and strictly environmental indicators, such as water quality and land use.

2. Maintenance of Biological Diversity and Conservation of Natural Resources

Achieving sustainable development presupposes that we can preserve biological diversity, maintain ecological processes and life support systems and use the world's species and ecosystems in a sustainable manner. Development based on the preservation of natural resources calls for energetic measures that will make it possible to protect the structure, functions and diversity of the natural systems on which life depends.

These measures must focus on species and ecosystems as well as on their genetic heritage. Consequently, the limits, on and the capacity for renewal of, natural resources such as soil, wild and domesticated species, forests, pasture and farm land, fresh water and marine ecosystems, must not be compromised. As well, the life of non-renewable resources should be extended by developing and using more effective and cleaner technologies and by encouraging re-use and recycling.

First of all must come changes in the behaviour of individuals and communities and in their attitude to the environment, along with the provision of genuine means for managing it better. New approaches at the state level must then integrate development and conservation of resources on the basis of sufficient information and knowledge and through appropriate legal and institutional instruments. Effort at the international level must be on promotion of the development, and adoption and implementation of conventions and protocols on the environment and natural resources.

3. Precaution, Prevention and Evaluation

Precaution, prevention and evaluation are the starting points for genuine sustainable development; they must form an integral part of the planning and implementation of every development project. Planners and decision-makers must make it a routine to foresee and provide for the environmental consequences of their projects.

Current environmental protection measures are precautionary; however, in many cases, they are merely a band-aid solution that is not always compatible with the concept of sustainable development, particularly from a long-term perspective. However, the concepts of precaution, prevention and evaluation are difficult to instill because they are often removed from the day-to-day reality and have benefits that will be felt only in the more or less distant future. Forewarned is forearmed, foresight is knowledge and evaluation enables planning: it is imperative that countries and societies adopt these three watchwords so that present development can be transformed into sustainable development.

4. Cooperation, Partnership and Participation

Achieving sustainable development has become a collective responsibility that must be fulfilled through action at all levels of human activity. Consultation and cooperation in all decision-making are essential to the sustainable management of terrestrial, aquatic and marine ecosystems. It is incumbent upon all states and all nations to cooperate in good faith and in a spirit of partnership in implementing effective strategies to protect, preserve and restore the environment. All must take an active part and do their fair share in accordance with their capabilities and the means at their disposal.

All governments must accept their responsibilities by introducing economic growth policies and programs compatible with the protection of their own environment and that of others. They must ensure the protection of ecosystems of particular importance for agriculture and the way of life of the populations that depend on it. Furthermore, they must facilitate the participation of non-governmental organizations and decentralized or local communities to ensure they can play a greater role in all development- and environment-related activities.

In addition, states must join forces to strengthen international law by adhering to existing environmental conservation and management conventions and protocols and by passing the necessary statutes for their implementation. They must also promote and develop new agreements and instruments considered necessary to achieving sustainable development.

Cooperation and partnership also presuppose that the richest countries introduce financial and technical assistance measures that will enable the poorer countries to integrate environmental issues more easily into their development programs. The creation of specific environmental protection and restoration funds is certainly worth considering.

The preservation of biological diversity clearly illustrates how interdependent are the "North and South blocs" in the necessary establishment of new partnerships. The main "centres or sources of biological diversity" are situated more particularly in the countries of the South, whereas the major "technological or biotechnological centres" are mainly in the countries of the North. In other words, the countries of the South as well as those of the North must be party to all discussions, solutions and conventions necessary to the achievement of sustainable development. They must all ensure that the measures chosen are suited to the situation of each. The more developed countries will no doubt have to make the necessary efforts to bring about a higher degree of development in the poorer countries and, in particular, the latters' improved access to the most suitable technologies.

5. Education, Training and Awareness

Safeguarding the environment and achieving sustainable development depend not only on technical and economic matters, but also on changes in ideas, attitudes and behaviour. The direct participation of individuals and communities is essential. All must become fully aware of their environment, know its demands and limits and alter their habits and behaviour accordingly.

To this end, countries must develop strategies to better educate, inform and sensitize their populations on environmental matters and sustainable development. For example, ecological and environmental concerns can be integrated into school programs; the awareness of the general public can be raised through extensive information campaigns, particularly through the media; "green" projects can be encouraged in local communities, and training programs can be developed to promote more informed resource management and the use of clean technologies.

10.6 ENVIRONMENTAL DEGRADATION

Environmental degradation may be defined as " the deterioration of the environment through depletion of resources such as air, water and soil; the destruction of ecosystems and the extinction of wildlife". Environmental degradation has occurred due to the recent activities in the field of socio-economic, institutional and technologies.

10.6 CAUSES FOR ENVIRONMENTAL DEGRADATION

The causes of environmental degradation are often as complex the problems that result. The primary cause is human disturbance. The degree of the environmental impact varies with the cause, the habitat, and the plants and animals that inhabit it. There are many causes of environmental degradation.

These include environmental changes are based on many factors which include:

- Urbanization
- Population growth
- Economic growth
- Intensification of agriculture

Increase in energy use, increased and uncontrolled human activities like industries,transportation, agriculture, health care, dwelling, and energy generation are some of the causes of environmental pollution.

The United Nations International Strategy for Disaster Reduction defines environmental degradation as "*The reduction of the capacity of the environment to meet social and ecological objectives, and needs".* Environmental degradation is of many types. When natural habitats are destroyed or natural resources are depleted, the environment is degraded Efforts to counteract this problem include environmental protection and environmental resources management.

10.7 ENVIRONMENT POLLUTION

Environmental Pollution occurs in various ways and pollution of air, water , land is alarmingly moving northwards. Pollution is categorized into the following division -

10.7.1 Radiation Pollution

For whatever purposes nuclear energy is used – be it for peaceful purpose or nuclear warfare – the physical and bio environment cannot get way with its hazards. These are the delayed effect of fall out and increasingly important hazards of peacetime user of radiation.

10.7.2 Air Pollution

All most all chemicals released into air eventually find their way to atmosphere. Chemicals such as pesticides are often sprayed as mists which may drift for several kilometers from their point of application. Pollutants like asbestos fibres, which can

cause virulent lung cancer which can occur many years after the actual exposure. Similarly, nitrogen oxides exhausted from the car are component of automobile smog and nickel and chromium containing dusts which can initiate lung cancer.

10.7.3 Water Pollution

Pollution of fresh water is one of the most serious environmental problems for the world as a whole. Industrial process requires huge quantity of water but at the same time dilute waste products to the river. Serious sources of water pollution is the leaching of sulphide from mine working and dump and became toxic which flows down to river causing serious contamination of water and health hazards.

10.7.4 Soil Pollution

Soil in a forest is liable to get eroded quickly through the rain or wind unless it is adequately covered by the vegetation. Researchers initially blamed the climatic condition, today suspicion focused on environmental pollution, particularly the acid rain caused auto and industrial emissions. Acid rain prevents micro organism in soil from converting organic debris into fertilizer.

10.7.5 Noise Pollution

Noise usually defined as unwanted sound or sound without value. Noise as an environmental pollutant becomes an object of serious social concern. Yet noise is a persistent pollutant in many practical situations where noise sources cannot be suppressed and degrades the quality of life.

10.8 HOW TO PROTECT THE ENVIRONMENT?

The following **protective and control measures** are aimed at environmental protection.

i. Reforestation.

Trees are very important. They play a great role in air purification; they are water catchment areas and a home to many other living species. The more trees we have the purer the air and the less the chances of having water problems. Animals also have their own habitat in the forests.

ii. Use green technologies.

Factories should try to go green. Use more environmentally friendly gases that are not harmful. Wind energy is one way to go about it. Solar energy is also an applicable method. Use of renewable energy will reduce the harmful chemicals.

iii. Use less chemicals in factories.

When the chemicals are less, this means that waste is also minimal. Not only the factories but also those who do farming. Most of the pesticides and fertilizers used in farms end up in water bodies. It is important to use a reasonable amount that will not be harmful.

iv. Share your car or use public transport.

Since cars are a major air pollutant, trying to minimize the number of cars on the road is important. People can choose to use more of public transport. Families can share cars rather than each member of the family having a car or use bicycles where possible.

v. Create awareness.

It is important to educate people on the importance of environmental protection. The little things people do will do a long way in environmental protection. Encourage them on the importance of reusing and recycling. Encourage use of energy savers as well as collecting rain water. It is also important to educate on animal conservation as well as taking part in tree planting programs. There are so many organizations all over the world that are planting trees in the aim of saving the world.

vi. Be sustainable.

Try as much as possible to reduce or eliminate waste and use the environment is an eco-friendly way. Sustainability means reducing the use of natural resources so as to reduce the chances of depleting them. Use more of fluorescent tubes, use rechargeable batteries, use renewable energy, and use renewable bags for shopping are some of the ways to be sustainable.

vii. Plant trees along sea-beach.

Sea beaches are low-lying lands that are bear. Planting trees in these areas will play a great role in protecting the environment. They can serve as air purifiers and reduce the chances of harmful waste reaching the sea and oceans. They will also serve the purpose of preventing dunes.

10.9 SUMMARY

Sustainable development is a means of meeting present needs in a ways that do not harm future generation and other species from meeting our needs. But because of human greed he has spoiled the natural environment in which he lives. The environmental pollution may be categories as radiation pollution, air pollution, water pollution, soil

pollution and noise pollution. There are various causes for the environmental pollution such as, urbanization, population growth, economic growth, intensification of agriculture etc., to reduce this environmental pollution we have to follow the concept of sustainable development. To implement the sustainable development Indian government passed number of laws on environment such as, Water (prevention and control of pollution) Act, 1974, Air (Prevention and Control of Pollution) Act, 1981, Environment (Protection) Act, 1986, National Environment Tribunal Act, 1995, National Green Tribunal Act, 2010. The sustainable development is possible only when all the citizens of the country realize their responsibilities and protect the environment.

10.10 KEY WORDS

Sustainable,

Polluters

Equity,

Radiation

10.11 SELFASSESSMSENT QUESTIONS

1. What is meant by sustainable development?
2. What is environmental degradation?
3. What is environmental pollution?
4. Explain the principles adopted under sustainable development.
5. What are the causes of environmental degradation?
6. What are the various types of pollution faced by the society?

10.12 REFFERENCES

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UNIT – 11 : ENVIRONMENTAL LEGISLATIONS

Structure

11.0 OBJECTIVES

After studying this unit you will be able to:

- discuss various the environmental legislations
- expalin environment impact assessment
- unit a note on the global warming and greenhouse gases
- discuss impact of global warming

11.1 ENIRONMENTAL LEGISLATIONS; ENVIRONMENT POLICY - INSTRUMENTS

The Indian Constitution, as adopted in 1950, did not deal with the subject of environment or prevention and control of pollution untill 1970. The original text of the Constitution under Article 372(1) has incorporated the earlier existing laws into the present legal system and provides that notwithstanding the repeal by Constitution of enactments referred to in Article 395, but subject to other provisions of the Constitution, all laws in force immediately before the commencement of the Constitution to remain in force until altered, repealed or amended by a competent legislature or other competent authority.

The post-independence era, until 1970, did not see much legislative activity in the filed of environmental protection. Two early post-independence laws touched on water pollution. The Factories Act of 1948 required all factories to make effective arrangements for waste disposal and empowered State Governments to frame rules implementing this directive.

It was the Stockholm Declaration of 1972 which turned the attention of the Indian Government to the broader perspective of environmental protection. The government made its stand well known through five year plans as well as the legislations enacted subsequently to curb and control environmental pollution. After 1970, following comprehensive (special) environmental laws were enacted by the Central Government in India.

The Wildlife (Protection) Act, 1972, aimed at rational and modern wild life management. The Water (Prevention and Control of Pollution) Act, 1974, provides for the establishment of pollution control boards at Centre and States to act as watchdogs for prevention and control of pollution. The Forest(Conservation) Act, 1980 aimed to

check deforestation, diversion of forest land for non-forestry purposes, and to promote social forestry. The Air(Prevention and Control of Pollution) Act,1981, aimed at checking air pollution via pollution control boards. The Environment (Protection) Act, 1986 is a landmark legislation which provides for single focus in the country for protection of environment and aims at plugging the loopholes in existing legislation. It provides mainly for pollution control, with stringent penalties for violations. The Public Liability Insurance Act, 1991, provides for mandatory insurance for the purpose of providing immediate relief to person affected by accidents occurring while handling any hazardous substance. The National Environment Tribunals Act, 1995, was formulated in view of the fact that civil courts litigations take a long time (as happened in Bhopal case). The Act provides for speedy disposal of environmental related cases through environmental tribunals

In 1992, the Union Government adopted a "National Conservation Strategy and Policy Statement on Environment and Development (NCS). The preamble to the NCS adopts the policy of "sustainable development" and declares the government's commitment to re-orient policies and action in unison with the environmental perspective. The NCS proceeds to recognize the enormous dimensions of the environmental problems facing India and declares strategies for action in various spheres such as agriculture, forestry, industrial development, mining and tourism. Special sections in the NCS deal with the rehabilitation of persons ousted by large development projects; the role of NGOs; and the special relationship between women and the environment.

Again, in 1992, the Union Government came out with "Policy Statement for Abatement of Pollution". This statement declares the objective of the government to integrate environmental considerations into decision-making at all levels. To achieve this goal, the statement adopts fundamental guiding principles, namely:

(i) Prevention of pollution at source;

(ii) Adoption of the best available technology;

(iii) Polluter pays principles; and

(iv) Public participation in decision-making.

Further, it should noted here that general legislations like IPC, Cr. PC, CPC, MV Act, Labour Acts, etc., could be quite effective in controlling environmental violations because of the easy availability of the enforcement machinery (Police, judiciary, etc.,) in every district of the country. Some of these Acts have been amended recently to incorporate current trends and requirements. Thus, besides an effective implementation

of these Acts and creating a greater public awareness about them, there should be coordination between different authorities so as to effectively preserve and protect the environment.

11.2 ENVIRONMENT AUDIT

A separate and independent concept, "environmental audit" find its way into the Environment (Protection) Rules. This was added by the amendment notification in 1992. The rules made the submission of an environmental audit report compulsory. Every person carrying on an industry, operation or process requiring consent under the Water or Air Act or authorization under the Hazardous Waste (Management and Handling) Rule, 1989 has to submit an audit statement for the financial year (ending 31st March) to the State Pollution Control Board

What is environmental auditing?

Environmental auditing is essentially an environmental management tool for measuring the effects of certain activities on the environment against set criteria or standards. Depending on the types of standards and the focus of the audit, there are different types of environmental audit. Organisations of all kinds now recognise the importance of environmental matters and accept that their environmental performance will be scrutinised by a wide range of interested parties. Environmental auditing is used to

- investigate
- understand
- identify

These are used to help improve existing human activities, with the aim of reducing the adverse effects of these activities on the environment. An environmental auditor will study an organisation's environmental effects in a systematic and documented manner and will produce an environmental audit report. There are many reasons for undertaking an environmental audit, which include issues such as environmental legislation and pressure from customers.

Definitions

The term 'audit' has its origins in the financial sector. **Auditing**, in general, is a methodical examination - involving analyses, tests, and confirmations - of procedures and practices whose goal is to verify whether they comply with legal requirements, internal policies and accepted practices.

The International Chamber of Commerce (ICC) produced a definition in 1989 which is along the same lines

A management tool comprising systematic, documented, periodic and objective evaluation of how well environmental organisation, management and equipment are performing with the aim of helping to safeguard the environment by facilitating management control of practices and assessing compliance with company policies, which would include regulatory requirements and standards applicable.

Source: after International Chamber of Commerce (1989)

There are other definitions available, although the above definition is still seen as the industry standard. The key concepts, which occur in all the definitions, are as follows.

- **Verification**: audits evaluate compliance to regulations or other set criteria.
- **Systematic**: audits are carried out in a planned and methodical manner.
- **Periodic**: audits are conducted to an established schedule.
- **Objective**: information gained from the audit is reported free of opinions.
- **Documented**: notes are taken during the audit and the findings recorded.
- **Management tool**: audits can be integrated into the management system (such as a quality management system or environmental management system).

Distinctions between financial audits and environmental audits

	Financial audits	Environmental audits
Legal basis of audit	Part of regulatory (legal) process, organisations have to perform it	With few exceptions, environmental audits are voluntary affairs. Even the preparatory environmental review which is mandatory under ISO 14001 is voluntary as the standard is voluntary
Frequency	Annual affairs	Whenever the organisation decides to perform one
Who does it?	Performed by external staff, certified to do so	Performed by external and/or internal staff. Professional indemnity considerations, there are no legal requirements of auditors to be competent or trained, although professional bodies in many countries try to stop this
Methodology	Financial audits are based on comparative standards which are publicly available - General Principles of Accounting etc	Varies very much between auditors and companies
Access to audit	The results are public documents in the form of annual reports	Very few audits are public, although some results are often published in the Environmental Reports
Liability	Auditors are partially liable for their reports. They have to provide a 'true and fair' view of the organisation	With few exceptions that are negotiated between auditor and auditee, there is no external liability implication in environmental audits

What are their benefits

Benefits vary depending on the objectives and scope of the audit. Environmental auditing benefits include:

- Organisations understand how to meet their legal requirements;
- Meeting specific statutory reporting requirements;
- Organisations can demonstrate they are environmentally responsible;
- Organisations can demonstrate their environmental policy is implemented;
- Understanding environmental interactions of products, services & activities,
- Knowing their environmental risks are managed appropriately;
- Understanding how to develop and implement an ISO 14001 EMS; and
- Improving environmental performance and saving money.

11.3 ECOMARK

It is a label given to environmental-friendly consumer products. Any product will get eco-mark if its life-cycle (manufacturing process, raw material, product use, disposal and packaging) is environment-friendly at every stage.

In 1991, the Ministry of Environment and Forests (MoEF) decided to institute a scheme on labeling environment friendly products. Household and other consumer products can be accredited and labeled as satisfying environmental criteria, in addition to quality requirements laid down by the Bureau of Indian Standards for the product. The label is known as Ecomark. The scheme was meant to provide incentive to the manufacturers, to assists consumers to become environmentally responsible, and to improve the quality of environment leading to sustainable management of resources. In certain categories such as toilet soaps and detergents, paints, paper and laundry soaps, the MoEF has already finalized and notified the criteria for the product.

The objectives of the Eco-mark scheme

- Encourage all citizens to use and buy products which are environment-friendly
- Reward and promote genuine initiatives by companies to reduce the adverse environmental impact on their products.
- Provide incentive for manufacturers and importers to control the ill effects of their products on the environment

- Improve the overall quality of the environment and promote sustainable management of resources in India.

Criteria for awarding Eco-mark

The products which get the Eco-mark need to strictly follow the environmental requirements and also pass stringent quality control tests to keep their certification valid. The following conditions are evaluated before awarding the Eco-mark certification to a product:

- Substantially less potential for pollution in production, usage and disposal;
- Recycled, recyclable, made from recycled or biodegradable products;
- Make significant contribution in saving non-renewable resources and natural resources;
- Production process including source of raw material;
- Likely impact on the environment;
- Suitability for recycling or packaging;
- Biodegradability.

11.4 ENVIRONMENT IMPACT ASSSESSMENT (EIA)

It is essential that consequences of projects, plans or policies at different levels be assessed before they are executed. Environmental Impact Assessment (EIA) examines these consequences and predicts future changes in the environment. Approval of projects without a proper impact study is a danger that throws environmental management out of gear. It is often alleged that location of industrial projects in India is often decided on parochial, regional and political considerations rather than on environmental factors. Under Rule 8(2) of the Hazardous Wastes (Management and Handling) Rules 1989, framed under the Environment Protection Act, 1986, there is provision for an environmental impact study. The State Government or any person authorized by it, is responsible for the study.

11.5 GLOBAL WARMING

Global warming is arguably the most critical and controversial issue facing the world in the twenty-first century, one that will affect every living creature on the planet. It is also an extraordinarily complex problem, which everyone needs to understand as clearly and completely as possible.

Global warming is the increase in the average temperature of the Earth's near-surface air and the oceans since the mid-twentieth century and its projected continuation. Global surface temperature increased 0.74 ± 0.18 °C (1.33 ± 0.32 °F) during the 100 years ending in 2005.

11.6 GREENHOUSE GASES

Greenhouse gas is a natural part of the atmosphere. It absorbs solar radiation and keeps the earth warm enough to support life. Human activities including burning fossil fuels for energy, land clearing and agriculture have increased the amount of greenhouse gas in the atmosphere.

Apart from water vapour, which is the most common greenhouse gas, there are six main greenhouse gases:

- carbon dioxide
- methane
- nitrous oxide
- hydrofluorocarbons
- perfluorocarbons
- sulphur hexafluoride.

The first three occur naturally in the atmosphere, while the last three are synthetic, and are either used in industry or created as a by-product of industrial processes.

11.7 GLOBAL WARMING IMPACTS

Global warming is already having significant and costly effects on our climate, our health, and our environment. Global warming has serious worldwide implications, though the type and magnitude of local effects varies considerably by region. Steps need to ne taken to reduce global warming emissions, these impacts will continue to intensify, grow ever more costly and damaging, and increasingly affect the entire planet. Some of the impact of global warming are:

11.7.1 Accelerating Sea Level Rise and Increased Coastal Flooding

Average global sea level has increased eight inches since 1880, but is rising much faster on the now. Global warming is now accelerating the rate of sea level rise, increasing flooding risks to low-lying communities and high-risk coastal properties whose development has been encouraged by today's flood insurance system.

11.7.1 Longer and More damaging Wildfire Seasons

Wildfires are increasing and wildfire season is getting longer in the as temperatures rise. Higher spring and summer temperatures and earlier spring snow-melt result in forests that are hotter and drier for longer periods of time, priming conditions for wildfires to ignite and spread.

11.7.3 More Frequent and Intense Heat Waves

Dangerously hot weather is already occuring more frequently than it did 60 years ago—and scientists expect heat waves to become more frequent and severe as global warming intensifies. This increase in heat waves creates serious health risks, and can lead to heat exhaustion, heat stroke, and aggravate existing medical conditions.

11.7.4 Costly and Growing Health Impacts

Climate change has significant implications for our health. Rising temperatures will likely lead to increased air pollution, a longer and more intense allergy season, the spread of insect-borne diseases, more frequent and dangerous heat waves, and heavier rainstorms and flooding. All of these changes pose serious, and costly, risks to public health.

11.7.5 An Increase in Extreme Weather Events

Strong scientific evidence shows that global warming is increasing certain types of extreme weather events, including heat waves, coastal flooding, extreme precipitation events, and more severe droughts. Global warming also creates conditions that can lead to more powerful hurricanes.

11.7.6 Other impacts:

As temperatures increase, more rain falls during the heaviest downpours, increasing the risk of flooding events. Climate change affects a variety of factors associated with drought and is likely to increase drought risk in certain regions.Our aging electricity infrastructure is increasingly vulnerable to the growing consequences of global warming, including sea level rise, extreme heat, heightened wildfire risk, and drought and other water supply issues.Spring arrives much earlier than it used to — 10 days earlier on average in the northern hemisphere. Snow melts earlier. Reservoirs fill too early and water needs to be released for flood control. Vegetation and soils dry out earlier, setting the stage for longer and more damaging wildfire seasons.

Temperatures are rising in the planet's polar regions, especially in the Arctic, and the vast majority of the world's glaciers are melting faster than new snow and ice can

replenish them. Scientists expect the rate of melting to accelerate, with serious implications for future sea level rise. Rising temperatures and the accompanying impacts of global warming — including more frequent heat waves, heavier precipitation in some regions, and more severe droughts in others — has significant implications for crop production. Global warming has the potential to seriously disrupt our food supply, drive costs upward, and affect everything .

A changing climate affects the range of plants and animals, changing their behavior and causing disruptions up and down the food chain. The range of some warm-weather species will expand, while those that depend on cooler environments will face shrinking habitats and potential extinction.

11.8 SUMMARY

To prevent all sort of pollutions Indian government passed number of laws such as the Wildlife (protection) Act, 1972, the Water (prevention and control of pollution) Act, 1974, the Forest (conservation) Act, 1980, the Air (prevention and control of pollution) Act, 1981, the environment (protection) Act,1986 and other laws.

All entrepreneurs who are carrying an industry have to submit a report called "environmental audit". Every person carrying on an industry, operation or process requiring consent under Water or air Act or authorization under the Hazardous Waste Rule, 1989 has to submit an audit statement for the financial year (Ending March 31). To encourage environmental friendly process of manufacturing the government gives an ecomark. The ecomark indicates that the product it is environmental friendly every stage of its manufacturing process. Global warming is arguably the most critical and controversial issue facing the world. The global warming impact the planet in various ways such as rise in the sea level, longer and more damaging wildfire seasons, more frequent and intense waves, impact on health of all creature on the earth.

11.9 KEY WORDS

Audit,

Greenhouse

Ecomark

Global warming

11.10 SELF STUDY QUESTIONS

1. What is meant by environmental audit?
2. What is ecomark?
3. What is global warming?
4. What is meant by greenhouse gases?
5. What are the various impacts of global warming?

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UNIT- 12 : TERRORISMS, NUCLEAR PROLIFERATION, NATURAL DISASTERS.

Structure

12.0 OBJECTIVES

After studying this unit you will be able to understand:

- explain the terrorism and it's the business environment
- discuss the nuclear proliferation and protection of environment
- elaborate various forms of natural disasters

12.1 TERRORISM

Terrorism refer only to those violent acts that are intended to create fear (terror); are perpetrated for a religious, political, or ideological goal; and deliberately target or disregard the safety of non-combatants (e.g., neutral military personnel or civilians).

Some definitions now include acts of unlawful violence and war. The use of similar tactics by criminal organizations for protection rackets or to enforce a code of silence is usually not labeled terrorism, though these same actions may be labeled terrorism when done by a politically motivated group.

The word "terrorism" is politically loaded and emotionally charged, and this greatly compounds the difficulty of providing a precise definition In some cases, the same group may be described as "freedom fighters" by its supporters and considered to be terrorists by its opponents.

The concept of terrorism may be controversial as it is often used by state authorities (and individuals with access to state support) to delegitimize political or other opponents, and potentially legitimize the state's own use of armed force against opponents (such use of force may be described as "terror" by opponents of the state). At the same time, the reverse may also take place when states perpetrate or are accused of perpetrating state terrorism. The usage of the term has a controversial history, with individuals such as ANC leader Nelson Mandela at one point also branded a terrorist.

Since 1994, the United Nations General Assembly has repeatedly condemned terrorist acts using the following political description of terrorism:

Criminal acts intended or calculated to provoke a state of terror in the general public, a group of persons or particular persons for political purposes are in any circumstance unjustifiable, whatever the considerations of a political, philosophical, ideological, racial, ethnic, religious or any other nature.

By distinguishing terrorists from other types of criminals and terrorism from other forms of crime, terrorism could be :

- ineluctably political in aims and motives
- violent – or, equally important, threatens violence
- designed to have far-reaching psychological repercussions beyond the immediate victim or target
- conducted by an organization with an identifiable chain of command or conspiratorial cell structure (whose members wear no uniform or identifying insignia) and perpetrated by a subnational group or non-state entity.

For example, firebombing a city, which is designed to affect civilian support for a cause, would not be considered terrorism if it were authorized by a government. This criterion is inherently problematic and is not universally accepted because: it denies the existence of state terrorism, the same act may or may not be classed as terrorism depending on whether its sponsorship is traced to a "legitimate" government; "legitimacy" and "lawfulness" are subjective, depending on the perspective of one government or another; and it diverges from the historically accepted meaning and origin of the term.

Top 5 Ways Terrorism Impacts the Economy

The high-profile terrorist attacks in the United States, Bangladesh, Iraq, France and Istanbul, are only some of the more than 1,000 known terror attacks between the Nov. 13, 2015 attack in Paris and July 2016. Investors and businesses in the United States have dealt with the realities and tragedies of global terrorism since at least 2001, and the threat has only increased. While the human cost is devastating, the economic impact may be larger than most realize. The following are five ways that terrorism has an impact on the economy.

1. Direct Economic Destruction

The most immediate and measurable impact of terrorism is physical destruction. Terrorists destroy existing plants, machines, transportation systems, workers and other economic resources. On smaller scales, acts of terrorism may blow up cafes, temples or roads. Large-scale attacks, most infamously the World Trade Center bombings on Sept. 11, 2001, can destroy billions of dollars' worth of property and senselessly kill thousands of productive workers.

The impact of terrorism and war is always negative for the economy, and physical destruction is a large reason why. Productive resources that might have generated valuable goods and services are destroyed, while other resources are almost invariably diverted from other productive uses to bolster the military and defense. None of this creates wealth or adds to the standard of living, even though military spending is often erroneously cited as a stimulant; this is the "broken window fallacy" sometimes mentioned by economists.

2. Increased Uncertainty in the Markets

Even if you do not live anywhere near terrorist attacks, you might still be negatively impacted indirectly. This is because all kinds of markets hate uncertainty, and terrorism creates a lot of it. The financial markets literally shut down after Sept. 11, and did not really recover until months after the 2003 invasion of Iraq, Indian stock markets largely affected by Mumbai terror attack.

There is plenty of debate about the depth and pervasiveness of the actual impact on financial markets. As the threats and publicity of global terrorism continue to rise, markets appear to be more and more resilient. Stock market indexes did not decline much after the terrorist attacks in France killed at least 129 people in 2015. However, the deadly attack in Nice, France in 2016 only adds to the sentiment that France may be an increasingly unstable place to live and do business in. The real threat of global terrorism from an investor's perspective is about the broader picture, not individual incidents. International investment and cooperation are lower in a world full of terrorism.

3. Insurance, Trade, Tourism and FDI

There are two obvious industries especially vulnerable to the effects of terrorism: insurance and tourism. Not all insurance companies pay out in the event of international terrorism or foreign wars, so the impact is likely less than you might first expect. Nevertheless, terrorism is risky business for everyone, and insurance companies hate risk as much as anyone else.

Tourism is even more concerning. In France, for example, tourism accounts for approximately 7 to 8% of total gross domestic product (GDP). Vanguelis Panayotis, a director of MKG tourism consultancy, told Reuters that he expected a 30% decline in visitors to France in the month after the Nice attacks.

On a broader scale, terrorism hurts international trade. This may be due to imminent threats, such as compromised trade routes and distribution systems, or because of the psychological and physical reactions to terrorism. This also means less foreign direct investment (FDI), especially in unstable countries.

4. War Is the Health of the State

There is an old saying in the study of political economy that reads "war is the health of the state." It means that during times of conflict, reactive governments and nervous citizens are far more inclined to give up economic and political freedoms in exchange for security. This could result in higher taxes, higher government deficits and higher inflation. During wartime, the government often implements price controls and sometimes even the nationalization of industries.

Governments are less effective at managing resources for productive economic activity than private individuals, especially when those resources are co-opted to achieve a strategic military objective. When governments militarize, the private economy suffers. As economist and historian Robert Higgs demonstrated in his book "Crisis and Leviathan," many government controls stay in place long after military campaigns end.

5. Increased Nationalism and Foreign Scepticism

The final risk to the economy is political risk. This is already on display in the United States and Europe in 2016, where there has been a rise in scepticism of foreign cultures, businesses, immigrant workers and refugees. Populist movements already won a victory of sorts in the United Kingdom, where anti-globalist and anti-trade sentiments helped pass Brexit. These kinds of major political events have an uncertain economic fallout on everything from currency to trade and diplomacy.

Closing down borders to trade and immigrant workers reduces the size and diversity of economic transactions and limits productive resources. Economists as early as Adam Smith contended that the division of labour and gains from trade are limited to the size of available factors of production. Just as a single household or town is less productive if it only relies on internal resources, so too do national economies limit themselves to the extent that they wall off external producers and consumers.

12.2 NUCLEAR PROLIFERATION

Nuclear Proliferation is a term used to describe the spread of nuclear weapons and weapons-applicable nuclear technology and information, to nations which are not recognized as "Nuclear Weapon States" by the Treaty on the Nonproliferation of Nuclear Weapons, also known as the Nuclear Nonproliferation Treaty or NPT. One critique of the NPT is that it is discriminatory in recognizing as nuclear weapon states only those countries that tested nuclear weapons before 1968 and requiring all other states joining

the treaty to forswear nuclear weapons before 1968 and fequiring all other States joining the treaty to forswear nuclear wepons.

There are many reasons for nuclear proliferation around the world in this new missile age. Unlike during the Cold War, where the Soviet Union and the United States were the only two world powers with nuclear capabilities, today's world is much different. There are many nations with nuclear weapons. Some of these nations are hostile or have the potential to be hostile with other nations. Many of the nations seeking nuclear weapons are also sponsors of terrorist organizations around the world. These organizations have also made it very clear that they will stop at nothing to hit targets at will.

Because of the increased threat of nuclear weapons being obtained by rogue nations, other peaceful nations feel they need to obtain nuclear weapons to protect themselves. They feel that the threat of retaliation with nuclear weapons is much more of a deterrent than with conventional weapons. This fear, if allowed to grow, will result in a world where most nations have nuclear weapons, and this will eventually lead to disaster. All it would take is one mistake by one country to set off a nuclear war.

12.3 NUCLEAR PROLIFERATION AND PROTECTION OF ENVIRONMENT

Nuclear warfare is considered a preeminent threat to global peace and an issue of major political, ethical, and social discourse. The destruction potential of nuclear weapons has been a global concern since their inception. Nevertheless, the environmental consequences of the development, testing, and use of nuclear weaponry are often given little consideration. The effects of the nuclear bombs used by the United States on Japan in the 1940s demonstrate the unprecedented destruction capability of nuclear weaponry.

The consequences of the bombs were horrific and continue to have environmental repercussions and, the environmental impacts of nuclear testing and development continue to threaten the environment. There is need to effectively manage nuclear waste sites and pay highest attention to the environmental consequences of its nuclear development. Nuclear waste and development sites, left unmanaged, pose long-term harm to their surrounding areas. The prevention of nuclear proliferation as well as the effective management of preexisting nuclear waste and development sites is an essential issue for the effective protection of the environment.

12.4 NATURAL DISASTERS

Natural disasters are extreme, sudden events caused by environmental factors that injure people and damage property. Earthquakes, windstorms, floods, and disease all strike anywhere on earth, often without warning. The natural disasters which could take place are:

12.*4.1 Landslide*

A landslide is a disaster involving elements of the ground, including rocks, trees, parts of houses, and anything else which may happen to be swept up. Landslides can be caused by an earthquake, volcanic eruptions, or general instability in the surrounding land. Mudslides or mudflows, are a special case of landslides, in which heavy rainfall causes loose soil on steep terrain to collapse and slide downwards.

12.*4.2 Avalanche*

An avalanche is a geophysical hazard involving a slide of a large snow or rock mass down a mountainside, caused when a buildup of material is released down a slope, it is one of the major dangers faced in the mountains in winter. As avalanches move down the slope they may entrain snow from the snowpack and grow in size. The snow may also mix with the air and form a powder cloud. An avalanche with a powder cloud is known as a powder snow avalanche. The powder cloud is a turbulent suspension of snow particles that flows as a gravity current.

12.*4.3 Drought*

A drought is an extended period of months or years when a region suffers a severe deficiency in its water supply. Generally, this occurs when a region receives consistently below average rainfall. It can have a substantial impact on the ecosystem and agriculture of the affected region. Although droughts can persist for several years, even a short, intense drought can cause significant damage and harm the local economy

12.*4.4 Wildfires*

Wildfires, or forest fires, are uncontrolled fires burning in wildland areas. Common causes include lightning, human carelessness, arson, volcano eruption, and pyroclastic cloud from active volcano. That can be a threat to those in rural areas and also to wildlife. Wildfires can also produce ember attacks, where floating embers set fire to buildings at a distance from the fire itself.

12.*4.5 Flood*

A flood is an overflow of an expanse of water that submerges land, a deluge. It is usually due to the volume of water within a body of water, such as a river or lake, exceeding the total capacity of the body, and as a result some of the water flows or sits outside of the normal perimeter of the body. It can also occur in rivers, when the strength of the river is so high it flows right out of the river channel , usually at corners or meanders.

12.*4.6 Tsunami*

A tsunami is a series of waves created when a body of water, such as an ocean, is rapidly displaced. Earthquakes, mass movements above or below water, volcanic eruptions and other underwater explosions, landslides, large meteorite impacts comet impacts and testing with nuclear weapons at sea all have the potential to generate a tsunami. A tsunami is not the same thing as a tidal wave, which will generally have a far less damaging effect than a Tsunami.

12.*4.7 Volcanic eruption*

A volcanic eruption is the point in which a volcano is active and releases lava and poisonous gasses in to the air. They range from daily small eruptions to extremely infrequent supervolcano eruptions (where the volcano expels at least 1,000 cubic kilometers of material.) Some eruptions form pyroclastic flows, which are high-temperature clouds of ash and steam that can travel down mountainsides at speeds exceeding that of an airliner.

12.*4.8 Tornado*

Tornadoes are violent, rotating columns of air which can blow at speeds between 50 and 300 mph, and possibly higher. Tornadoes can occur one at a time, or can occur in large tornado outbreaks along squall lines or in other large areas of thunderstorm development. Waterspouts are tornadoes occurring over water in light rain conditions.

12.*4.9 Earthquake*

An earthquake is the result of a sudden release of energy in the Earth's crust that creates seismic waves. Earthquakes are recorded with a seismometer, also known as a seismograph. The magnitude of an earthquake is conventionally reported on the Richter scale, with magnitude 3 or lower earthquakes being mostly imperceptible and magnitude 7 causing serious damage over large areas. Intensity of shaking is measured on the modified Mercalli scale. At the Earth's surface, earthquakes manifest themselves by shaking and sometimes displacement of the ground.

12.*4.10* *Hurricanes*

Hurricanes, tropical cyclones, and typhoons are different names for the same phenomenon: a cyclonic storm system that forms over the oceans. It is caused by evaporated water that comes off of the ocean and becomes a storm. The Coriolis Effect causes the storms to spin, and a hurricane is declared when this spinning mass of storms attains a wind speed greater than 74 mph. Hurricane is used for these phenomena in the Atlantic and eastern Pacific Oceans, tropical cyclone in the Indian, and typhoon in the western Pacific.

12.5 SUMMARY

Not only various nations affected by terrorism but aslo business houses across the globe facing the threat of terrorism. Prior to establishment of a firm, an entrepreneur has consider threat of terrorism. Terrorism refer only to those violent acts that are intended to create fear (terror); are perpetrated for a religious, political, or ideological goal; and deliberately target or disregard the safety of non-combatants (e.g., neutral military personnel or civilians). Apart from terrorism a an industry is affected by natural disasters, these are extreme, sudden events caused by environmental factors that injure people and damage property. Earthquakes, windstorms, floods, and disease all strike anywhere on earth, often without warning. Although a business man may not able to avoid suddenly these natural disasters but he can reduce them through protecting the environment by producing eco-friendly products.

12.6 KEY WORDS

Terrorism

Nuclear

Environment

Avalanche

12.6 SELF ASSESSMENT QUESTIONS

1. What is meant by terrorism?
2. What is Nuclear proliferation?
3. What is meant by natural disasters?
4. Explain various types of natural disasters which affect people and business.

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DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

M.B.A I Semester

COURSE - 6

BUSINESS ENVIRONMENT

BLOCK

4

REGULATORY ENVIRONMENT

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BLOCK -4 : REGULATORY ENVIRONMENT

A country's economic progress largely depends on its industries growth and employment. Each country has its own industrial policy.

A firm operates in legal environment set out by various regulatoty bodies and it needs to abide all the rules and regulation set by the regulatory bodies. This block deal with regulator environment of bussiness. This block has 4 units.

Unit-13 focusses on Industries policy and export import policy. The unit explains objective of industries policy and discussed industrial policy of 1948 and industrial policy of 1956 and 1991.

Then the unit focuses on EXIM policy and explains EXIM policy in various periods.

Unit- 14 is concerned with Industrial (development & regulation) act, 1951. The unit at the outset discusses the objectives, scope and salient features of industries (development & regulaties/ act, 1951. The unit also explains industries licensing, new industries policy.

Unit- 15 deals with competition law, a firm which operates and economy competes with large number of competitions. An understanding of competition law is an advantageous for a firm to compete and sustain growth without any legal complication. The unit at outset through light on the historical background of the competition law, then it discusses salient features of the act. Further, the unit discusses competitions commission and its duties and power.

Unit- 16 deals with consumer protection act, 1956. The act every buyer and seller need to be aware of, the unit discusses, meaning, scope and objectives of the act. The unit also explains consumer protection councils, and consumer disputes redressal agencies(CDRA). Further, the unit sheds light as the remedies available to the consumer.

UNIT-13 : INDUSTRIAL POLICY -EXPORT-IMPORT POLICY

Structure :

13.0 OBJECTIVES

After analyzing this Unit you are able to;

1. define the main objectives of industrial policy
2. analyse the salient features of Industrial policy,1948
3. explain foreign investment policy
4. discuss the merits of Exim policy
5. examine recent Exim policies

13.1 INTRODUCTION

Industrial Policy is an important document which lays a wide canvas and sets the tone for implementing promotional and regulatory roles of the Government. The term Industrial Policy refers to the Governments policy towards Industries, their establishment, functioning, growth and management.The Policy will indicate the respective areas of the large, medium and small scale sectors. It will also specifies about the Governments policy towards foreign capital, labour, tariff and other related aspects. Naturally, the industrial development of a country will be shaped, guided, fostered, regulated and controlled by its industrial policy. Industrial Policy is probably the most important document and it is helpful to planners and administrators in the Government for promoting and regulating industries. It is equally helpful to industrialists and others for deciding areas and of their priorities.

13.2 MAIN OBJECSTIVES OF INSTRSIAL POLICY

The main objectives Industrial policy were as follows,

It can,

- Correct the imbalances in the development of industries and help bring about a desirable balance and diversification in them
- Direct the flow of scarce resources in the most desirable areas of national priorities..

Prevent the wasteful use of scarce resources and ensure their conservation and judicious utilization.

Empower the government to regulate the establishment and expansion of privateindustries in accordance with the planned objectives.

- Demarcate areas among the public, private and pint sectors of the economy, as well as large and small scale industries.
- Prevent, through fiscal and monetary policies, the formation of monopolies and. concentration of wealth in a few hands so that the evils associated with monopolies can be effectively curbed.

13.3 INDUSTSRIAL POLICY, 1948

The Government of India announced a comprehensive industrial policy in April, 1948. The policy statement made it clear that the State would play a progressively active role in the development of industries. It also sought to lay down the different ways in which the State would extend aid to industries in the private sector. The following were the important features of the policy.

1. Industries were divide into four types of categories :

a. Exclusive Government Monopoly : Manufacture of arms and ammunitions, production and control of atomic energy and ownership and management of railways would be wholly state-owned and managed

b. Industries in which new factories were to be owned and un only by the Government : but the existing ones would he flowed to continue to be run under the private ownership andmanagement for a period of 10 years when the case would be reviewed. They were: coal, iron and steel, aircraft manufacture, ship-wilding, manufacture of telephone, telegraph and wireless apparatus excluding radio receiving sets and mineral oils.

c. Private industries subject to State Control and Regulation: these industries are to be left to purely private enterprise subject to control and regulation of the Government. 20 industrieswere put in this Category, e,g, heavy machines, automobile, electrical engineering, sugar, cement etc.

d. All other industries to be open to private enterprise but subject to general control of the State.

2. Small Scale Industries : The Government realized their importance and decided to pay greater attention for their development and bring about the much needed integration and cooperation between small scale and large scale industries.

3. Labour Management Relations : The Government felt the need for granting a share of profit to labourers.

4. Foreign Capital : The Government regarded the foreign capital as necessary for rapid industrialization but it felt that the conditions for its participation in Indian industries were to be regulated in the national interest.

5. Taxation Policy : would be so framed as to stimulate thrift and production and achieve just distribution of wealth.

6. Tariff Policy : would be so enforced as to prevent competition and utilize the national resources fully and efficiently.

13.4 THE INDUSTSRIAL POLICY 1956

Important provisions of the 1956 were,

New classification of industries . The resolution laid down three categories which bear a close resemblance to the earlier classification, but were more defined and were broader in coverage as to the role of the State. These categories were :-

Schedule A : those which were to be an exclusive responsibility of the state:

Schedule B : those which were to be progressively state-owned and in which the state would generally set up new enterprises, but in which private enterprise would be expected only to supplement the effort of the state: and

Schedule C: all the remaining industries and their future development would, in general be left to the initiative and enterprise of the private sector.

Under Schedule A were listed seventeen industries arms and ammunition, atomic energy, iron and steel, heavy castings and forgings of iron and steel; heavy machinery required for iron and steel production, for mining, for machine tool manufactures: etc.. heavy electrical industries; coal; mineral oils, mining; iron ore and other important minerals like copper, lead and zinc; aircraft: air transport, railway transport, shipbuilding: telephone, telegraph and wireless equipment, generation and distribution of electricity.

Under Schedule B, twelve industries were : other mining industries, aluminum and other non-ferrous metals not included in Schedule A; machine tools, tool steels, the chemical industry; antibiotics and other essential drugs; fertilizers; synthetic rubber, carbonization of coal', chemical pulp: road transport and sea transport.

13.5 THE INDUSTSRIAL POLICY, 1991

The Government headed by Mr P.V. Narasimha Rao, announced a new industrial policy which sought to drastically alter the industrial scenario in our country on 24th July 1991. There are several fundamental departures in the new policy. The most important initiatives are with respect to the virtual scrapping of industrial licensing and registration policies, on end to the monopoly low and a more welcoming approach to foreign investments, apart from redefining the role of the public sector.

Objectives :

The objectives of the New Industrial Policy are,

a. Self-reliance to build on the many sided gains already made.

b. Encouragement to Indian entrepreneurship, promotion of productivity and employment generation.

c. Development of indigenous technology through greater investment in R & D and bringing in new technology to help Indian manufacturing units attain world standards.

d. Removing the regulatory system and other weaknesses.

e. Increasing the competitiveness of industries for the benefit of the common man.

f. *Incentives for the industrialization of backward areas.*

g. Enhanced support to the small-scale sector.

h. Ensure running of public sector undertakings. (PSUs) on business lines and cut their losses. i.i. Protect the interests of workers.

j. To link Indian economy to the global market so that we acquire the ability to pay for make us less dependent on aid.

In pursuit of the above objectives, the Government has decided to take a series of initiatives respect of the policies relating to the following areas:

A. Industrial Licensing

B. Foreign Investment

C. Foreign Technology Agreements

D. Public Sector Policy

E. MRTP Act

A. Industrial Licensing :

Industrial licensing is governed by the Industries (Development & Regulation) Act, 1951 Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalized from time to time. In order to achieve the objectives of the strategy for the industrial sector for 1990 and beyond, it is necessary to make a number of changes in the system of industrial approvals, Major policy initiatives and procedural reforms are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgment. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policy and procedures must be geared to assisting entrepreneurs in their efforts.

The industrial licensing system has been gradually moving away from the concept of capacity licensing. The system of reservations for public sector undertakings has been evolving to the ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. As a whole, the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful placed in the world of industrial progress.

B. Foreign investment Policy :

The salient features were as follows,

1. Approval will be given for direct investment up to 51% in equity in high priority industries as against the present 40% equity in FERA which was later on amended
2. There shall be no bottlenecks of any kind in the clearance of proposals, for foreign equity participation.
3. The payment of dividend would be monitored through the Reserve Bank of India so as to ensure that outflows on account of dividend payments are balanced by export earnings over a period of time.

4. A Special empowered board would be set up to negotiate with a number of large International firms and approve foreign investment in selected areas.

5. Investment of foreign firms would be considered in totality free from predetermined parameters or procedures.

C. Foreign Technology agreements:

With a view to injecting the desired level technological dynamism in Industry, government would provide automatic approval of technology agreements related to high priority industries within specified parameters. No permission will be necessary for hiring of foreign technicians, foreign testing of indigenously developed technologies.

D. Public Sector Policy:

The Industrial policy gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which has a commanding role in the economy. Some of the features are as follows,

1. Portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure.
2. While reservation of industries for the public sector would be continued, there would be no bar for opening such areas to the private sector selectively.
3. The public sector will also be permitted to enter areas not reserved for it.
4. A social security mechanism will be created to protect the interest of workers likely to be affected by such rehabilitation packages.
5. In order to raise resources and encourage wider public participation, part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers.
6. The boards of directors of public sector companies would be made more professional and given greater powers.

E. Monopolies and Restrictive Trade Practices Act (MRTP ACT) :

The interference of the government through the MRTP Act in investment decisions of large companies has become deleterious in its effect on India's industrial growth. The pre-entry scrutiny of investment decisions by the so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopoly houses to obtain prior approval of the Central government for expansion, establishment of new undertakings, mergers, amalgamation and take over and the appointment of certain

directors. The thrust of policy will be more on controlling unfair or restrictive business practices, The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and the establishment of new undertakings. The provisions relating to merger, amalgamation, and takeover will also be repealed.

Similarly, the provisions regarding restrictions on the acquisition of and the transfer of shares will be appropriately incorporated in the Companies Act. Simultaneously, provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices.

13.6 MERITS OF 1991 POLICY

1. The 1991 Policy Statement is truly historic, whether it is the result of IMF pressure, ,or our own realization that the time has come to open up the economy.
2. The changes, long overdue, need to be welcomed as a bold initiative aimed of making Indian Industry more competitive internally as well as internationally and at freeing the industry from needless and irksome controls, most of which have outlived their utility.
3. The deli censing of a host of industries and the abolition of all registration schemes will free Indian entrepreneurs from the need to make endless trips to New Delhi. They can now concentrate on their business and move quickly to seize business opportunities.
4. The scrapping of any asset threshold or market shore prescription for the definition of an MRTP company and a dominant undertaking allows companies to go ahead with investment programmes without delay.
5. The liberalization of the rules relating to direct foreign investment, permitting 51 per cent equity in a wide range of industries, the easier facilitation of foreign technology agreements and other related measures go a long way in attracting foreign investment and technology.

13.7 EXPORT-IMPORT POLICY

Over the years the year the foreign trade structure and policies of the countr4y have gone through a sea- change. In the initial plan period the emphasis was on import substitution. This policy was thought of as a means of strengthening the external balance of payments and as a means of enabling the nation to develop its core industrial sector.

Since then the Government India had to change the route and a major emphasis on a policy of economic liberalization and globalization was placed. It put great onus on promoting exports as they are vital for a developing country like India. This has led to promulgation of a new export policy as host of incentives and benefits for exporters. For this purpose the sound foreign trade policy of India should be so framed to achieve the following objectives,

a. to restrict the imports to essential items b. To promote the exports substitutes by encouraging domestic producers.C. to promote the exports of traditional as well as new items. d. To encourage the fair distribution of goods at reasonable rates. On the whole the foreign trade policy should primarily aim at promoting exports and restricting imports.

13.8 EXPORT IMPORTJ POLICY DURING PLAN PERIOD

The needs of massive programme of industrialization in the second plan led to adoption of a liberal import policy in mid 50,s . Imports went up sharply both in the private and public sectors. During this period, it was felt that export earnings could not be significantly increases unless industrialization gathered momentum. This fact was given expression in the following words ‘ India’s export earnings are derived from a few commodities.

Later on the Government appointed the import and export policy committee headed in 1962 to review Government’s trade policy. The committee felt that developmental and maintenance imports were both essential for a growing economy and therefore, urged upon the govt. to provide facilities for the import of raw materials, components, etc., for all existing Industries.

13.9 EXPORT ORIENTED EXPORT - IMPORT POLICY

Since 1975-76, the Government has been following a liberalized import policy with the objective of increasing production, especially export production, There has been an increased emphasis on maintenance imports in order to promote capacity utilization. Since the principal purpose of the import policy was to encourage exports, it is characterized as export-oriented import policy.

Exim Policy 1985

For the first time the Government announced the policy on three year policy on the 12th July 1985. The basis aim of the new policy was to facilitate production through easier and quicker access to imported inputs, impart continuity and stability of exim policy.

Export-Import Policy (1990) :

The Government announced on April , l990 a new exim policy for a period of 3 years. The new policy has therefore provided further momentum to the ongoing process of liberalization with emphasis on strengthening the impulses of industrial and export growth.

High lights of Exim Policy 1992-1997 :

In tune with the ongoing reforms process, the amendment in exim policy (1992-97) announced on March 31,1995 further liberalized the import regime with special emphasis on boosting the domestic manufacturing sector.

13.10 EXIM POLICY 1997-2002

The new exim policy focuses on liberalization, openness, transparency and globalization. Our approach to eximpolicy for the ninth plan aims at consolidating the gains made so far, restructuring in the changed trading environment. The existing export promotion schemes such as advance license and the EPCG schemes have been revamped restricted.

Exim Policy 2002-2007 :

The new Exim policy 2002-2007 is primarily guided to meet the imperatives of globalization. It has mainly focused on three aspects, 1. Small scale sector 2. Agricultural Sector. 3. Export oriented special economic zones (SEZs). The export promotion schemes are now further improved and more innovative schemes are being introduce. In

the new regime of multilateral trade rules the quantitative restrictions on importation of any product is prohibited.

13.11 EXIM POLICY 2009-2014

Highlights :

1. Higher support for market and product diversity
2. technological up gradation
3. Support for green products and products from north east
4. status holders
5. Stability, continuity of the Foreign trade Policy
6. Marine sector, .Agriculture sector, Leather sector , Tea Handlooms, Pharmaceutical sectors
7. EOUs
8. Flexibility provided to exporters
9. Waiver of incentives recovery
10. Simplication of procedures
11. Reduction of Transaction costs
12. Directorate of Trade Remedy Measures

13.12 SUMMARY

The industrial policy covers the procedures, principles, rules and regulations which inputs the industrial establishments of a country and shape the pattern of industrialization. The first industrial policy of the Government of India was passed in the year 1948. Subsequently Industrial policy resolutions were announced in 1956 ,1980, 1990 and 1991. The progress in industrial policy reforms, enabled the country to pass through a long but successful journey. The policy changes brought out after 1991, have been announced in the form of press notes by the Department of Industrial policy and promotion.

13.13 KEY WORDS

1.Industrial Policy

2. Industrial Licensing

3. Exim policy

4. Foreign Investment Policy

5.MRTP

6. Foreign Technology Agreements

7. Liberalisation

8. Globalisation

9.Public sector policy

13.14 SELF ASSESSMENT QUESTIONS

1. Critically examine the new Industrial Policy 1991.

2.Write a note on the highlights of new industrial policy 1948.

3. Explain the significance of the Industrial policy 1956.

4. Discuss the main objectives of Industrial licensing policy.

5. Prepare a note on Foreign Investment policy.

6. What are the highlights of Exim policy 1997-2002

7. Bring about the importance e of Exim policy 2009-14

8. Write a short note on Public sector Policy.

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UNIT-14 : INDUSTRIAL (DEVELOPMENT & REGULATION) ACT, 1951,

Structure

14.0 OBJECTIVES

After studying this unit you are able to understand about,

- examine the significance of Industrial Licensing
- discuss the salient features of Industrial (D&R) Act,1991
- explain impact of New industrial policy,1991
- explain Constitution and functions of Central advisory Council
- elaborate Objectives of Industrial Licensing

14.1 INTRODUCTION

The Industrial (Development &Regulation) Act, seeks to secure planned industrial development of the country by regulating, controlling and developing industries that are included in the First schedule to the Act. Regulation of industries is sought to be achieved by means of registration of existing industrial undertakings, licensing of substantial expansion, production of new articles, change of location of existing undertakings, etc. control over these industries is sought to be achieved by causing investigation into the working of these industries and taking over of their management and control. Development of these industries on the other hand, in sought to be secured primarily through the agencies of Central Advisory Council and Development Councils and by offering certain facilities as the government may think fit to be necessary for the development of the scheduled industries.

14.2 OBJECTIVES OF THE ACT

The act has 3 important objectives,

1. **Implementation of the industrial policy:** the act provides necessary means to the central government in order to implement its industrial policy.
2. **Regulation and development of important industries:** the act brings under the control of the Central Government the development and regulation of the number of important industries listed in the first schedule attached to the act as the activities of such industries will affect the country as a whole.
3. **Planning and future development of new undertakings:** a system of licensing is introduced under the act to regulate planning and future development of new

undertakings of sound and balanced lines as may be deemed expedient in the opinion of the central government.

14.3 SCOPE OF THE ACT

This act has brought under the central control the government and regulation of a number of important industries, the activities of which affect the country as a whole and the development of which must be governed by economic factors of all India import. The planning of future development on sound and balance lines is sought to be secured by the licensing of all new undertakings by the Central Government. The act confers on government power to make rules for the registration of existing undertaking, for regulating the production and development of the industries in the schedule and for consultation with state governments on these matters.

14.4 SALIENT FEATURES OF THE ACT

2.4 The Central Advisory Council and the Development Councils :

Section 5: establishment and constitution of central advisory council and its functions:

1. For the purpose of advising it on matters concerning the development and regulation of scheduled industries, the central government may, by notified order, establish a council to be called the central advisory council.
2. The advisory council shall consist of a chairman and such other members, not exceeding thirty in number, all of whom shall be appointed by the central government from among persons who are in its opinion capable of representing the interests of –

a. Owners of industrial undertakings in scheduled industries.

b. Persons employed in industrial undertakings in scheduled industries

c. Consumers of goods manufactured are produced by scheduled industries

d. Such other class of persons including primary producers, as in the opinion of the central government, ought to be represented on the advisory council.

Section 6: establishment and constitution of development councils and their functions:

1. the central government may by notified order, establish for any scheduled industry or group of scheduled industries,a body of persons to be called a development council which shall consist of members who in the opinion of the central government are-

a. Persons capable of representing the interests of owners of industrial undertakings in the scheduled industry or group of scheduled industries.

b. Persons having special knowledge of matters relating to the technical or other aspects of the scheduled industry or group of scheduled industry.

c. Persons capable of representing the interest of persons employed in industrial undertakings in the scheduled industry or group of scheduled industries.

d. Persons not belonging to any of the aforesaid categories, who are capable of representing the interests of consumers of goods manufactured or produced by the scheduled industry or group of scheduled industries.

2. A Development Council shall perform such functions of a kind specified in the second schedule as may be assigned to it by the central government and for whose exercise by the development council it appears to be central government expedient to provide in order to increase the efficiency or productivity in the schedule industry or group of scheduled industries. For which the development council is established, to improve or develop the service that such industry or group of industries renders or could render to the community, or to enable such industry or group of industries to render such service more economically.

14.5 REGULATION OF SCHEDULED INDUSTSRIES

As per section 10: registration of existing industrial undertakings

1. The owner of every existing industrial undertaking, not being the central government, shall, within such period as the central government may, by notification in the official gazette fix in this behalf with respect to industrial undertaking generally or with respect to any class of them, register the undertaking in the prescribed manner.

2. The central government shall also cause to be registered in the same manner every existing industrial undertaking of which it is the owner.

3. Where an industrial undertaking is registered under this section there shall be issued to the owner of the undertaking or the central government, as the case may be, a certificate of registration containing the productive capacity of the industrial undertaking and such other particulars as may be prescribed.

Licensing of new industrial undertaking

As per Section 11:

1. No person or authority other than the central government, shall after the commencement of this Act, establish any new industrial undertaking except under and in accordance with a license issued In that behalf by the central government:

Provided that a government other than the central government may with the previous permission of the central government, establish a new Industrial undertaking.

2. asilence or permission under sub-section :

(1) may contain such conditions including in particular, condition as to the location of the undertaking and the minimum standards in respects of size to be provided therein as the central government may deem fit to impose in accordance with the rules, if any, made under section 30.

Section 11-A.

license for producing or manufacturing new articles.- the owner of an industrial undertaking not being the central government which is registered under section 10. Or in respect of which a license or permission has been issued under section 11 shall not produce or manufacture any new articles unless-

a. In the case of an industrial undertaking registered under section 10, he has obtained a license for producing or manufacturing such article, and

b. In the case of an industrial undertaking in respect of which a license of permission has been issued under section 11, he has had the existing license or permission amended in the prescribed manner.

Section 11-B.

Power of central government to specify the requirements which shall be complied with by small scale industrial undertakings-

1. the central government may with a view to ascertaining which ancillary, and small scale industrial undertakings need supportive measures, exemptions or other favorable treatment under this Act to enable them to maintain their viability and strength so as to be effective in-

a. promoting in a harmonious manner the industrial economy of the country and easing the problem of unemployment, and

b. securing that the ownership and control of the material resources of the community are so distributed as best to sub serve the common goods.

Section 12: revocation and amendment of licenses in certain cases

If the central government is satisfied either on a reference made to it in this behalf or otherwise, that any person or authority, to whom or to which a license has been issued under section 11, has without reasonable cause, failed to establish or to take effective steps to establish the new industrial undertaking in respect of which the license has been issued within the time specified there fore or within such extended time as the central government may think fit to grant in any case, it may revoke the license.

Section 13: further provision for licensing of industrial undertaking in special cases:

1. No owner of an industrial undertaking, other than the central government shall-

a. In the case of an industrial undertaking required to be registered under section 10, but which has been registered within the time fixed for the purpose under that section, carry on the business of that undertaking after the expiry of such period, or

b. In the case of an industrial undertaking the registration in respect of which has been revoked under section 10-A, carry on the business of the undertaking after the revocation, or

c. In the case of an industrial undertaking to which the provisions of this Act did not originally apply but become applicable after the commencement of this Act for any reason, carry on the business of the undertaking after the expiry of 3 months from the date on which the provisions of this Act became so applicable, or

d. Effect any substantial expansion of an industrial undertaking which has been registered or in respect of which a license or permission has been issued, or

e. Change the location of the whole or any part of any industrial undertaking which has been registered;

Except under, and in accordance with, a license issued in that behalf by the central government, and in the case of a state government, except under and in accordance with the previous permission of the central government.

2. the provisions of sub-section (2) of section 11 and of section 12 shall apply, so far as may be, in relation to issue of licenses or permissions to any industrial undertaking referred to in this section as they apply in relation to the issue of license or permissions to a new industrial undertaking.

Section 14: Procedure for the grant of license are permission-

Before granting any license or permission under section 11-A, section 13 or section 29-B, the central government may require such officer or authority as it may appoint for the purpose, to make a complete investigation in respect of applications received in this behalf, and report to it the result of such investigation and in making any such investigation, the officer or authority shall follow such procedure as may be prescribed.

Section 15: power to cause investigation to be made into scheduled industries or industrial undertaking-

Where the central government is of the opinion that-

a. in respect of any scheduled industry or industrial undertaking or undertakings.

i) there has been, or is likely to be a substantial fall in the volume of production in respect of any article or class of articles. Relatable to that industry or manufactured or produced in the industrial undertaking or undertakings, as the case may be, for which having regard to the economic conditions prevailing there is no justification; or

ii) there has been, or is likely to be, marked deterioration in the quality of any article or class of articles relatable to the industry or manufactured or produced in the industrial undertakings as the case may be, which could have been or can be avoided; or

iii) there has been or is likely to be a rise in the price of any article or class of articles relatable to that industry or manufactured or produced in the industrial undertakings as the case may be, for which there is no justification; or

iv) it is necessary to take any such action as is provided in this chapter for the purpose of conserving any resources of national importance which are utilized in the industrial undertaking or undertakings, as the case may be; or

b. any industrial undertaking is being managed in a manner highly detrimental to the scheduled industry concerned or to public interest; the central government may make or cause to be made a full and complete investigation onto the circumstances of the case by such person or body of persons as it may appoint for the purpose.

Section 19: Powers of inspection:

1. For the purpose of ascertaining the position of working of any industrial undertaking or for any other purpose mentioned in this Act or the rules made thereunder, any person authorized by the central government in this behalf shall have the right-

a. to enter and inspect any premises.

b. to order the production of any document, book, register or record in the possession or powers of any person having the control of, or employed in connection with, any industrial undertaking; and

c. to examine any person having the control of, or employed in connection with, any industrial undertaking.

2. any person authorized by the central government under sub-section(1) shall be deemed to be a public servant within the meaning of section 21 of the Indian Penal Code, 1860.

14.6 INDUSTRIAL LICENSING

Objectives of industrial licensing :

A license of a written permission issued by the central government to an industrial undertaking stating such details as the location, the article to be manufactured, production capacity and other relevant particulars. It is also subject to a validity period within which the licensed capacity should be implemented.

The main objectives of licensing are:

- To limit industrial capacity within the targets set by the plans;
- To direct investment in industries according to plan priorities;
- To regulate the location of industrial units so as to secure a balanced regional development;
- To prevent both monopoly and concentration of wealth;
- To protect small-scale industries against undue competition from large-scale industries;
- To foster technology and economic improvement in industries by ensuring units of economic size and adopting modern processes; and

- To encourage new entrepreneurs to start industrial units, thus broadening the entrepreneurial base.

The major objective of licensing is to give effect to the industrial policy of the government. Any change in the industrial policy, therefore, will have its repercussions on the licensing system.

14.7 THE INDUSTRIAL LICENSING POLICY

According to the Industries [Development and Regulation] act of 1951, new industrial undertakings were required to obtain a license, during the period of 15 years of its operation, it was found that the Act had not served its purpose in full. Certain weaknesses were pointed out in its working.

Firstly, only certain regions were preferred in the location of the new industrial units

Secondly, many large and medium sized industrial groups were able to secure too many licenses for industrial units.

Thirdly, the large industrial houses were also able to obtain large funds from the public sector financial institutions like the I.F.C and I.D.B.I they therefore were able to become richer and powerful. Therefore, the government felt the necessities of revising the industrial licensing policy. This problem was studied by the Mahalnobis committee of distribution of income and levels of living [1960], the monopolies enquiry commission [1964], and the industrial licensing policy enquiry committee [1967] popularly known as Dutt committee as a result, the industrial licensing policy was modified and the new policy was announced by the government on February 18, 1970.

14.8 THE NEW INDUSTRIAL LICENSING POLICY (FEBRUARY 1970)

This policy [February 1970] aimed at curbing the monopolies.

The main features of this policy were as follows:

1. The industries are divided into 3 parts:

   a. course sector,

   b. middle sector,

   c. De- licensed sector including the small sector.

2. The course sector consist of basic, critical and strategic industries, it includes industries included in schedule 'A' of the Industrial policy of 1956. These industries would continue to be exclusively in the public sector.

3. In the middle sector, industries involving investments between Rs. 1crore and Rs. 5 crores will be permitted and license will be liberally given to all the entrepreneurs except large industrial houses.

4. Licenses per undertaking belonging to large industrial houses and foreign groups will be given for normal expansion where such expansion is necessary to achieve greater costs efficiency.

5. New undertakings or substantial expansion of units requiring investments of Rs. 1 crore or less are not required to take any license, subject to certain conditions.

6. The middle and the decentralized sectors will be open for all classes of entrepreneurs in the private sector. However, the small sector is to be reserved for small entrepreneurs and large industrial houses cannot enter them.

7. As regards the agro- industries such as processing, sugarcane, jute and other agricultural commodities, preference in licensing will be given to co-operative sector.

8. All new investments of over Rs. 5 crores will be deemed to be the heavy investment sector. The large industrial houses and foreign concerns will participate in the establish of industries in the heavy investment sector as well as in crore sector, except in Schedule 'A' industries.

9. The scope of the public sector should be substantially expanded beyond the fields included in the Industrial policy of 1956. Formerly, the government was expected to undertake basic and key industries. Now it can undertake even consumer goods industries as well.

10. The new policy also clearly points out the method to be adopted by the public financial institutions for providing financial assistance. They should have the option of converting the loans given by them into equity share capital so that they may have an active say in the management of the borrowing undertakings.

14.9 NEW INDUSTRIAL LICENSING POLICY [February 1973]

The government noticed some serious imbalances in the pattern of industrial growth in th country in the last few years and was therefore compelled to revise its industrial policy so as to correct these imbalances. In order to correct these imbalances, the government of India announced its new industrial licensing policy in February 1973.

The main features of this policy were as follows:

1. Hence forward, all industrial units with assets worth not less than Rs. 20 crores would be deemed to be larger industrial houses as laid down by the monopolies and Restrictive Trade Practices Act of 1969.
2. The core industries of importance to the national economy in the future and industries with direct linkages with such core industries and industries with long-term export potential were considered as basic, critical and strategic importance.
3. Foreign concerns and subsidiaries and branches of foreign companies would also be eligible to participate in the industries in the above mentioned lists along with other applicants,
4. Co- operatives and small and medium entrepreneurs would be encouraged to participate in the production of mass consumption goods with public sector also taking an increasing role.
5. The central and state governments would continue to take active participation as at present either directly or through their corporations with the private parties. This will be the 'joint sector'. The joint sector units have already come into existence and many more would be formed in future according to the needs of the plan.
6. The central and state governments would develop 'joint sector' as a promotional instrument in priority areas.

In October 1975, some changes were effected by the governments in its licensing policy so as o make it more liberal. 21 industries were delicensed and permission was granted for unlimited expansion, beyond the liberalized cense capacity, to foreign companies and monopoly houses in 30 other important industries. Again in November 1975, the licensing policy was further liberalized so as to legalize the excess unauthorized Capacity of big business houses.

14.10 LIBERALIZATION OF INDUSTRIAL LICENSING AFTER 1980

The Industrial policy of 1980 made a sea-change in the terms of liberalization of licensing policy in favour of large business houses, particularly in terms of making them free from the provisions of MRTP Act FERA. The major changes introduced were as under:

a. Liberalization of licensed capacity- automatic increase was granted to units wanting to achieve economies of scale and a 49 symbol rise in capacity due to modernization

was allowed. In January 1986, the government relicensed 23 industries for MRTP and FERA companies, provided the industrial undertaking were located in any of the centrally- declared backward areas.

b. Concept of broad-banding introduced- to encourage production and to provide flexibility to the manufactures to adjust their product-mix depending on the market demand, the concept of broad-banding was introduced in a large number of items.

Some of these were machined to, motorized two wheelers, motorized four wheelers, paper and paper pulp, chemical, pharmaceutical, petro-chemical and fertilizer machinery industry and entertainment electronics.

The basic advantage of broad-banding was that licenses issued in terms of broad-category would enable a given undertaking to manufacture any type of item covered so long as total productiondid not exceed the overall licensed capacity.

c. Raising the asset limit of MRTP companies- the threshold asset limit for companies under MRTP Act was raised from Rs. 20 crores to Rs. 100 crores. As a consequence, 112 companies came out of the purview of the MRTP Act. The government also announced its decision to exempt 49 industries from the section 22 A of MRTP Act and FERA.

d. Relaxation of industrial licensing- the number o industries requiring compulsory licensing was reduced from 56 to 26.

14.11 NEW LICENSING PLICY, 1991

The main aim of the new industrial policy was :-

a) To unshackle the Indian industrial economy from cobwebs of unnecessary bureaucratic control,

(b) To introduce liberalization with a view to integrate the Indian economy with the world economy,

(c) To remove restrictions on direct foreign investment as also to free the domestic entrepreneur from the restrictions of MRTP Act, and,

(d) The policy aimed to shed the load of the public enterprises which have shown a very low rate of return or were incurring losses over the years

List of Industries in Respect of which Industrial Licensing will be Compulsory:

1. Coal and lignite. 2, Petroleum (other than crude) and it distillation products 3. Distillation and brewing of alcoholic drinks 4.Sugar 5.animal fats and oils. 6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes 7. Asbestos and asbestos-based products 8. Plywood, decorative veneers, and other wood based products such as particle board, medium density fiber block board 9. Raw hides and skins, leather, chamois leather and patent leather. 10, Tanned or dressed for skills 11. Motor cars 12 Paper and Newsprint except bagasse based units 13. Electronic airospaceand defense equipment; all types. 14. Industrial explosives, including detonating fuse, safety fuse, gun powder. Nitrocellulose and matches 15. Hazardous chemicals. 16. Drugs and pharmaceuticals (according to Drug Policy). 17. Entertainment electronics (VCRs, Colour TVs, C.D. Playerstape Recorders) 18. White goods (Domestic Refrigerators, domestic dish washing machines, programmable domestic washing machines, Microwave ovens, air conditioners)

The compulsory licensing provisions would not apply in respect ofthe small-scale units taking up the manufacture of any of the above itemsreserved for exclusive manufacture in small-scale sector.

b. Areas where security and strategic concerns pre dominate, will continue to be reserved for the public sector.

List of Industries to be Reserved for Public sector:

1. Arms and ammunition and allied items ofdefense equipments, Defense aircraft and warships. 2. Atomic energy. 3. Coal and lignite 4. Mineral oils. 5. Mining of iron ore, manganese ore, chrome ore, gypsum sulphur gold and diamond 6. Mining of copper. lead, zinc, molybdenum and wolfram. 7. Minerals specified in Schedule to the Atomic Energy (Control of production and use) Order, 19538. Railway transport.

(C') In projects where imported capital goods are required, automatic clearance will be given in caseswhere foreign exchange availability is ensured through foreign equity; or if the CIF value of imported capital goods required is less than 25% of total value (net of taxes) ofplant and equipment, upto a maximum value of Rs. 2 crore.

In other cases, imports of capital goods will require clearance from the Secretariat of Industrial Approvals (SIA) in the Department of Industrial Development according to availability of foreign exchange resources.

(D) In locations other than cities of more than 1 million population, there will be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing. In respect of cities with population greater

than 1 million, industries other than those of a non-polluting nature such as electronics, computer software and printing will be located outside 25 kms of the periphery, except in prior designated industrial areas.

14.12 SUMMARY

The New industrial policy, 1991 of the government abolished industrial licensing from July 1991, for all projects except for a short list of 18 industries related to security and strategic concerns, social and environmental reasons, hazardous chemicals and items elitist consumption further, compulsory licensing provision is not applicable to small scale units taking up manufacture of any of the items reserved exclusively for them. The progress in Industrial Policy reforms enabled the country to pass through a long but successful journey. The policy changes brought after 1991 have been announced in the form of press notes by the Department of industrial policy and Promotion.

14.13 KEY WORDS

1. Industrial Policy
2. Industrial Licensing
3. Liberalization
4. Central Advisory Council
5. MRTP
6. Industrial Undertaking
7. Development Council

14.14 SELF ASSESSMENT QUESTIONS

1. What is an Industrial License ?
2. Explain the objectives of Licensing.
3. Bring out the salient features of Industrial (Development & Regulation Act) 1951.
4. Discuss the nature and changes brought about in the licensing systems during 1970-1991.

5. Critically examine the thrusts of the Licensing policies in the 80's and 90,s respectively.
6. Write a note on Licensing of new Industrial Undertaking.
7. Explain the constitution and function of Central Advisory Councils.
8. Elucidate the impact of the New Industrial Policy initiated in 1991.

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UNIT- 15 : COMPETITION LAW

Structure

15.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the historical background of Industrial Policy
- analyze important definitions
- understand about prohibition of Anti-Competitive Agreement
- examine the duties and powers of Competition Commission
- comment on Competition Advocacy

15.1 INTRODUCSTION

Prior to the era of liberalization which started in the year 1991, India followed and policies comprising of laws, rules, regulations and executives orders. The Monopolies and Restrictive Trade Practices Act, 1969 (MRTPAct) was one of the important Act to regulate the competition in India. It was in 1991 that widespread economic reforms were undertaken and consequently the march from command and control economy to an economy based more on free market principles was undertaken. Accordingly there is a need for an effective competition regime.

In this background, India has choose to enact a new competition law called Competition Act, 2002. The MRTP Act has metamorphosed in to the new law, i.e., Competition Act, 2002. The new law designed to repeal the existing MRTP Act.

15.2 HSITORICAL BACKGROUD

Indian Industrial Policy:

India started her quest for Industrial development after independence in 1947. The industrial Policy Resolution of 1948 marked the beginning of the evolution of Industrial Policy, and thereafter with the economic and social development there has been shift in industrial policy from the directed and regulated economy in 1991. The 1948 and 1956 Policy Resolution, to the free market economy in 1991. The 1948 Resolution while defining the broad contours of the industrial policy, delineated the role of the State in the industrial development both as an entrepreneur and as an authority. The 1956 Resolution was to achieve the objective of growth, social justice and self reliance in the industrial sector and defined the parameters of the Government's regulatory mechanism.

Some of the politically induced measures of the seventies like the Bank nationalization, the takeover of the wholesale trade in food grains, the increasing stringency of Government controls through Monopolies and Restrictive Trade Practices Act, 1969 and the Foreign Exchange Regulation Act,1973, increased the control of the Government over the means of production and industrialization.

The Government announced a new industrial policy on the 24th July,1991 which envisaged liberalization and competitive environment. Its main thrust has been to unfetter the spirit of enterprise and expose the economy to greater competition, internal and external. The new industrial policy is a drasticdiversion from the policy laid down in 1956 Industrial Resolution. The basic changes in the new policy relate to industrial licensing, foreign investment and technological collaboration, the role of public sector and the future treatment of large industrial houses governed by the MRTP Act.

The 1991 policy has shifted the emphasis diametrically and dramatically from import substitution to export generation to enable the economy to become more competitive and efficient. This resulted in the introduction of changes in policies relating to industrial licensing, foreign investment, technology imports, governmental ownership of industries and special controls on very large private enterprises. For Industrial Policy, the objectives are to increase the degree of competition between firms, so that there is incentive for raising productivity, efficiency and reduction of costs. Thus July, 1991 saw radical changes in the Government policy relating to trade, investment and economy. All these aim at economic growth and at rectifying distortions and imbalances in the economic structure of the country. The main thrust is to unfetter the spirit of enterprise and expose the economy to greater competition, internal and external.

Competition - Advantages and disadvantages :

The advantages of perfect competition are three fold, they are as follows,

1. Allocative efficiency, which ensures the effective allocation of resources,
2. Productive efficiency, which ensures that costs of production are kept at a minimum ,and
3. Dynamic efficiency, which promotes innovative practices.

Consequently competition offers important benefits, as it stimulates innovation and efficiency, provides the consumer with set of alternatives, enhances product differentiation and better satisfaction of consumer demand.

The need of Competition Regulations ;

In order to ensure a really free competitive market and to assure consumers low prices and high quality that flow from the effective competition, it is necessary to curb abuses of market power. The process of competition should have to be supported by regulations which preclude any attempt at subversion of free trade and competition. Monopoly imposes heavy costs in every society. It is a conspiracy against the public, to raise prices. It hates competition because competition lowers the price to a level which is fair and honest earned under competitive environment. Monopoly is exercised through a collusion between competitors or through market shares gained by buying up or bullying the present competitions out of, and the potential from, the market. It also destroys efficiency and discourages innovation. Competition enhances consumer choice and promotes competitive prices, with the result society as a whole benefits from the best possible allocation of resources. Most countries in the world have enacted competition laws to protect their free market economies- an economic system in which the allocation of resources is determined solely by supply and demand.

In India, The Raghavan Committee report discussed in detail and made recommendations on both Policy and Law of Competition. It recommended that the competition law should cover all consumers who purchase goods or services, regardless of the purpose for which is made. The State monopolies, government procurement and foreign companies should be subject to the competition. Based on the report of Raghavan, later the Competition Law of India was enacted.

15.3 THE COMPETITION ACT, 2002

The Competition Act, 2002, was enacted to provide for the establishment of a commission to prevent practices having adverse effect on competition, to promote and sustain competition in market, to protect the interests of the consumers and to ensure freedom of trade carried by the other participants in markets, in for matters connected therewith or incidental thereto. The Act was amended by the Competition (Amendment) Act ,2007 to provide for the establishment of Competition Tribunal to hear appeal against any direction issued or decision made or order passed by the Competition Commission of India.

Main object of the Act :

The main object of the Act is to promote free competition in India and to protect the interests of the consumers. The object of the Competition policy is as follows, "

Competition policy, in this context, thus becomes instrument to achieve efficient allocation or resources, technical progress, consumer welfare and regulation of concentration of economic power. Competition policy should thus have the positive objective of promoting consumer welfare."

15.4 IMPORTANT DEFINATIONS

1. 'Agreements' includes any arrangements or understanding or action in concert- whether or not such agreement, understanding or action is formal or in writing or whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

2 'Appropriate Tribunal' means the Competition Appellate tribunal established under sub section(1) of Section 53A

3. 'Cartel'includes an association or producers, sellers, distributors, traders or service providers who, by agreement amongst themselves , limit, control or attempts to control the production, distribution, sale or price of, or, trade or provision of services ;

4. 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 consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use

(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 consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first-mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use;

5 'Goods' means goods as defined in the Sale of Goods Act,1930 and includes- products manufactured, processed or mined ; debentures, stocks and shares after allotment; in relation to goods supplied, distributed or controlled in India, goods imported in to India:

6. 'Price', in relation to the sale of any goods or to the performance of any services, includes every valuable considerations, whether direct or deferred, and includes any consideration which in effect relates to the sale of any goods or to the performance of any services although ostensibly relating to any other matter or thing:

7. 'Service' means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial matters such as 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 ;

8. 'Trade' means any trade, business, industry, profession or occupation relating to the production, supply, distribution, storage or control of goods and includes the provision of any services :

15.5 SALIENT FEATURES OF THE ACT

Prohibition of Anti competitive agreements :

1. No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision a services, which causes or is likely to cause an appreciable adverse effect on competition within India

2. Any agreement entered into in contravention of the provisions contained in subsection (1) shall be void.

3. Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which—

(a) Directly or indirectly determines purchase or sale prices;

(b) Limits or controls production, supply, markets, technical development, investment or provision of services;

(c) Shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other Similar way;

(d) Directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition:

Provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or of goods or provision of services.

15.6 ABUSE OF DOMINANCE

The Act does not frown upon dominance, but upon abuse. Abuse of dominance by any enterprises is prohibited. Dominance is the position of strength enjoyed by an enterprise which enables, it to operate independently of competitive pressure in the relevant market and also to appreciably affect the relevant market, competitors, consumers by its actions.

Accordingly, under Sec 4 , no enterprise or group shall abuse its dominant position.There shall be an abuse of dominant position under sub-section (1), if an enterprise or a group- directly or indirectly, imposes unfair or discriminatory – a) condition in purchase or sale of goods or services or b) price in purchase or sale of goods or services :

15.7 REGULATION OF COMBINATIONS

As per sec 6(1) of the Act,

No person orenterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

(2) Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, shall, at his or its option, give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within thirty days of—

(a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section the case by the board of directors of the enterprises concerned with such merger or amalgamation, a case may be;

(b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (h) of that section.

2A No combination shall come into effect until two hundred and ten days which the notice has been given to the Commission under sub-section (2) orders under section 31, whichever is earlier.

3.The Commission shall, after receipt of notice under sub-section (2), deal with the provisions contained in sections 29, 30 and 31.

(4) The provisions of this section shall not apply 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 covenant of a loan agreement or investment agreement.

(5) The public financial institution, foreign institutional investor, bank or venture capital fund, referred to in cub-section (4 1 shall, within seven days from the date of the acquisition, file, in the form as may be specified by regulations, with the Commission the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be.

15.8 ESTABLISHMENT OF COMPETITION COMMISSION OF INDIA

Establishment of Commission : As per Sec.7(1),

With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, a Commission to be called the "Competition Commission of India.

(2) The Commission shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued,

(3) The head office of the Commission shall he at such place as the Central. Government may decide from time to time.

(4) The Commission may establish offices at other places in India.

Composition of Commission (Sec. 8)

As per Sec 8(1) The Commission shall consist of a Chairperson and not less than two and not more than six other members to be appointed by the Central Government:

(2) The Chairperson and every other Member shall be a person of ability, integrity and standing and who,has specialknowledge of, and such professional experience of not less than fifteen years in, international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs, or competition matters, including competition law and policy, which is in the opinion of the Central Government, may be useful to the Commission.

(3) Chairperson and other Members shall be whole-time Members.

Selection Committee for Chairperson and Members of Commission (Sec. 9)

As per Sec (9) (1) The Chairperson and other Members of the Commission shall be appointed by the Central Government a panel of names recommended by a Selection Committee consisting of the Chief Justice of India or his nominee, the Secretary in the Ministry of Corporate Affairs, the Secretary in the Ministry of Law and Justice, and two experts who have special knowledge of, and professional experience in international trade, economics, business, commerce, law, finance, accountancy, management, public affairs or competition matters including competition law and policy.

15.9 DUTIES, POWERS AND FUNCTIONS OF COMMISSION

Sec 18 specifies about the duties of the Commission,

Subjects to the provisions of this Act, it shall be the duty of the commission to eliminate the practices having adverse effect on competition, promote and sustain competition, protect the interest of consumers and ensure freedom of trade carried on by other participants, I markets in India. Provided that the commission may, for the purpose of discharging its duties or performing it functions under this Act, enter into any memorandum or arrangement with the prior approval of the central of the central government, with any agency of any foreign country.

Inquiry into certain and dominant position of enterprise (sec.19)

1. The commission may inquire into any alleged contravention of the provisions contained in subsection of section 3 or sub- section of section 4 either on its own motion or on-

a. Receipt of any information, in such manner and accompanied by such fee as may be determined by regulations, from any person, consumer or their association or trade association; or

b. A references made to it by the central government or a state government or a statutory authority.

2. without prejudice to the provisions contained in sub- section 1. The powers and functions of the commission shall include the powers and functions specified in sub- sections 3. To 7.

3. The commission shall, while determining whether an agreement has an appreciable adverse effect on competition under section 3, have due regard to all or any of the following factors, namely:-

a. Creation of barriers to new entrants in the market

b. Driving existing competitors out of the market

c. Foreclosure of competition by hindering entry into the market

d. Accrual of benefits to consumers

e. Improvements in production or distribution of goods or provision of services

f. Promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

4. the commission shall, while inquiring whether an enterprise enjoys a dominant position or not under section 4, due regard to all or any of the following factors namely:

a. Market share of the enterprise

b. Size and resources of the enterprise

c. Size and importance of the competitors

d. Economic power of the enterprise including commercial advantages over competitors

e. Vertical integration of the enterprises or sale or service network of such enterprises

f. Dependence of consumers on the enterprise

g. Monopoly or dominant position whether acquired as a result of any statute or by virtue of being a government company or a public sector undertaking or otherwise

h. Entry barriers including barriers such as regulatory barriers, financial risk. High capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers.

i. Countervailing buying power

j. Market structure and size of market

k. Social obligations and social costs

l. Relative advantage, by way of the contribution to the economic development, by the enterprise enjoying s dominant position having or likely to have an appreciable adverse effect on competition.

Many other factor which the commission may consider relevant for the inquiry.

5. For determining whether a market constitutes a "relevant market" for the purposes of this act, the commission shall have due regard to the "relevant geographic market" and "relevant product market" A 371

6. The commission shall, while determining the "relevant geographic market", have due regard to all or any of the following factors namely:-

a. Regulatory trade barriers

b. Local satisfaction requirements

c. National procurement policies

d. Adequate distribution facilities

e. Transport costs

f. Language

g. Consumer preferences

h. Need for secure or regular supplies or rapid after- scales services

7. The commission shall, while determining the "relevant product market", have due regard to all or any of the following factors, namely:-

a. Physical characteristics or end use of goods

b. Price of goods or service

c. Consumer preferences

d. Exclusion of in-house production

e. Existence of specialized producers

f. Classification of industrial products

Inquiry into combination by Commission (Sec. 20)

The Commission may, upon its own knowledge or information relating to acquisition referred clause(d) of section 5 or acquiring of control referred to in clause (b) of section 5 or merger or amalgamation referred to in clause (c) of that section, inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India;

provided that the Commission shall not initiate any inquiry under this sub-section after the expiry of one ear from the date on which such combination has taken effect.

(2) The Commission shall, on receipt of a notice under sub-section (2) of section 6, inquire whether a combination referred to in that notice or reference has caused or is likely to cause an appreciable adverse effect on competition in India.

(3) Notwithstanding anything contained in section 5, the Central Government shall, on the expiry of a period of two years from the date of commencement of this Act and thereafter every two years, in consultation with the Commission, by notification, enhance or reduce, on the basis of the wholesale price index or fluctuations in exchange rate of rupee or foreign currencies, the value of assets or the value of turnover, for the purposes of that section

(4) For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely —

a.actual and potential level of competition through imports in the market; (b) extent of barriers to entry into the market; (c.) level of combination in the market; (d) degree of countervailing power in the market. (e) likelihood that the combination would result in the. parties to the combination being able to significantly and sustainably increase prices or profit margins, (f) extent of effective competition likely to sustain in a markettai in a market,

(g) extent to which substitutes are available or arc likely to be available in the market; (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination; (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market; (j) nature and extent of vertical integration in the market; (k) possibility of a failing business; l) nature and extent of innovation; (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have

appreciable adverse effect on competition; (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

15.10 PENALTIES FOR NON COMPLIANCES

The Act contains provisions for punishing contravention of the orders of the Commission, failure to comply with its direction and of the Director general, making false statements or omission to furnish material information. It also provides for offences in relation to furnishing of information.

15.11 COMPETITION ADVOCACY

The Competition Commission of India has a positive advocacy role in shaping policies affecting competition. It is required to give its opinion, when the central government so requests in the course of formulating a policy, on possible effect of such policy on competition. The Commission shall also take suitable measures for the promotion of competition advocacy, creating awareness and imparting training about competition issues.

15.12 COMPETITION FUND

The Act provides for the constitution of Competition fund and the fund shall be applied for meeting,-

1. The salaries and allowances payable to the Chairperson and other members and the administrative expenses including the salaries, allowances and pension payable to the Director General, Additional, Joint, Deputy, Assistant Directors General, the Registrar and other employees of the commission.
2. The other expenses of the commission in connection with the discharge of its functions for the purposes of this Act.
3. The fund shall be administered by a committee of such members of the commission as may be determined by the Chairperson.
4. The committee appointed under sub section 3 shall spend the money of the fund for carrying out the objects for which the fund has been constituted.

15.13 COMPETITION APPELLATE TRIBUNAL

Establishment of Tribunal :

As per sec 53 A

The Central Government shall, by notification, establish an Appellate Tribunal to be known as Competition Appellate Tribunal –

(a) To hear and dispose of appeals against any direction issued or decision made or order by the Commission under sub-sections (2) and (6) of section 26, section 27, section 28, sec31, section 32, section 33, section 38, section 39, section 43, section 43A, section 44, section 45, section 46 of the Act;

(b) To adjudicate on claim for compensation that may arise from the findings of the Commissioner, the orders of the Appellate Tribunal in an appeal against any finding of the Commission order section 42A or under subsection (2) of section 53Q of this Act, and pass orders for the rearm!. of compensation under section 53N of this Act.

The Headquarter of the Appellate Tribunal shall be at such place as the Central Government may by notification, specify,

Appeal to Appellate Tribunal : As per Sec 53(b)-

(l) The Central Government or the State Government or a local authority or enterprise or any person, aggrieved by any direction, decision or order referred to in clause (a) 53A may prefer appeal to the Appellate Tribunal.

(2) Every appeal under sub-section (1) shall be filed within a period of sixty days from the date on which a copy of the direction or decision or order made by the Central Government or the State Government or a local authority or enterprise or any person referred to in that sub-section and it shall tic in such form and be accompanied by such fee as may be' prescribed.

Provided that the Appellate Tribunal may entertain an Appeal after the expiry of the said period of sixty days if it is satisfied that there was sufficient cause for not filing within that period.

(3) On receipt of an appeal under Sub sec (1), the Appellate tribunal may, after giving this parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the direction, decision or order appealed against.

(4) The Appellate Tribunal shall send a copy of every order made by it to the commission and the parties to the appeal.

Procedures and powers of Appellate Tribunal : As per sec 53 0-

(1) The Appellate Tribunal shall not be bound by the procedure laid down in the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act and of any rules made by the Central Government, the Appellate Tribunal shall have power to regulate its own procedure including the places at which they shall have their sittings.

(2) The Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:-

1. Summoning and enforcing the attendance of any person and examining him on oath;
2. Requiring the discovery and production of documents;
3. Receiving evidence on affidavit;
4. Subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872 (1 of 1872), requisitioning any public record or document or copy of such record or document from any office;
5. Issuing commissions for the examination of witnesses or documents;
6. Reviewing its decisions;
7. Dismissing a representation for default or deciding it ex parte;
8. Setting aside any order of dismissal of any representation for default or any order passed by it ex parte;
9. Any other matter which may be prescribed".

Contravention of orders of Appellate Tribunal :

53Q. (I) Without prejudice to the provisions of this Act, if any person contravenes, ground, any order of the Appellate Tribunal, he shall be liable for a penalty one crore or imprisonment for a term up to three years or with both as Magistrate, Delhi may deem fit:

Provided that the Chief Metropolitan Magistrate, Delhi shall not take cognizance of any offence punishable under this sub-section, save on a complaint made by an officer authorized by the Appellate Tribunal.

(2) Without prejudice to the provisions of this Act, any person may make an application to the Appellate Tribunal for an order for the recovery of compensation from any enterprise for any loss or dot shown to have been suffered, by such person as a result of the said enterprise contravening, without any reasonable ground, any order of the Appellate Tribunal or delaying in carrying out such order of the Appellate Tribunal.

15.14 SUMMARY

This enactment is to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interest of the consumers and to ensure freedom of trade carried on by other participants in markets in India and for matters connected therewith or incidental thereto.

15.15 KEY WORDS

a. Anti Competition Agreements

b. Abuse of dominance

c. Combination Regulation

d. CompetitionAdvocacy

e. Competition Commission

f. Goods

g. Services

h. Trade

i. Appellate Tribunal

15.16 SELF ASSESSMENT QUESTIONS

1. Explain the historical background of competition law in India.

2. Write a note on Indian industrial policy.

3. Examine the advantages and disadvantages of competition.

4. Explain the salient features of Competition Act, 2002.

5. Discuss the composition, power and functions of Competition Commission of India.

6. Comment on: Regulation of Competition.

7. Write a note on prohibition of certain agreements, Abuse of dominant position.

8. What is Competition Advocacy?

15.17 REFERENCES

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UNIT-16 : CONSUMER PROTECTION ACT, 1986

Structure

16.0 OBJECTIVES

After studying this unit, you would be in a position to:

- explain the general objectives of the Act
- analysse the history of Consumerism
- trace the objectives of the Act
- examine the constitution, powers and functions of consumer protection Councils
- identify the Consumer Disputes Redrassal Agencies CDRA
- explain the Composition, powers, jurisdiction of adjudicating bodies
- appreciate the Provisions relating to appeals and penalty

16.1 INTRODUCTION

The term consumerism was first coined by business men in the middle of the 1960's because they thought that the consumer movement, like any other movement, is threatening Capitalism. Consumerism may be defined as a collective movement of the consumers to protect their own interest as against the business man. " Consumerism is the organize effert of the consumers seeking redressall, restriction and remedy for dissatisfaction they have accumulated in the acquisition of their standard of living." It is considered as a social force designed to protect consumer interest in the market place by organizing consumer pressures on business. It indicates an attitude of dissatisfaction of the consumers with the marketing practices of the business men. It is also indicates an organized effort of individuals, public, private agencies and government to protect the interest of consumers from the unfair, undesirable and destructive practices of the businessmen.

16.2 GENESIS OF THE ACT

It is said that in a free market economy, a consumer is a king and consumer sovereignty prevails all over the market place. But this idea is now proved to be fallacious. In the real world, consumer is neither the king nor the queen nor does he or she has any supremacy in the free market economy. On the other hand, it is the businessman- whether he be a manufacturer or a wholesaler or a retailer or any other middle man - who is dominant and all powerful. Therefore, the interests of the businessmen prevail over the interests of the consumers: 71 (the need for consumer movement is the consumer

dissonance. The word 'dissonance' means after-purchase doubts, dissatisfaction, disappointment, disillusion and discontent. In most of the cases, consumers, after their purchase, experience the feelings of a dethroned sovereign. In a free market economy, most of the products have sellers' market. In other words, the sellers are in a far better and stronger bargaining position in the market whereas the consumers do not have any voice and even if it is there, it will go unheard and uncared for. A consumer, left alone, is not at all in a position to protect his interest as against 'le businessmen. Hence, theprotection of the interest of the consumers has now become absolutely essential.

The protection which consumers require is of the following types;

1. Physical Protection. Ex: protection against unsafe or harmful products that endanger helath and well- being of the consumers.
3. Protection against unfair and deceptive trade practices.
3. Protection against all types of pollution such as, air pollution, water pollution, etc. resulting in ecological and environmental pollution. Such pollution is caused by the modern factory system, transport system, large scale use of chemicals, fertilizers, etc. and refinery complexes.
4. Protection from monopolies and their restrictive trade practices.

'There have been a number of laws enacted by the Government to safeguards the interest of the consumers. The Essential Commodities Act, Trade and Merchandise Marks Act, Specific Relief Act, Indian Standards Institution Act, Agricultural Produce Act, Prevention of Food Adulteration Act etc. The Indian Penal Code provides punishment for certain offences. The Consumer Protection Act , 1986 marks the growth of the enlightened consumer movement in our country. In intends to provide simple, speedy and inexpensive redressal to consumers grievances, particularly against unfair trade practices of consumers.

16.3 SCOPE OF THE ACT

The main idea behind the Consumer Protection Act is to promote the welfare of the society by securing justice to the consumers to participate directly in the open market economy. The act facilitates the consumers to overcome from various problems relating to goods and services. Many times the goods and services provided are not of merchantable quality, which are unfit for human consumption. In regulating and preventing consumer problems in India, the Consumer Protection Act, 1986 has become a milestone among other socio-economic legislations. The system of trade and commerce in India

is basically rested on trust, honesty and integrity, which are the pillars. The fundamental objective of this Act is to promote and to provide speedy and simple redressal of consumers disputes.

16.4 OBJECTIVES OF THE ACT

The object of the act is given in the preamble of the Act. It says " an Act to make provision for better protection of the interests of consumers and for that purpose to make provision for the establishment of the consumer councils and other authorities for the settlement of the disputes and for matters connect therewith".

The Consumer Protection Act, 1986 seeks to provide for better protection of the interests of the consumers. This Act seeks inter alia, to protect and promote the basic rights of the consumers, which includes, right to safety, right to be informed, right to choose, right to be heard, right to seek redressal, right to consumer education and right to healthy environment.

16.5 EXTENT, COMMENCEMENT AND APPLICATION OF THE ACT

1) This Act may be called the Consumer Protection Act, 1986.

(2) It extends to the whole of India except the State of Jammu and Kashmir.

(3) It shall come into force on such date as the Central Government may be notification appoint and different dates may be appointed for different States and for different provisionsof this Act.

(4) Save as otherwise expressly provided by the Central Government, by notification, this Act shall apply to all goods and services.

If a consumer is not satisfied by the decision of a District Forum, he may apply to the State Commission, against the order of the State Commission, he may approach the National Commission.

16.6 DEFINITIONS

In this Act, unless the context otherwise requires,-

(1) "Complaint" means—

(i) A consumer; or

(ii) Any voluntary consumer association registered under the companies Act, 1956 (1 of 1956), or under any other law for the time being in force; or

(iii) The Central Government or any State Government, who or which makes a complaint;

(iv) One or more consumers where there are numerous consumers having the same interest;

(v) In case of death of a consumer, his legal heir or representative who or which makes a complaint;

(2) "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 consideration paid or promised or partly paid or partly promised or under any system of deferred payment when such use is made with the approval of such person but does not include a person who obtains such goods for resale or for any commercial purpose; or

(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 consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person [but does not include a person who avails of such services for any commercial purpose];

(3) "Consumer dispute'' means a dispute where the person against whom a com plaint has been made, denies or disputes the allegations contained in the complaint;

(4) "Defect" means any fault, imperfection or short coming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or [under any contract express or implied or] as is claimed by the trader in any manner whatsoever in relation to any goods;

(5) "Deficiency" means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service;

(6) "Services" means service of any description which is made available to potential [users and includes, but not limited to, the provision of] facilities in connection with banking, Financing insurance, transport, processing, supply of electrical or other energy, board or lodging or both, [housing construction] entertainment, amusement or the

purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service;

(7) "Trader" in relation to any goods means " a person who sells or distributes any goods for sale and includes the manufacturer thereof, and where such goods are sold or distributed in package form, includes the packer thereof";

(8) "Unfair trade practice" means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:

The practice of making any statement, whether orally or in writing or by visible representation which,

(i) Falsely represents that the goods are of a particular standard, quality, quantity; grade-composition, style or model;

(ii) Falsely represents that the service of a particular standard, quality or grade;

(iii) Falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods;

(iv) Represents that the goods or service have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or service do not have;

(v) Represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have

(vi) Makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services.

16.7 CONSUMER PROTECTION COUNCILS

The Central Consumer Protection Council-

(1) The Central Government shall, establish with effect from such date, a council to be known as the Central Protection Council.

(2) The Central Council shall consist of the following members, namely—

(a) The Minister in charge of the (consumer affairs) in the Central Government, who shall be its Chairman, and

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

Objects :—The main objects of the Central Council shall be to promote and protect the rights of the consumers, such as,

(a) The right to be protected against the marketing of goods and services, 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 [and services] at competitive prices ;

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

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

(f) The right to consumer education

The State Consumer Protection Council.—

The State Government shall, establish, with effect from such date, a Council to be known as the State Consumer Protection Council.

The State Council shall consist of the following members, namely

(a) The Minister incharge of the consumer affairs in the State Government who shall be its Chairman;

(b) Such number of other official or non official members representing such interests as may be prescribed by the State Government.

(c) Such number of other official or non-official members , not exceeding ten, as may be nominated by the Central Government.

Objects of the State Council.—

The objects of every state Council shall be to promote and protect within the State the rights of the consumers.

The District Consumer Protection Council.

The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection council with effect from such date.

The District Consumer Protection Council ,will consist of the following members, namely:

(a) The Collector of the District , who shall be its Chairman; and

(b) Such number of other official and non-official member, representing such interests as may be prescribed by the State Government.

Objects of the District Council.—The objects of every District Council shall be to promote and protect within the district the rights of the consumers.

16.8 CONSUMER DISPUTE REDRESSAL AGENCIES (CDRA)

The main objectives of this agency are to protect and promote the rights of consumers and to provide less expensive and speedy disposal of consumer disputes. Sec.9 of C.P.A 1986 , provides for the establishment of 3-tier Consumer Disputes RedressalAgencies as,

(a) The District forum.

(b) The State Commission

(c) The National Commission

16.9 THE DISTRICT FORUM

Sec 10 of the CPA provides the composition of District forum as follows

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

(b) Two other members who shall be persons of ability, integrity and standing have the adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law , commerce, accountancy, industry public fairs or administration, one of them shall be a woman. So far as a member is concerned , no educational qualification is fixed except for the president. The president and members of the District Forum should be less than 65 years of age. They are appointed by the State Government on the recommendation of the selection committee consisting of

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

(ii) Secretary (Law) to the State (member)

(iii) Secretary (incharge of the department dealing with consumer affairs) in the State (member)

Jurisdiction : It has the jurisdiction to entertain complaints, if the cost of goods or services and compensation asked for is up to Rupees 20 Lakhs.

Where to file a consumer complaint :

A complaint shall be instituted in the District Forum/State Commission/National Commission within the local limits of whose jurisdiction—

(a) The opposite party 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 party(s), at the time of the institution of the complaint, actually and voluntarily resides, or carries onbusiness , or personally works for gain, provided that in such case either the permission of the District forum/State Commission/ National Commission is given, or the opposite party(s) who do not reside, or carry on business , or personally work for gain, as the case may be, acquiesce in such institution, or

(c) The cause of action arises.

WHO CAN FILE COMPLAINTS

The Complaints may be filed with the District Forum/State Commission/National Commission by :-

1. The consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.
2. Any recognised consumer association, whether the consumer to whom goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided, is a member of such association or not.
3. one or more consumers, where there are numerous consumers having the same interest with the permission of the District Forum, on behalf of or for the benefit of, all consumers so interested.
4. The Central or the State Government. Every compliant filed shall be filed along with such amount of fee as may be prescribed.

Tenure of Office

Every member of the District Forum shall hold office for a term of five years or upto the age of 65 years whichever is earlier. The CPA requires both the president and the members of the District Forum to give an undertaking that he does not or will not have any such financial or other interest, which is likely to affect prejudicially his functions as a member. A member of the forum may resign to his post but such resignations become effective only when it is accepted by the competent authority.

Removal of the members

According to Section 30 (2) of the CPA, every State Government has the power to remove the president or member of a District Forum when

(1) He has been adjudged as insolvent; or

(2) He has been adjudged of an offence which in the opinion of the State Government, 'involves moral turpitude': or

(3) Has become physically or mentally incapable of acting as such member; or

(4) Has acquired such financial or other interest as it likely to affect prejudicially his functions as a member; or

(5) Has so abused his position as to render his continuance in office prejudicially to the interest of the public.

16.10 THE STATE COMMISSION

Composition :

The State Commission shall consist of its president and two other members. The president of the Commission shall be a person who is or has been a judge of a High Court, appointed by the State Government concerned after consultation with the Chief Justice of the High Court. The other members of the commissions shall be persons of integrity ,ability and standing to be appointed by the State Government on the recommendation of the Selection Committee consisting of the President of the State Commission ,Secretary of the Law Department of the State and the Secretary, in charge of the department dealing with consumer affairs in the state. The members of the State Commission must have adequate knowledge or experience in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration one among them should be a woman.

It has the Jurisdiction to entertain complaints, If the cost of goods or services and compensation asked for is more than rupees twenty lakh , but less than rupees one Crore.

The State Commission also has the jurisdiction to entertain appeal against the orders of any District Forum within the State.

It also has the power to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State if :-

(a) It appears that such District Forum has exercised any power not vested in it by law

(b) Has failed to exercise a power rightfully vested in it by law

(c) Has acted illegally or with material irregularity.

16.11 THE NATIONAL COMMISSION

Composition :

As per Section 20 , the National Commission consists of ,

(a) The President, who shall be a person who is or has been a judge of the Supreme Court, to be appointed by the Central Government in Consultation with the Chief Justice of India;

(b) Other members (four) who shall be persons of ability, integrity and standing and have adequate experience and knowledge in dealing with the problems relating to economics, law, commerce, accountancy, industry, public affairs or administration. One of whom shall be woman who shall be appointed by the Central Government on the recommendation of the Selection Committee.

It has jurisdiction to entertain complaints—

If the cost of goods or services and compensation asked for exceed rupees one crore then the complaint can be filed before the National Commission at New Delhi.

The National Commission besides entertaining the original complaints also has jurisdiction to entertain appeals against the orders of any State Commission; and 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:

(a) Where it appears to it that such Commission has exercised a jurisdiction not vested in it by law,

(b) Has failed to exercise a jurisdiction so vested

(c) Has acted in the exercise of its jurisdiction illegally or with material irregularity.

Tenure of the Members

Both the President and the four members of the Commission shall hold the office for a term of five years or upto the age of 70 years whichever is earlier.

Limitation Period for filing the complaint:

The Period of Limitation prescribed for the filing of complaints before District Forum, the State Commission, or the National Commission is two years from the date on which the cause of action has arisen. However, if the complainant satisfies the District Forum / State Commission, that he had sufficient cause for not filing the complaint within two years, such complaint may be entertained by it after recording the reasons for condoning the delay.

Powers of Dispute Redressal Agencies:

For the purpose of protecting the interests of the consumers wide discretionary powers are granted under the Act. The District Forum, State Commission and the National Commission are vested with the powers of a civil court while trying a suit in respect of the following matters:-

1. The summoning and enforcing attendance of any defendant or witness examining the witness on oath;
2. The discovery and production of any document or other material producible as evidence;
3. The reception of evidence on affidavits:
4 The requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;
5. Issuing of any commission for the examination of any witness; and
6. Any other matter which may be prescribed.

They also have the power to :-

(i) To issue remedial orders against the opposite party.

(ii) To dismiss frivolous and vexatious complaints and to order the complainant to make payment of costs, not exceeding 10,000 to the opposite party.

16.12 THE REMDEDIES AVAILABLE TO THE CONSUMERS

There are various reliefs available to the consumers under the Act. The District Forum / State Commission / National Commission may pass orders to grant relief to the aggrieved consumer :-

(a) To remove the defect pointed out by the appropriate laboratory from the goods in question

(b) To replace the goods with new goods of similar description which shall be free from any defect

(c) To return to the complainant the price, the charges paid by the complainant

(d) To pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party.

(e) To remove the defects in goods or deficiencies in the services in question

(f) To discontinue the unfair trade practice or the restrictive trade practice

(g) Not to offer the hazardous goods for sale

(h)To withdraw the hazardous goods from being offered for sale

(i) To cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature

(k) To issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement

(l) To provide for adequate costs to parties.

16.13 APPEALS AND PENAL PROVISIONS

(i)Against the orders of District Forums**:**

Any person aggrieved by an order made by the Forum may prefer an appeal to the State Commission within thirty days from the date of the impugned order

(ii)Against the orders of State Commission**:**

Similarly, any person aggrieved by any original order of the State Commission may prefer an appeal to the National Commission within thirty days from the date of the impugned order.

(iii)Against the orders of National Commission**:**

Any person aggrieved by any original order of the National Commission may prefer an appeal to the Supreme Court.

PENALTIES

Failure or omission to comply with any order of the Forum, State Commission or the National Commission by the party against whom such an order is passed is punishable with imprisonment for a term which shall not be less than one month, which may extend to 3 years, or with fine of not less than Rs. 2,000-& it may to up to Rs. 10,000-or with both.

16.14 SUMMARY

This Unit makes an attempt to provide the information regarding consumer, their grievances, their protection and the remedial provisions. Emphasis is also made on various authorities to dispose the consumer disputes speedily with less expenses. This also enlighten regarding the composition, jurisdiction and powers of District Forum, State Commission and National Commission. This bodies established for the purpose of giving proper, speedy remedial measures to all kinds of consumer lastly it throws some light on penal and Appeal Provisions.

16.15 KEY WORDS

- Consumer
- Deficiency of service
- Defect of goods
- Consumer disputes
- Consumer protection councils
- District Forum
- State Commission
- National Commission
- Jurisdiction
- Appeals
- Remedial measures

16.16 SELF-ASSESSMENT QUESTIONS

1. Define Consumer. Explain his rights.
2. Explain Consumer disputes and deficiency of services
3. Examine the powers and functions of consumer protection councils
4. Discuss the composition and jurisdiction and functions of National Commission
5. Explain the jurisdiction and powers of State Commission
6. Elucidate the composition and powers of District Forum
7. Explain the various remedies and reliefs that may be granted under the Act.

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DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

M.B.A I Semester

COURSE - 6

BUSINESS ENVIRONMENT

BLOCK

5

GLOBAL BUSINESS ENVIRONMENT

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BLOCK -5 : GLOBAL BUSINESS ENVIRONMENT

A firm is either operating in domestic market or operating in international market are directly or indirectly influenced by the trends and activities of global business. This block is divided into 4 units.

Unit- 17 focuses on business environment is developed developing and emerging countries, also discusses WTO- agreements. This unit briefly explains the business environment in the global. Further, the unit also discusses WTO arguments and their implications.

Unit- 18 deals with global outsourcing and MNC's. Today all business organisations are concerened with cost minimisation. Thus large organisations deligate some of their activities to someone who can efficiently finish the work without compromising the quality with minimum cost. The unit discusses rational behind outsourcing, gains and losses form outsourcing. Also the unit deals with MNC's, their dominance in the global economy and merits and demerits of MNC's.

Unit- 19 is concerened with FDI and FTAs. A country's economy influenced by the flow of foreign direct investment which helps economy to grow in many aspects. The unit at the outset discusses type of investment, significance of foreign investment and factors affecting international investment. And also the unit throughs light upon FDI in India, 2013 is FDI policy changes. Futher, the unit discusses on India's free trade agreements.

UNIT-17 : GLOBAL BUSINESS ENVIRONMENT, WTO: AGREEMENTS AND ISSUES

Structure

17.0 OBJECTIVES

After studying this unit, you will be able to:

- discuss the business environment in developed, developing countries and emerging markets
- examine the origin of GATT/ WTO
- appreciate the essence of WTO agreements
- discuss the merits and demerits/ criticisms of WTO
- explain the phases of implementation of WTO agreements
- explain implications of the agreements

17.1 BUSINESS ENVIRONMENT IN DEVELOPED COUNTRIES

A developed country, industrialized country, or "more economically developed country" (MEDC), is a sovereign state that has a highly developed economy and advanced technological infrastructure relative to other less industrialized nations. Most commonly, the criteria for evaluating the degree of economic development are gross domestic product (GDP), the per capita income, level of industrialization, amount of widespread infrastructure and general standard of living. Which criteria are to be used and which countries can be classified as being developed are subjects of debate.

According to the united Nations Statistics Division, There is no established convention for the designation of "developed" and "developing" countries or areas in the United Nations system. And it notes that the designations "developed" and "developing" are intended for statistical convenience and do not necessarily express a judgement about the stage reached by a particular country or area in the development process.

Developed countries have post-industrial economies, meaning the service sector provides more wealth than the industrial sector. They are contrasted with developed countries, which are in the process of industrialization, or undeveloped countries, which are pre-industrial and almost entirely agrarian. According to the International Monetary Fund, advanced economies comprise 65.8% of global nominal GDP and 52.1% of global GDP (PPP) in 2010. In 2013, the twelve largest

advanced economies by nominal GDP were the United States, Japan, Germany, France, the United Kingdom, Italy, Canada, Australia, Spain, and South Korea

According to the IMF there are 36 economies classified as "advanced economies" they are;

Australia, Austria, Belgium, Canada, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, Latvia, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Sa Marino, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Taiwan, United Kingdom, United States.

Among these developed countries some countries in the Western Europe began towards a common union in the 1950s. This initiative took off with agreement on reducing coals and steel tariffs, and the greatest success so far has been in the realm of free trade. The multinational organization, called the European Union since 1993, established with 6 countries in the heart of Europe, has been expanded to 25.

The European Union is vital movement counteracting Europe's political fragmentation. The Union is envisioned as a federation with common foreign policy and military force. Most member states have now adopted euro, the EU currency. Growing cross border connectivity characterizes the European Union, especially in Investments, business mergers and labour mobility. Clearly, the economic impetus is toward increased unity, a trend now underway for four decades, through progress politically has come more slowly. Within the zone called the Schengen Group- Germany, France, Italy, Spain, Portugal, the Netherlands, Belgium, and Luxembourg- all passport checks at border crossings have been eliminated. However, not all member countries are moving towards EU integration at the same rate. Scandinavia and the United Kingdom, in particular, are often seen out of step.

In other words, the economic environment in EU countries is different in various regions. In the past, various integration efforts have been blocked by regional politics and referendums. Still some countries have not adopted the common currency- the euro. In the beginning, 12 member countries have adopted the common currency. They are – Belgium, Germany, Greece, Spain, Ireland, Italy, Luxemburg, the Netherlands, Austria, Portugal and Finland. Some of these euro countries were faced sovereign debt crisis which are recovering now. We will discuss this issue in the later unit).

United States was also facing a recession which affected most of the countries in the world, now the United States economy is recovering from the crisis.

17.2 BUSINESS ENVIRONMENT IN DEVELOPING COUNTRIES

A **developing country**, also called a **less-developed country**, is a nation with a lower living standard, underdeveloped industrial base, and low Human Development Index (HDI) relative to other countries. There is no universal, agreed-upon criterion for what makes a country developing versus developed and which countries fit these two categories, although there are general reference points such as a nation's GDP per capital compared to other nations. Also, the general term less-developed country should not be confused with the specific least developed country.

There is criticism of the use of the term developing country. The term implies inferiority of a developing country or undeveloped country compared to a developed country, which many countries dislike. It assumes a desire to develop along the traditional Western model of economic development which a few countries, such as Cuba and Bhutan, choose not to follow. An alternative measurement that has been suggested is that of gross national happiness, measuring the actual satisfaction of people as opposed to how industrialised a country is.

Countries with more advanced economies than other developing nations but that have not yet demonstrated signs of a developed country, are often categorized under the term newly industrial countries.

In common practice, Japan in Asia, Canada and the United States in northern America, Australia and New Zealand in Oceania, and Western Europe are considered "developed" regions or areas. In international trade statistics, the South African Customs union is also treated as a developed region and Israel as a developed country; countries emerging from the former Yugoslavia are treated as developing countries; and countries of Central Europe and of the Commonwealth of Independent States in Europe are not included under either developed or developing regions.

17.3 BUSINESS ENVIRONMENT IN EMERGING MARKET COUNTRIES

An **emerging market** is a country that has some characteristics of a developed market but is not yet a developed market. This includes countries that may be developed markets in the future or were in the past. It may be a nation with social or business activity in the process of rapid growth and industrialization. The economies

of China (excluding Hong Kong and Macau, as both are developed) and India are considered to be the largest. Emerging market hedge fund capital reached a record new level in the first quarter of 2011 of $121 billion. The four largest emerging and developing economies by either nominal or PPP- adjusted GDP are the BRICS countries (Brazil, Russia, India China and South Africa). The next four largest markets are MIKT (Mexico, Indonesia, South Korea, and Turkey), although South Korea is not considered as an emerging market by some sources. Iran is also considered as an emerging market.

The ASEAN- China Free Trade Area, launched on January 1, 2010, is the largest regional emerging market in the world.

17.3.1 Technology

In the 1970s, "less developed countries" (LDCs) was the common term for markets that were less "developed" (by objective or subjective measures) than the developed countries such as the United States, Western Europe, and Japan. These markets were supposed to provide greater potential for profit, but also more risk from various factors. This term was thought by some to be politically incorrect so the emerging market label was created. The term is misleading in that there is no guarantee that a country will move from "less developed" to "more developed"; although that is the general trend in the world, countries can also move from "more developed" to "less developed".

The Center for Knowledge Societies defines Emerging Economies as those "regions of the world that are experiencing rapid informationalization under conditions of limited or partial industrialization." It appears that emerging markets lie at the intersection of non-traditional user behaviour, the rise of new user groups and community adoption of products and services, and innovations in product technologies and platforms.

Julien Vercueil recently proposed a pragmatic definition of the "emerging economies", as distinguished from "emerging markets" coined by an approach heavily influenced by financial criteria. According to his definition, an emerging economy displays the following characteristics:

- **Intermediate income:** Its PPP per capita income is comprised between 10% and 75% of the average EU per capita income.
- **Catching-up growth:** during at least the last decade, it has experienced a brisk economic growth that has narrowed the income gap with advanced economies
- **Institutional transformations and economic opening:** during the same period, it has undertaken profound institutional transformations which contributed to

integrate it more deeply into the world economy. Hence, emerging economies appears to be a by-product of the current globalization.

At the beginning of the 2010s, more than 50 countries, representing 60% of the world's population and 45% of its GDP, matched these criteria. Among them, the BRICS.

The term "rapidly developing economies" is being used to denote emerging markets such as The United Arab Emirates, Chile and Malaysia that are undergoing rapid growth.

1.3.2 International monetary fund list

As of July 16, 2012, the International Monetary Fund (IMF) labels the following countries as "emerging economies":

Argentina, Brazil, Bulgaria, Chile, China, Colombia, Estonia, Hungary, India, Indonesia, Latvia, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Romania, Russia, South Africa, Thailand, Turkey, Ukraine, Venezuela.

World Trade Organisation (WTO)

17.4 INTRODUCTION

The global business environment is very significantly influenced by the World Trade organization (WTO) principles and agreements. They also affect the domestic environment. For example, India has had substantially liberalise imports, including almost complete removal of quantitative import restrictions.

The libelisation of imports implies that domestic firms have to face an increasing competition from foreign goods. Libelisation of foreign investment can result in growing competition from local outfits of MNCs.

These liberalizations, on the other hand, also provides new opportunities for Indian firms as the foreign markets become more open for exports and investments.

The liberalization also enables Indian firms to seek foreign equity participation and foreign technology. This could help them to expand their business or improve competitiveness.

Further, the liberalization facilitates global sourcing by Indian firms so that they can improve their competitiveness. Indian suppliers can benefit from global sourcing by foreign firms.

Firms will have to be efficient and dynamic to survive the global competition. Inefficient firms may go out of business. Consumers stand to benefit significantly from the liberalization.

17.5 GATT and WTO

The rationale of international trade is comparative advantage so that all countries benefit through open and fair international trade. Many countries, particularly South East Asian countries have prospered through exports. In international trade, predictability of rules and regulations governing import, standards, tariffs, customs procedures and so on, are absolutely necessary if there is to be orderly growth of trade. Realizing that trade would suffer if there is no stability, leading trading nations entered into the General Agreement on Tariffs and Trade (GATT) in 1947-48 to ensure orderly and transparent international trade. The fundamental principles of such an Agreement are: (i) Most Favoured Nation (MFN)-every signatory will extend to every other signatory member, the same and equal treatment in a non-discriminatory manner. This is great benefit as all countries whether rich or poor, strong or weak, would be given same treatment by all signatory members and (ii) The second principle is National Treatment which means that imported goods and domestically-produced goods will be treated alike except for the payment of customs duty at the time of import.

Each country has to import and export goods and services. Like India has to import items like petroleum products, edible oils, pulses, electronic goods and gold and machinery. To pay for imports, countries have to earn foreign exchange through export of goods and services. These could range from tea to tobacco, rice to yearn, garments, diamonds, engineering goods, leather and tourism to IT services. Besides, exports provide substantial employment opportunities. In fact, there would be severe setback to employment if exports of many of the items are affected.

General agreement on Tariffs and Trade (GATT) is a multinational treaty that was signed in 1948 by 102 countries with the objective of bringing down tariff and non-tariff barriers to international trade. Until 1994, the main concerns of GATT were to check ‘dumping’ (we will discuss in detail in the later section) and unethical business

practices. The Uruguay Round Agreements of GATT (held during 1986 to 1994) envisaged an increase in the coverage of the legal provisions and establishment of an institution called the World Trade Organization (WTO).

Table 1. Road from GATT to WTO

Year	Place	No. of Countries Participated
1947	Geneva	23
1949	Annecy	13
1951	Torquay	38
1956	Geneva	26
1960-61	Geneva	62
1964-67	Geneva-Kennedy Round	62
1973-79	Geneva-Tokyo Round	102
1986-94	Punta Del Esta to Geneva(Urugauy Round)	123

The World Trade Organisation (WTO) was formed in 1995 with GATT with the objective to help producers of goods and services, exporters, and importers conduct their business internationally. WTO is the only global organization that deals with the rules of trade between nations.

Ministerial Conference held at least once in two years, would be the primary decision-making body of the WTO. The General Council of the WTO is responsible for overseeing regulatory operations and acts as the body for dispute settlement mechanism.

WTO's agreements are negotiated and signed by a large majority of the nations and ratified in their parliaments. These agreements are legal ground rules for international business. Essentially, they are contracts guaranteeing member countries important trade rights. They also bind governments to formulate their trade policies within the framework for the benefit of business firms.

17.6 BENEFITS OF WTO

1. GATT/ WTO has made significant achievements in reducing the tariff and non-tariff barriers to trade. Developing countries too have been benefitting significantly out of it.
2. The liberalization of investments has been fostering economic growth of a number of countries.
3. The liberalization of trade and investment has been resulting in increase in competition, efficiency of resource utilization, improvement in quality and productivity and fall in prices and acceleration of economic development.
4. WTO provides a forum for multilateral discussion of economic relations between nations.
5. It has system in place to settle trade disputes between nations.
6. WTO has a mechanism to deal with violation of trade agreements.
7. WTO does considerable research related to global trade and disseminates a wealth of information.

Drawbacks / Criticisms

As mentioned above, the WTO has been subjected to a number of criticisms. Important drawbacks/ criticisms include the following.

1. Negotiations and decision making in the WTO are dominated by the developed countries.
2. Many developing countries do not have the financial and knowledge resources to effectively participate in the WTO discussions and negotiations.
3. Because of dependence of developing countries on developed ones, the developed countries are able to resort to arms-twisting tactics.
4. Many of the policy liberalizations are done without considering the vulnerability of the developing countries and the possible adverse effect on them.
5. The WTO has not been successful in imposing the organization's disciplines on the developed countries.
6. The developing countries have, in general, been getting a raw deal from the WTO.

It may also noted that it has become a trend to blame WTO even for matters for which it is not responsible.

It is necessary that the developing countries do their home work properly before they go to the negotiating table, stand united to protect their common interest and formulate and implement strategies to combat the threats and to take advantage of the opportunities of the emerging world order.

The tragedy, however, is that not only that the developed countries are not earnestly implementing the provisions of the UR Agreement which will benefit the developing countries, but also they tend to become more protectionist in several respects. The irony is that while the developing countries have been increasingly opening up their markets, the developed countries have been increasing the barriers to the developing countries in several respects.

17.7 WTO AGREEMENTS AND IMPLICATIONS

WTO essentially stands for removing non-tariff barriers in the short run and for reducing tariff rates on imports in the long run. Important agreements of WTO are as follows.

17.*7.1 General Elimination of Quantitative Restrictions (QRs)*

"No prohibitions or restrictions other than duties and taxes whether made effective through quotas, import or export license or other measures, shall be instituted or maintained by any contracting country on the importation of any product of any other member country"(GATT, 1947).

Quantitative Restrictions (QR) refers to limits set by countries to restrict imports (or exports). This could be in the form of quotas, licensing (special import licence, restricted list and canalized list). Canalizing imports refers to allowing only a few firms to import specific items by the government agency responsible for monitoring the respective sector. Thus, QRs are the measures other than duties, taken to restrict imports.

Import tariffs (duties) per se do not prevent entry of products. On the other hand, QRs can be more trade restrictive than tariff measures. Therefore, WTO does not permit member countries to impose QRs under normal circumstances. However, the countries are allowed to impose QRs in a non-discriminatory manner for any of these reasons: (a) to safeguard the balance of payment position (b) as a safeguard measure when there is serious injury to domestic producers (c) restrictions on any agricultural or fisheries product when there is temporary domestic surplus of the product.

As per the agreement, India removed QRs on 1,429 importable items in 2000 and 2001 that has paved the way to import into India without restrictions.

17.7.2 Agreement on Agriculture (AOA)

The original GATT was applicable to agricultural trade, but it had loopholes. The agreement allowed member countries to use some non-tariff measures such as import quotas, and to subsidise. As an outcome of this agricultural trade was highly distorted, especially with the use of export subsidies that normally would not have been allowed for industrial products. Therefore, the reductions in agricultural subsidies were agreed in the Urugay Round, subject to conditions.

The Uruguay agreement was the first significant step towards order, fair competition and a less distorted sector. Participants agreed to initiate negotiations for continuing the reform process. Least developed countries do not have to cut their subsidies or lower their tariffs as much as developed countries, and they were given extra time to complete their obligations. Special provisions have been made keeping in view the interest of the least developed economies.

The AOA has three basic clauses:

(i) Market access

(ii) Domestic support

(iii) Export subsidies

As per AoA, "tariff alone" is the rule for 'market access' in agricultural products. The commitment required conversation of all non-barriers into equivalent tariff rates i.e., levels of protection. For example, if the previous policy meant domestic prices were 75% higher than the world prices, then the new tariff would be around 75%. (This conversion of quotas and other types of measures to tariffs was called "tarification".) The newly committed tariffs, covering all agricultural products, came into effect in 1995. Similarly, Uruguay Round participants agreed that developed countries would cut the tariffs by an average of 36% over a period of six years. While developing countries were to make 24% cuts over a period of 10 years, developing nations facing the problem of balance of payment were not required to cut their tariffs. For products whose non-tariff restrictions have been converted to tariffs, governments are allowed to take safeguard measures in order to prevent falling prices or surges in imports that would hurt their farmers. However, the agreement specified when and how these emergency actions can be introduced.

The Agriculture Agreement distinguishes between support programmes that stimulate production directly, and those that are considered to have no direct effect.

'Domestic Subsidies' that do have a direct effect on production and trade were to be reduced in countries where support exceeded the level specified (using calculations known as "total Aggregate Measurement of Support" or "Total AMS") for the agricultural sector per year in the base years of 1986-88. The subsidy level specified was 5% and 10% of AMS in developed and developing countries respectively. Least developed counties were not required to make any cuts.

There are some categories of support measures that were not subject to reduction. They are

(a) Green Box measures (b) Blue Box measures

(a) Green Box measures are the ones with minimal impact on trade and can be used freely. They include government services such as research, disease control, and infrastructure and food security. They also include payments made directly to farmers that do not stimulate production, such as certain forms of direct income support, assistance to help them restructure agriculture, and direct payments under environmental and regional assistance programmes.

(b) Blue Box measures include indirect payments to farmers where they are required to limit production, certain government-assisted programmes to encourage agricultural and rural development in developing countries and other measures when compared with the total value of the product or products supported (5% or less in the case of developed countries and 10% or less for developing countries).

The Agriculture Agreement also require WTO members to reduce their export subsidies. Developed countries are required to reduce their subsidy by 36% and developing countries by 24%.

17.7.3 Agreement on Textiles and Clothing (ATC) 1995-2004

The member countries of WTO, particularly countries in Europe and America, have removed the quota restrictions on imports of textiles and clothing, as part of implementation of ATC agreement on 1 January 1995. Before the Agreement came into effect, a large part of textiles and clothing exports from developing to the industrial countries was subject to quotas under a special regime.

Till the end of the Uruguay Round, textile and clothing quotas were negotiated bilaterally and governed by the rules of the Multifibre Arrangement (MFA). This provided scope for the application of selective quantitative restrictions when surge in imports of particular products caused serious damage to the industry of the importing country. The

Multifibre Arrangement was a major deviation from the basic GATT principle of non-discrimination. On January 1, 1995, it was replaced by the WTO Agreement on Textiles and Clothing, which set out a transitional process for the ultimate removal of these quotas that prevailed in the form of special import licence, canalized items and so on.

Article 3 of WTO deals with quantitative restrictions (or measures with similar effect) other than those under the MFA. Members who had such restrictions in place (which could not be justified under a GATT provision) were required either to bring them in accordance with GATT rules or phase them out within the ten year transitional period.

Article 5 of the ATC contains rules and procedures regarding circumvention of the quotas through trans-shipment, re-routing, false decoration of origin or falsification of official documents. These required consultation and full cooperation in the investigation of such practices by members concerned. Once sufficient evidence is available, possible recourse might include the denial of entry of goods. There is also a provision whereby all members should establish, consistent with their domestic laws and procedures, the necessary legal provisions to address and take action against circumvention.

The Textiles Monitoring Body (TMB) was established to supervise the implementation of the ATC and ensure that they are in conformity with the rules. It is quasi-judicial standing body which consists of a chairman and ten TMB members, who discharge their functions taking all directions by grouping of WTO members into constituencies. There can be rotation within the constituencies. These characteristics make the TMB a unique institution within the WTO framework.

17.7.4 General Agreement on Trade in services (GATS)

The General Agreement on Trade in Services (GATS) is the first ever set of multilateral, legally-enforceable rules covering international trade in services. It was agreed by WTO member countries in the Uruguay Round. Like the agreements on goods, GATS operates on three levels: the main text containing general principles and obligations; annexes dealing with rules for specific sectors; and individual countries' specific commitments to provide access to their markets. However, unlike in goods, GATS has a fourth special element; lists showing where countries are temporarily not applying the "Most Favoured Nation" principle of non-discrimination. These commitments-like tariff schedules under GATT-are an integral part of the agreement. A WTO Council for Trade

in Services oversees the operations of the agreement. Even as negotiations on commitments have taken place after the Uruguay Round, GATS requires more negotiations. The goal is to take the liberalization process further by increasing the level of commitments in schedules.

The agreement covers all internationally-traded services. GATS classifies services into four categories, they are as follows:

GATS Classification of Services

- Services supplied from one country to another (e.g. international telephone calls), officially known as "cross-border supply"
- Consumers or firms making use of a service in another country (e.g. tourism), officially known as "consumption abroad"
- A foreign company setting up subsidiaries or branches to provide services in another country (e.g. foreign banks setting up operations in a country), and is officially known as "commercial presence"
- Individuals travelling from their own country to supply services in another country (e.g. fashion models or consultants), officially called "presence of natural persons"

Most-Favoured Nation (MFN) treatment: MFN means treating one's trading partners equally. Under GATS, if a country allows foreign competition in a sector, equal opportunities in that sector should be given to service providers from all other WTO members. (This applies even if the country has made no specific commitment to provide companies access to its markets under the WTO). MFN applies to all services, but some special temporary exemptions have been allowed.

Transparency: GATS says that governments must publish all relevant laws and regulations so that foreign companies and governments can use them to obtain information about regulations in any service sector. Similarly, governments have to notify the WTO of any change in regulations that apply to the services that come under specific commitments.

Regulations: Since domestic regulations are the most significant means of exercising influence or control over services trade, the agreement states that governments should regulate services reasonably, objectively and impartially. When a government makes an administrative decision that affects a service, it should also provide an impartial means for reviewing the decision (for example a tribunal).

International payments and transfers: Once a government has made a commitment to open a service sector to foreign competition, it must not normally restrict money from being transferred out of the country as payment for services supplied ("Current transactions") in that sector. The only exception is when there are balance-of-payments difficulties, and even in such cases, the restrictions must be temporary and subject to other limits and conditions.

17.7.5 Agreement on Trade Related Investment Measures (TRIMS)

The Agreement on Trade-Related Investment Measures (TRIMS) recognizes that certain measures can restrict and distort trade, and states that no member shall apply any measure that discriminates against foreigners or foreign products. According, the governments cannot impose measures which require particular levels of local procurement by an enterprise ("local content requirements"). It also discourages measures which limit a company's imports or set targets for the company to export ("trade balancing requirements".)

17.7.6 Agreement on Import Licensing

Although less widely used now than in the past, import licensing systems are subject to disciplines in the WTO. The Agreement on Import Licensing Procedures says import licensing should be simple, transparent and predictable, if there are quantitative restrictions. For example, the agreement requires governments to publish sufficient information for traders to know how and why the licences are granted. It also describes how countries should notify the WTO when they introduce new import licensing procedures or change existing procedures. The agreement offers guidance on how governments should assess applications for licences. The agreement sets criteria for automatic licensing so that the procedures used do not restrict trade. The agreement tries to minimize the importer's burden in applying for licences, so that the administrative work does not restrict or distort imports. The agreement says the agencies handling licensing should not normally take more than 30 days to deal with an application-60 days when all applications are considered at the same time. It is now part of the WTO package signed by all WTO members.

17.7.7 Agreement on the Valuation of Goods at Customs

For importers, the process of estimating the value of a product at customs poses problems that can be just as serious as the actual duty rate charged. The WTO agreement on customs valuation aims for a fair, uniform and neutral system for the valuation of

goods for customs purposes – a system that outlaws the use of arbitrary customs values. However, a related Uruguay Round ministerial decision gives customs administrations the right to request further information in cases where they reason to doubt the accuracy of the declared value of imported goods.

17.7.8 Agreement on Pre-shipment Inspection

Pre-shipment inspection is the practice of employing specialized companies (or'idependent entities') to check shipment details – essentially price, quantity and quality-of goods ordered from overseas. The purpose is to safeguard national interests like prevention of capital flight, commercial fraud and customs duty avoidance.

The WTO agreement recognizes that GATT principles and obligations apply to the activities of pre-shipment inspection agencies mandated by governments. The obligations of exporting members towards countries using pre-shipment inspection include non-discrimination in the application of domestic laws and regulations, prompt publication of those laws and regulations and the provision of technical assistance where requested. The agreement establishes an independent review procedure. It is administered jointly by an organization representing inspection agencies and a body representing exporters. Its purpose is to resolve disputes between an exporter and an inspection agency.

17.7.9 Agreement on Rules of Origin

'Rules of origin' are the criteria used to define where a product was made. Rules of origin are also used to compile trade statistics, and for "made in…" lables that are attached to the products. This agreement requires WTO members to ensure that their rules of origin are transparent and do not have restricting, distorting or disruptive effects on international trade. The agreement aims for common (harmonized) rules of origin among all WTO members, except in some kinds of preferential trade. For example, countries setting up a free trade area are allowed to use different rules of origin for products traded under their free trade agreement.

17.7.10 Agreement on Technical Barriers to Trade (Technical Regulations and Standards)

Technical regulations and industrial standards are important, but they vary from country to country. Having too many different standards make like difficult both for the producers and the exporters. It the standards are set arbitrarily, they could be used as an excuse for protectionism and become obstacles to trade. The Agreement on Technical Barriers to Trade (TBT) tries to ensure that regulations, standards, testing and certification

procedures do not create unnecessary obstacles. The WTO's version is a modification of the code negotiated in the1973-79 Tokyo Round. However, the agreement recognizes countries rights to set the standards they consider appropriate – for example, for human, animal or plant life or health, for the protection of the environment or to meet other consumer interests. In order to prevent too much diversity, the agreement encourages countries to use international standards wheresover appropriate.

The agreement says the procedures used to decide whether a product conforms with national standards have to be fair and equitable. It discourages any methods that would give domestically-produced goods an unfair advantage. The agreement also encourages countries to recognize each other's testing procedures. This way, a product can be assessed to certify if it meet the importing country's standards through testing in the country where it is made. Manufacturers and exporters also ought to know about the latest standards in their prospective markets.

17.7.11 Agreement on Anti-dumping

If a company exports a product at a price lower than the price it normally charges on its own home market, it is said to be "dumping" the product. It disciplines anti-dumping actions, and it is often called the "Anti-Dumping Agreement" we will discuss in detail in the next unit.

17.7.12 Trade Related Intellectual Property Rights (TRIPS)

India has already implemented TRIPS Agreement by launching the product patent system from January 2005 (the country has moved from process patent to product patent regime). Another notable point in this field has been in the passing of TRIPS plus legislation in the field of Copyright Law. The 1994 amendments to the Act of 1957 provide protection to all original literary, dramatic, musical and artistic works, cinematographic films and sound recordings. The most recent changes bring sectors such as satellite broadcasting, software and digital technology under Indian copyright protection.

17.7.13 Information Technology (IT) Agreement

During Singapore Ministerial Conference of WTO, a Ministerial Declaration on Trade Information Technology Products was adopted. This Declaration aims to expand world trade in information technology products. India participated in the negotiations

on the agreement from the early stages and after extensive discussions with trading partners, joined as a participant on April 1, 1997.

17.7.14 Regional Trade Arrangements

Although Regional Trade blocks are based on the principle of discriminatory trade, WTO has a special provision for this. Using this condition, many regional trade groups such as North American Free Trade Area (NAFTA), European Free Trade Area (EFTA), Association of South East Asian Nations (ASEAN), Brazil, Russia, India, China and South Africa (BRICS) and Gulf Co-operative Council (GCC) have been set up. India has been instrumental in setting up the South Asian Association for Regional Cooperation (SAARC), whose major achievement in 1995 was the conclusion of the negotiations on trade preferences within the framework of the SAARC Preferential Trading Arrangement (SAPTA). SAPTA became operational on December 7, 1995 and includes preferential tariff concessions on 226 items and product groups. The Indian Ocean Rim Association for Regional Cooperation was formed along with 13 other countries in the region. Economic cooperation is expected to take place in trade facilitation, promotion and liberalization, promotion of foreign investment, promotion of scientific and technological cooperation, tourism, the movement of natural persons and service provides, and the development of infrastructure of human resources. An enabling clause to identify other areas of cooperation is also included in the agreement. India has also signed sub-regional agreements with Nepal, Bangladesh, Myanmar and Bhutan and more recently with Bangladesh, Sri Lanka and Thailand.

17.8 SUMMARY

A developed country, industrialized country, or "more economically developed country" (MEDC), is a sovereign state that has a highly developed economy and advanced technological infrastructure relative to other less industrialized nations. The European economy is recovering from sovereign debt crisis and Indian economy is not much affected by the debt crisis of Europe. Other developed countries such as USA and other countries were into the financial crisis and these economies are also recovering now. Emerging markets have been attractive destination for the global investment among the emerging markets India and China are the main destinations which attract international capital. Emerging market hedge fund capital reached a record new level in the first quarter of 2011 of $121 billion

The principles and Agreements of WTO have very significant impact on national economies and globalization. The Uruguay round substantially expanded the scope of

multilateral trade negotiation by including services, intellectual property rights (TRIPs) and trade related aspects of investment measures (TRIMs), as against only goods in the past. WTO is GATT plus a lot more. Under the GATT there was only one major agreement-GATT. Under WTO, there are agreements related to three major areas-GATT, GATS and TRIPs. A significant achievement of the UR is the measures to liberalise trade in agriculture, which was a highly protected sector, particularly in the developed countries. These measures are tariffication, tariff binding, tariff cuts and reduction in the subsidies and domestic support.

The Uruguay round agreement seeks to liberalise trade in manufacturing by enlarging tariff bindings, reducing tariffs and removing tariffs. According to UR all member countries are required to adopt product patent (as also process patent). India had only process patent for drugs, food and chemical substances for which the patent period was 7 years and 14 yeas for other products. Under the WTO regime the patent period for all products is 20 years.

As under GATT, under WTO also developing countries, particularly least developed countries, are accorded a number of concessions and favours. Their liberalization requirements are lower and they are allowed longer period to fulfill the liberalization commitments. The WTO also calls upon the developed nations to grant special preferences to imports from developing countries. There are also some commitments under the WTO to look after the interests and special needs of the developing countries.

And there is a general complaint that the fruits of the liberalization accrue mostly to the developed countries. It is pointed out that the industrialized countries, which make up only 20 per cent of the membership, will appropriate about 70 per cent of the additional income generated by the implementation of UR agreements. The losers, mostly in Africa and Caribbean, are some of the poorest countries in the world. The developed countries gain substantially because of their higher level of participation in trade and because of the fact that significant part of liberalization has been in respect of goods of the interest to them. Liberalization of trade in the textiles, by phasing out MFA, however, will substantially benefit the developing countries.

Estimates of India's possible gain from the trade liberalization of trade liberalization vary very widely between $2 billion and $ 7 billion a year. Although the

liberalization of trade in textiles will benefit the developing countries, India's gain will depend a lot on her competitive strength vis-à-vis other textile exporters.

India's gain from the trade liberalization will be much less than that of many other developing countries, such as the South East Asian economies and China, because India's share in the world trade is very low.

17.9 KEY WORDS

Tariffs

Quotat

Licensing

Export,

Anti-dumping

17.9 SELF ASSESSMENT QUESTIONS

1. Discuss the Agreement on Agriculture and its implications.
2. Discuss the Agreement on Textiles and Clothing (ATC) under WTO framework.
3. WTO rules make life easier for all. Do you agree with the statement? Why?
4. Discuss the arguments for and against India's membership of WTO.
5. What is meant by removal of Quantitative Restrictions on imports?

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UNIT - 18 : GLOBAL OUTSOURCING, MNCs

Structure

18.0 OBJECTIVES

After studying this unit, you will be able to:

- discuss Rational behind the Outsourcing.
- analyse the implications of the Business Process Outsourcing
- identify recent developments with reference to Global Outsourcing
- bringout meaning of MNCs and its their role in the global economy
- explain role of multinational companies in Indian economy.

18.1 INTRODUCTION

In a world dominated by Internet, Internet and the IT revolution, business and knowledge no longer have to be homegrown. In this increasingly competitive world, it can be contracted, to reduce the cost and maximize the profit, without compromising on quality and time. Such a contract is known as outsourcing, which is a powerful management tool for redefining and re-energizing any organization. It is useful, not only for maximizing the present profits of the organization, with the existing clientele, but it also relieves and enables employees to work on higher value added jobs. It offers online support services that use the Internet as a platform to build the desired recognition value in the eyes of customers, through good customer servicing. Outsourcing business process helps in taking care of increases profit and time to concentrate on new business avenues. In this unit we will study the background of the meaning, and the extent of global outsourcing in the current economic scenario. It elaborates upon the rationale for outsourcing and illustrates its advantages through the use of economic theory.

18.2 RATIONALE FOR GLOBAL OUTSOUSRCING

Why do everything yourself, when someone else can do it at low cost? In the current scenario, the theory says exactly the same. The global market today is highly competitive and continuously changing. A company must, thus, focus on improving productivity and at the same time, cut down costs. This is the basic premise of outsourcing. Outsourcing works because what is non-core for one organization, is core for another. In brief, business process outsourcing can be seen as a process in which a company delegates some of its in-house operations or processes to a third party. Thus, it is a transaction through which one company acquires services from another, while maintaining ownership and ultimate responsibility for the processes. The company then informs its

provider what it wants, and how it wants the work to be performed. The main motive for business process outsourcing is to allow the company to invest more time, money and human resources into core activities and building strategies, which fuel company growth.

18.3 BUSINESS PROCESS OUTSOURCING

In today's business environment, outsourcing is often not a decision that needs to be justified. BPO companies are often considered to provide more flexible, faster, cheaper and effective services. They help free up a company's capital, and reduce costs. The operations or processes being outsourced vary from manufacturing, to customer service, to software development, and much more. Most of the companies, that are looking to outsource, are multinationals, or companies from western countries and most of the BPO units are in countries such in India, China, Philippines, Malaysia and even Russia.

Outsourcing is a combination of execution, expertise and leadership. The company's proposition is to deliver value to the clients, by bringing operational excellence and functional knowledge to their critical business processes. Outsourcing includes serving several industries, like travel, insurance, financial services, healthcare, professional services, manufacturing, distribution and retail, and providing essential corporate functions, such as finance and accounting, human resources (payroll and benefits administration), research and analytics. Likewise, companies are outsourcing chunks of their administrative work and supporting systems.

According to Webster's 10th Dictionary, the word outsourcing was coined in 1982. It can be defined as the transfer of an organization's entire non-core, but critical, business process/function to an external vendor who uses an IT-based delivery. By doing so, BPO helps an organization to concentrate on its core competencies, improve efficiency, reduce cost and improve shareholder's value.

Though IT outsourcing has been happening for so many years, an increased momentum has been witnessed since the late 1990s, due to the rise of internet and communication technologies. Several global giants from various industries have begun to realize the importance of BPO, and have started outsourcing their non-core business functions. This has given rise to many specialized BPO vendors across the globe, with India being a major hub, owing to its large computer-literate, English-speaking population, low billing rates, strategically favorable time zone and high quality. Throughout Asia as well as globally, India and the Philippines have both been popular destinations for business process outsourcing (BPO) by global companies. And a recent report by consulting firm Tholons shows that this remains to be so. India ranks number one followed by Philippines.

The controversy that outsourcing has resulted in job losses in the USA, is largely seen as more political than economic in India. Ever since the US Senate passed the Bill on banning government outsourcing to foreign countries in January, 2004, there has been a lot of resentment in Indian IT industry. India had 2.8 million citizens employed in the BPO industry as of 2012, while the Philippines had just around 750,000 in the same year. Looking forward, India's information technology industry body NASSCOM anticipates that the sector will generate $50 billion in revenue by 2020. Meanwhile, the Philippines is aiming for $27.4 billion in revenue by 2016. American business themselves, do not want to be restrained in any way from tapping cheaper sources outside the United States. The major US concerns comprise of the prediction that by 2015, roughly 3.3 million US business-processing jobs will have moved abroad. Research suggests that the number of US service jobs lost to off-shoring will accelerate at the rate of 30 to 40% annually, during the next five years. Because of this reason Obama was chanting a mantra 'Say no to Bangalore and yes to Buffalo,'

These fears are without proper basis as a large percentage of jobs in US require the consumer and the retailer to be present in the same place. Any job losses must be seen as a part of economic restructuring, with which the US economy is well acquainted. Liberalised, competitive economies can generally cope with such restructuring. History suggests that over the medium to long term flexible job market and the mobility of US workers will make it possible for the US to create new jobs faster than off-shoring eliminates them.

Most of the jobs created in India are either in call centres or at IT firms. But call companies in both Britain and US suffer from rising staff turnover and struggle to recruit more people. In fact, 'not moving work abroad' would make the companies of developed countries less competitive. By focusing on creation of jobs, they could miss the chance to raise their productivity.

Similarly, the loss of call-centre jobs is a particular concern in Britain's less prosperous regions. Outsourcing does not mean net job losses to Britain. Losses from Britain companies sending work to places like India have been outweighed by gains from foreign companies sending work to Britain. A report by Advanced Institute of Management Research says that as companies increased their outsourcing operations over the past 20 years, Britain greatly benefitted from it. British companies save a minimum of 10 pounds for every 1,000 jobs they move offshore, particularly to India (estimate by the ICICI One Source, an outsourcing agency of India's ICICI Bank).

Most importantly, India has a young population. It is estimated that between 2003 and 2020, India will be adding about 250 million workers to the labour pool. $3.6 billion outsourcing industry in India has emerged as a single biggest employment generator in recent years. In terms of total cost and availability of skilled and semi-skilled manpower, it is difficult for smaller European countries to compete with countries like India,.China and the Philippines.

There are roughly 200 Fortune 500 companies, which outsource work of India. According to NASSCOM (National Association of Software and Service Companies) estimates, over 50% of the Fortune 500 companies have incorporated offshore outsourcing into their strategies, and around 80% of these now use India as their development base. The leading companies in India, in both the IT and BPO industries are fighting hard to win a broader variety of work, particularly higher value activities. Examples include EXL Services, carrying out a broad range of insurance work for British and American firms. ICICI One Source, another Indian BPO Company provides research services for consultants and investment bankers. Wipro and EXL services are applying the same management disciplines, that GE applies to its industrial businesses to the way they provide services.

After the success of IT and ITES, Indian pharma companies are now beginning to recognize the opportunity that outsourcing brings about. The costs of manufacturing, conducting clinical trials and research are at least 50% lower in India than those in the US. Indian companies have started looking at a space between full-time equivalence manufacturing (full time of a facility pledged to the client) and contract research (where a common pool of resources maybe tapped). However, this is as yet an emerging opportunity. India currently has a presence in manufacturing formulations, manufacturing patented products for the formulated market, exporting bulk drugs and contract research. With an estimated USD 55 to 65 billion worth of drugs expected to go off-patent within the next 2 to 3 years, India could potentially capture a good size of this.

18.4 RATIONALE BEHIND OUTSOURCING

According to Forrester Research, 3.4 million jobs will be outsourced by 2015. That may sound enormous, but it implies an annual outflow of only 0.5% of the jobs in the industries affected. In an average year, the American economy destroys some 30 million jobs, and creates slightly more, dwarfing the effects of off-shoring. For example, American radiologists need not be condemned to flipping burgers when their work is shipped to Chennai. They can turn skills to the obesity epidemic, or to the burgeoning

field of plastic surgery. There is, surely, more than enough work to be done. But what is the reason behind using outsourced model, by the traditionally vertically integrated firms, at an increasing rate. The analysis revealed that three main factors are responsible for this change, and they can be identified as:

a. The emergence of world-class service providers. Often, these companies get started, responding to the needs of one or more current customers. But once they do, the marketplace gets defined, and the power of the free-market economy takes over. Before long, it becomes difficult for any organization to justify in-sourcing when their capabilities are tested against a competitive market of specialized providers.

b. Technology. Technology makes much of the work of the modern organization "placeless." It no longer matters where information is processed, where accounting is done or where an 800 number call is answered. Technology is the leading area for outsourcing, but it is just as important as the top enabler of outsourcing. Once the physical barrier of where the work is done is broken, breaking the organizational barrier is a lot easier.

c. Competition. As competition (local, global, and clicks) intensifies, organizations must simultaneously get more efficient and more effective to survive. The idea that in today's hypercompetitive environment any organization can go it alone, even the largest and best funded, is simply naive.

d. Exporting jobs helps to create a balanced global audience. The need to export is particularly true of the technology sector, because the United States is the leader in technological advances. This offers the greatest bargaining power, which equates to greater gains. US companies have a limited customer set, unless they contribute to the improvement of global technology, or at least introduce beneficial elements to other societies and cultures. The overseas markets that might be considered as "taking away our jobs" are product markets in themselves. Out of India's one billion population. 300 million is classified as middle class. This is larger than the entire US population, and represents as enormous marketing opportunity. In China, with a population of 1.2 billion, only about 5% (65 million) are considered middle class. Yet, given that China is early in its explorations into the market economy, this is a significant potential market. Sweetening the pot, India and China offer preferential treatment to companies that participate in their local economies, such as reduced entry barriers, lower taxes or tariffs, and better currency exchange rates.

The basic premise that stems from the free-trade axiom is that when a rich country sends blue-collar jobs overseas, it creates opportunities back home for workers to move up the skill ladder. The more recent corollary is that sending service jobs overseas would do the same for white-collar workers back home. But the rising number of skilled, white-collar jobs migrating from rich nations to developing countries are raising fears that, well-paid workers in developed countries will have trouble finding equally well-paid computer, design and medical jobs at home.

18.5 OUTSOURCING-GAINS AND GAINERS

It becomes essential to study its advantages, and contrast them with it's often harped upon downsides. For much of the developing world, outsourcing is providing hope and vision, after decades of disappointing economic development strategies, pushed by the major industrial nations, including import substitution policies. In a global economy based on skilled services, outsourcing has become the backbone of many efficient, well-organised enterprises. By allowing companies to devote scarce resources to their unique core skills and products, outsourcing can increase revenue, improve cost-effectiveness, and enable organizations to better manage their assets, and redefine their markets. Some clear gains or advantages from outsourcing include:

- **Cost saving:** The foremost reason, and the one driving the outsourcing boom, cost saving. For every dollar of corporate spending that is outsourced, US companies save 58 cents, most of this coming from labour savings, due to the lower wage rates prevalent in the developing nations. This also means that companies in such nations can hire better qualified workers for lesser, and workers in the US. Wage differentials tend to be compelling for skilled jobs too. For software developers for example the ratio between US and India is about 8:1. Thus, cost saving continues to accrue as the companies go higher up on the skills ladder, with their offshore outsourcing.
- **Higher performance**: Not only does outsourcing imply lower costs, in a large number of cases, it also means superior performance and the pairing of savings with distinctive skills. Asia's manufacturing operations attain high levels of performance, and many other skills are more abundant in Asia than in the developed world. China, for example, produces more than 350,000 graduate engineers every year, compared with 90,000 for US engineering schools. Most leading IT outsourcing firms operate at the highest degree of expertise, compared to internal IT departments in the US. China and Taiwan are also developing world class design expertise in specific technologies.

- **Better deal for consumers**: As companies pass on the savings they get from lower costs, in the form of lower prices for their goods, consumers benefit. Global sourcing of components has reduced the cost of IT hardware by upto 30 percent since 1995, boosting demand and adding as much as $230 billion to the US GDP in that period. Lower prices for medical practices and technologies have made them affordable for more people.
- **Increased efficiency**: companies that do everything themselves have much higher research, development, marketing and distribution expenses, all of which must be passed on to customers. An outside provider's cost structure and economy of scale can give the firm an important competitive advantage.
- **Repatriated profits**: Many Indian outsourcing firms are owned in whole, or in part, by US companies, such as GE and EDS, and repatriate some of their earnings. Operations owned by foreign (mostly US) companies generate 30 percent of the Indian offshore industry's revenues. In this way, an additional four cents of every dollar spent on outsourcing returns to the US economy.
- **Redeployed labour**: The direct benefits to a country, strongly into outsourcing, like the United States, total about 67 cents for every dollar. Also, the savings made through outsourcing can be invested in new business opportunities, and this investment will boost productivity and create new jobs. In the U.S., as jobs in call centres and repetitive IT functions go offshore, opportunities to train labour and invest capital to generate opportunities in higher value added occupations, such as research and design, are appearing.
- **New markets**: outsourcing and expanded trade facilitate the development of new markets, new trade items, an exchange of knowledge, service and commodities. Exporting jobs helps to create a balanced global audience. The markets to which a country outsources, ultimately, through development, become product markets for goods of developed nations.
- **World economy**: From a marketing perspective, global outsourcing expands supply and distribution channels, product recognition and loyalty. It also expands market opportunities and supports greater choice. Diversification of currency, costs, infrastructure, and the development base keeps a global company viable in the changing world economy. Single country shifts do not damage corporate solvency, cash flows, or balance sheets as significantly as the dependence on a single economy or market. The risks are shared, and therefore, so must be the benefits.

- **Start new projects quickly**: A good outsourcing firm has the resources to start a project right away. Handling the same project in house might involve taking weeks or months to hire the right people, train them and provide the support they need. And if a project requires major capital investments (such as building a series of distribution centres), the startup process can be even more difficult.
- **Level the playing field:** Most small firms simply can't afford to match the inhouse support services that larger companies maintain. Outsourcing can help small firms act "big", by giving them access to the same economies of scale, efficiency and expertise, that large companies enjoy.

18.6 OUTSOURCING -LOSERS

The downsides of global outsourcing can be specified as follows.

(i) Outsourcing work that was previously done in house results in a large number of workers being displaced and losing their jobs.

(ii) Companies tend to overestimate the savings to be had from going abroad and fail to recognize the problems, such as dealing with inventory, obsolescence and currency exchange rates.

(iii) For many manufacturers, the importance of direct labour is declining rapidly. Since it often accounts for just 7 to 15 percent of the cost of goods sold, hard-goods and high tech manufacturers often say that wage rates are hardly the most critical determinants of their overall economic performance.

For the outsourcing of manufacturing operations in particular, the following concerns are raised:

- Exposure to supplier risks and issues of quality control.
- The danger of suppliers reaping undue advantages by imitating superior products or technologies.
- A possible change in supplier behavior from collaborative to opportunistic.
- Difficulty in measuring actual costs of the supplier, typically above baseline costs, due to the experience curve.
- Potential problems with taking an outsourced function back, or substituting the supplier when the outsourcing agreement terminates.

It is essential for organizations to identity, exploit and protect their core business. They should retain or insource those manufacturing functions that are critical to the product, and those the company is distinctively good at making. Thus, only those manufacturing functions should be outsourced in which suppliers have a distinct comparative advantage.

18.7 THE FUTURE OF OUTSOURCING IN INDIA

Today, with outsourcing being the top business trend, the biggest question on everyone's mind is: what will the future of the outsourcing industry look like in the next 10 or 20 years? Though India has managed to position itself as a major outsourcing hub, questions about its future in outsourcing continue to surface in industry circles. The dynamics of global business are changing, and outsourcing is no different.

18.7.1 Current and Future Trends that will affect the Outsourcing Market

With the outsourcing industry emerging from the aftermath of the global recession, there are a number of trends that give us a glimpse of the future:

- Analysts are predicting that the industry will continue to fight short-term cost pressures, and that there will be pressure on service providers for more flexible pricing contracts.
- Buyers will seek more standardized solutions from their outsourcing engagements, so they will have to differentiate themselves through performance rather than pricing. Hence pricing structures will be stabilized to some extent.
- Many small alliances, focused on increased operational efficiencies, better quality control and reduced back-office costs, are being set up. This trend is going to continue.
- Shared and common services were always considered a threat to outsourcing, but the trend is changing. Sharing critical business and IT services has been proven to cut costs, reduce errors and improve productivity.
- Industry experts predict that Latin America and Europe will be the new outsourcing destinations in the near future.
- Brazil and Russia will make their presence felt in the global outsourcing market and China will continue to move ahead.
- The rising price of oil will put pressure on companies to take advantage of technology and outsource work to remain profitable.

- According to industry experts, consumption-based technologies that are delivered through the cloud will grow, as they are cost effective.
- Some analysts predict that European carmakers will start outsourcing their business. This would result in cars being developed by other companies while being sold under their brand names.
- Big pharmaceutical companies will launch new drugs in the market at a fraction of the current cost by partnering with India, China, and Russia in molecular research and clinical testing.

18.7.2 India's role in the outsourcing industry

India continues to be the major destination for outsourcing because it has been able to evolve with changing needs. NASSCOM, (National Association of Software & Service Companies) the apex body of India's premier IT software and service (IT & BPO) companies, reported that India's share in the global outsourcing market rose from 51% in 2009 to 55% in 2010. India still stands out for its customer service and efficiency, so its future is bright. Today, customers are not only looking at cost-effective solutions for their outsourced business but also for skilled staff, enhanced productivity, service quality and business process excellence. India, with its large population and multiple-skilled people, would continue to be preferred for both back-end and front-end outsourcing.

18.7.3 Opportunities for the Indian Outsourcing Industry

The growth of Indian outsourcing industry has been phenomenal. As markets worldwide are becoming knowledge-intensive, India has evolved to become the most preferred destination for knowledge services. Knowledge Process Outsourcing may soon be the biggest revenue grosser in India. India has a large pool of skilled manpower– Chartered Accountants, MBAs, Doctors, Lawyers, Research Analysts, etc., which strengthens its position in the knowledge service industry.

Opportunities for India in terms of outsourcing are:

- In services that require advanced English, like KPO, Content and Medicine, India will continue to excel. NASSCOM predicts that India will emerge as a global hub for knowledge services by 2015.
- India has a large pool of English-speaking lawyers with expertise in foreign legal systems who can offer legal support and patent services. A few Indian companies are already affiliated with American legal firms and they have captured a small part of the American market.

- India is now the leader in the FAO market with many Fortune 500 companies already having their outsourced operations in India with firms like IBM, ACS, TCS etc.
- India has a big market in pharmaceuticals, in terms of clinical research and manufacturing. Availability of talent for high-quality trials and data management gives it an edge over competitors. Ranbaxy, a major Indian pharmaceutical firm, has tied up with GlaxoSmithKline to manufacture certain compounds together.
- Another vertical that presents great potential for India is Infrastructure Management Services. A wide range of management services for IT infrastructure, application operations, IT security and maintenance can be provided.
- According to a study done by Booze and Company, India will become a dominant player in the Engineering R&D market which is expected to expand to $1.4 trillion by 2020. India's domestic market is expected to contribute 10-15% of the global ER&D services market.

218.7.4 Challenges for the Indian Outsourcing Industry

The industry is undergoing an evolution, and will continue to be driven by changes in demand. A survey done by Pricewaterhouse Coopers and Duke University's Offshoring Research Network found that the outsourcing industry is transforming as new providers are emerging while existing providers are expanding into new markets. India has made remarkable achievements and has built a strong reputation in the outsourcing industry.

India will face some new emerging challenges, such as:

- The industry is growing rapidly and requires corresponding growth in infrastructure as well, an area where India is lacking—this needs to be addressed.
- Due to the rise in labor costs in Indian metro cities, companies are moving towards smaller Tier II cities.
- Though India continues to be the world leader in the outsourcing business, it will face tougher challenges in the near future, from South-east Asian countries like Indonesia, Malaysia, the Philippines, Singapore, Vietnam and Thailand, which are improving their positioning as alternative offshore locations.
- India's competitiveness is being challenged by countries like Indonesia, which offer cheaper labor in IT and business process skills, while India is experiencing increased labor costs and high attrition, which are of concern, and need to be addressed.

- Political crises in markets like the US and UK might result in outsourcing restrictions being put in place.

18.8 MULTINATIONAL CORPORATIONS (MNCs)

The dynamics of the business environment fostered by the drastic political changes in the erstwhile communist and socialist countries and the economic liberalization across the world has enormously expanded the opportunities for the multinational corporations, also known by such names as international corporation, transnational corporation, global corporation (or firm, company or enterprise) etc.

The rapidity with which MNCs are growing is indicated by the fact that while according to the World Investment Report 1997 there were about 45000 MNCs with some 280,000 affiliates, according to the World Investment Report 2004 there were over 61,500 of them with about 926,950 affiliates. Only less than 12 percent of these affiliates were in the developed countries. China was host to about 4.24 lakh of the affiliates (i.e., more than 45 percent of the total) compared to more than 1400 in India.

The MNCs account for a significant share of the world's industrial investment, production, employment and trade.

Although the multinational corporation took birth in the early days, the United States was the home of most of the MNCs. Now there are a large number of Japanese and European multinationals. In the list of the 10 or 20 largest MNCs, Japan has the largest number. Multinational have been emerging from the developing countries too. South Korea has, for example, well known MNCs like Samsung, Hyundai, LG and Daewoo.

MNCs of the US are more focused, i.e., they confine their business to one industry or product category. In fact, several American MNC's which attempted diversification, mostly by the acquisitions MNCs, most European companies have much broader product line. Japanese companies, generally, have product lines that are much too broad. Of the top ten corporation in the US, only one (General Electric) is a classic conglomerate, while in Japan eight are conglomerates and only two are not (Toyota Motor and Nippon Telegraph & Telephone). Similarly, the Korean corporations are far too diversified. Recent trends indicate that the diversified corporations have many odds against them and the focus strategy is more successful.

18.9 DEFINITION AND MEANING

As the concept of multinationality has several dimensions, there is no single universally agreed definition of the term multinational corporation. According to and ILO report, "the essential nature of the multinational enterprises lies in the fact that its managerial headquarters are located in one country i.e., home country, while the enterprise carries out operations in a number of other countries as well i.e., host countries .What is meant is "a corporation that controls production facilitates in more than one country, such facilities having been acquired through the process of foreign investment. Firms that participate in international business, however large they may be, solely by exporting or by licensing technology are not multinational enterprises."

Among the various other benchmarks sometimes used to define 'multinationality' are that the company in question must:

- Produce (rather than just distribute) abroad as well as in the headquarters country
- Operate in a certain minimum number or nations (six for example)
- Derive some minimum percentage of its income from foreign operations (e.g., 25 percent)
- Have a certain minimum ratio of foreign to total number of employees, or of foreign total value of assets.
- Possess a management team with geocentric orientations
- Directly control foreign investments (as opposed simply to holding shares in foreign companies).

The definitions of the terms transnational corporation (used to mean the same thing as MNC and similar terms) foreign affiliate, subsidiary and branch given in the UN's World Investment Report are as follows.

Transnational Corporation are incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is deemed as an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain equity capital state. An equity capital stake of 10 per cent or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for an unincorporated enterprise, is normally considered as a threshold for the control of assets (In some countries such as Germany and United Kingdom, the threshold is a stake of 20 per cent or more).

A Foreign Affiliate is an incorporated or unicorporated enterprise in which an investor, who is resident in another economy, owns a stake that permits a lasting interest in the management of that enterprise (an equity stake of 10 percent for an incorporated enterprise or its equivalent for an unicorporated enterprise. In the World Investment Report, subsidiary enterprise, a subsidiary enterprise, associate enterprise and branches are all referred to as foreign affiliates.

A Subsidiary is an incorporated enterprise in the host country in which another entity directly owns more than a half of the shareholders voting power and has the right to appoint or remove a majority of the members of the administrative, management or supervisory body.

An Associate is an incorporated enterprise in the host country in which an investor owns a total of at least 10 percent, but not more than a half, of the shareholders' voting power.

A Branch is a wholly or jointly owned unincorporated enterprise in the host country which is one of the following: (i) a permanent establishment or office of the foreign Investor: (ii) an unincorporated partnership or joint venture between the foreign direct investor and one or more third parties; (iii) land, structures (except structures owned by government entities), and/or immovable equipment and objects directly owned by a foreign resident; (iv) mobile equipment such as ships, aircraft, gas or oil-drilling rigs operating within a country other than that of the foreign investor for at least one year.

As the World Investment Report 1999 observes, transnational corporations (TNCs) establish, under the common governance of their headquarters, international production systems in which factors of production move, to a greater or lesser extent, among units located in different countries. These systems increasingly cover a variety of activities, ranging from research and development (R&D) to manufacturing to service functions such as accounting, advertising, marketing and training, dispersed over host-country locations and integrated to produce final goods or services. They are also increasingly being established, especially in developed countries, through mergers between existing firms from different countries or the acquisition of existing enterprises in countries by firms from others. Once internationally dispersed production units under common governance are established, mobile and location bound factors of production to which a TNC has access in home and host countries (and sometimes even third

countries) are combined in each unit in ways and for production that contribute the most to the firm's economic and strategic objectives. From the perspective of factor use- as distinct from that of location as host or home country for enterprises engaged in international production- all of the production that takes place in these TNC production systems (in parent firms or home-country units as well as foreign affiliates or host-country units) constitutes international production.

18.10 ORGANIZATIONAL MODELS

Terms such as International Corporation, Multinational Corporation, Transnational Corporation and global advanced stage of transnational organization and operations that it becomes necessary to draw some distinction between these terms.

However, the interpretations of these terms given by different authors are not same. Sometimes the differences arise from the differences in the context.

With reference to the configuration or resources and responsibilities, parent subsidiary relationship, and the mentality towards the overseas operations are the salient characteristics of these corporations pointed out by Bartlett and Ghoshal are highlighted below. Some of these descriptions are at variance with those given by some other authors. The following account, however, is very useful in understanding the distinctive features of these different types of organizations.

18.10.1 Multinational Corporation

This was the type of corporation popular when many European companies internationalized during the pre-war (1920s and 1930s) when the trade barriers were very high. According to Barlett and Ghoshal, the multinational organization is defined by the following characterstics: a decentralized federation of assets and responsibilities, a management process defined by simple financial control systems overload on informal personal coordination, and a dominant strategic mentality that viewed the company's worldwide operations as a portfolio of national business. In a multinational organization, the decisions, obviously, are decentralized.

18.10.2 International Organisation Model

This organization structure was predominant in the case of the American companies which internationalized in the early postwar years.

In the international organization, the structural configuration of which is described as coordinated federation, many assets, resources, responsibilities and decisions are decentralized but controlled from the headquarters. The overseas operations are regarded

essentially as appendages to a central domestic corporation. In this model, the headquarters transfers knowledge and expertise to overseas environments that were less advanced in technology or market development. While local subsidiaries are often free to adapt the new products or strategies, their dependence on the parent company for new products, processes, or ideas dictated a great deal more coordination and control by the headquarters than in the classical multinational organization.

18.10.3 Global Organisational Model

The Japanese companies which internatioalised since the mid 1960s through the 1970s and 1980s adopted global organization model. The global configuration is based on centralization of assets, resources and responsibilities; overseas operations are used to reach foreign markets in order to build global scale. The role of local subsidiaries is to assemble and sell products and to implement plans and policies developed at headquarters. Compared with subsidiaries in multinational or international organisations, they have much less freedom to create new products or strategies or even to modify existing ones.

In the global model, management treats overseas operations as delivery pipe lines to a unified global market, is described as centralized hub.

The rapid decline in tariffs, coupled with dramatic improvements in transportations and communication of this period made a truly export-based strategy feasible.

The global organization model, where authority and decision making are centralized and subsidiaries are used basically as implementing agencies, is described as a centralized hub.

18.10.4 Transnational Model

The transnational organization and model seeks to eliminate some of the drawbacks of the other models. In endeavours to achieve global competitiveness through, inter alia, multinational flexibility and worldwide learning.

In a transnational, the specialized resources and capabilities are dispersed among the various operating units globally. These units are interdependent and integrated and have large flows of components, products, resources, people and information among them. An important feature of the transnational, therefore, is the complex process of coordination and cooperation in an environment of decision making.

18.11 DOMINANCE OF MNC'S AND GLOBAL ECONOMY

The global liberalisation has paved the way for fast expansion and growth of the MNC's. The value added by all foreign affiliates of MNC's as a percentage of world GDP increased from about 5 per cent in the beginning of the 1980s to nearly 7 percent at the end of the 1990s.

The following paragraphs excerpted from the World Investment Reports 2000 and 2003 provide some indications of the economic dominance of the multinationals.

Virtually all countries and economic activities, rendering it a formidable force in today's world economy.

The size of large TNCs is sometimes compared to that of countries' economies, as an indicator of the influence that the former have in the world economy. According to one comparison of the sales volume of firms with the GDP of countries, the sales of the top 200 firms accounted for 27.5 per cent of world GDP in 1999. Of the 50 largest "economies", 14 were TNCs and 36 were countries.

Their economic impact can be measured in different ways. In 2001, foreign affiliates accounted for about 54 million employees, compared to 24 million in 1990; their sales of almost $ 19 trillion were more than twice as high as world exports in 2001, compared to 1990 when both were roughly equal; and the stock of outward foreign direct investment (FDD, increased from $1.7 trillion to $6.6 trillion over the same period. Foreign affiliates now account for one-tenth of world GDP and one-third of world exports. Moreover, if the value of worldwide TNC activities associated with non-equality relationships (e.g., international subcontracting, licensing, contract manufacturers) is considered. TNCs would account for even larger shares in these global aggregates.

The universe of TNCs is quite diverse, and includes a growing number of small and medium sized enterprise, TNCs from countries in Central and Eastern Europe that have only recently begun to engage in international production, and large TNCs based in the developing world. Although less transnational overall than the world's top 100 TNCs, some of the developing-country TNCs are quite sizeable-witness. for example, the size of the foreign assets ($8 billion) of Petroleos de Venezuela, the largest TNC from the developing world and the only developing-country firm to appear in the top 100 list.

Evidence on the expansion of international production over the past two decades abounds. Gross product associated with international production and foreign affiliates sales worldwide, two measures of international production, increased faster than global

GDP and global exports, respectively. Sales or foreign affiliates worldwide ($19 trillion in 2004, $3 trillion in 1980s) are now nearly-twice as high as global exports, and the gross product associated with international production is about one-tenth of global GDP, compared with one-twentieth in 1982.

The number of transnational parent firms in 15 developed home countries increased from some 7,000 at the end of the 1960s to some 40,000 at the end of the 1990s.

The economic clout of the MNCs is indicated by the fact that the GDP of most of the countries is smaller than the value of the annual sales turnover of the multinational giants. The value of the annual sales of Wal-mart Stores in 2004 was about $288 billion. Only a very small number of developing countries like India, China, Mexico, Brazil, Russia, Argentina, Indonesia and Republic of Korea had GDP which was higher than the figure. There were also several developed countries whose value of GDP was less than this. The total sales of the three largest automobile firms of the world (G M, Ford and Toyota) far exceed the value of GDP of India.

With sales totaling $183, billion in 2000, General Motors, which maintained the No.1 position in terms of sales for a long time, had fallen behind Exxon Mobil Corporation's $232.7 billion and Wal-Mart Stores. Since 2001, the global retail chain Wal-Mart Stores has been on the top of the Fortune 500 list. In 2003, the second position in terms of sale was occupied by Exxon Mobil ($213 billion). General Motors and Ford Motor came in third and fourth respectively, with revenues of $196 billion and $164 billion. General Electric (GE), the provider of everything from jet engines to sitcoms, remained at No. 5 with revenue of $134 billion. In terms of profits, Exxon Mobil was first with $21.5 billion in earnings.

18.12 MNCs AND INTERNATIONAL TRADE

Peter Drucker remarks that multinationalism and expanding world trade are two sides of the same coin. He points out that the period of most rapid growth of multinationals – the fifties and sixties was the period of most rapid growth of multinational trade. Indeed, during this period the world trading economy grew faster at an annual rate of 15 percent or so in most years – than even the fastest growing domestic economy, that of Japan.

It is estimated that between one-fourth and one-third of manufactured goods now moving in world trade are being shipped from one branch to another of the MNCs; that

is, they are intra-company shipments. The sales of foreign subsidiaries in the host countries in which they are located are three to four times as large as total world exports.

There was a very significant increase in the export intensity (i.e., the percentage of exports to total sales) of the foreign affiliates of many MNCs. The export intensity of foreign affiliates of US MNCs, for example, increased from less than 20 percent in the mid sixties to over 40 percent in the early 1990s for all economies; it doubled from about 20 to 40 percent in the case of the Latin American affiliates and from 23 to 64 percent for developing Asia. The average export intensity of all the affiliates has however, remained between 21-24 percent for a long time. In the case of India, however, it has very low. More than 40 percent of the total exports of China is done by MNC affiliates. The export contribution of foreign affiliates in China is far larger than the total exports of India.

Apart from trade in commodities, other transactions also take place extensively between the different parts of these enterprises – for example, the granting of loans, the licensing of technology and the provision of services. In all such transactions, transfer prices may be settled which are different from the price which would have been the case between independent parties operating at arm's length. Such differences may reflect the legitimate concerns of the companies but are also capable of being used in order to shift profits from high to low tax countries or to get around exchange or price controls or customs duties. As the Brandt Commission observes, the ability of multinationals to manipulate financial flows by the use of artificial transfer prices is bound to be a matter of concern to Governments. The monitoring and control of transfer prices involves inter-companies. This is necessary to make effective tax laws covering transfer prices which exist in many counties. Intra-firm trade also opens up the possibility for corporations to impose restrictive business practices within their own organization; they can limit the exports of their affiliates; allocate their markets between nations or restrict the use of their technology or that developed by their affiliates. Such practices, although best pursued in the best business interests of the companies, may conflict with the developmental objectives and national interests of host countries.

18.13 MERITS OF MNCs

As the preface to the ILO report on Multinational Enterprises and Social Policy observes, "for some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital, technology and employment; for others,

they are monsters which our present institutions, national or international, cannot adequately control, a law to themselves with no reasonable concept, the public interest or social policy can accept."

The important arguments in favour of and against the MNCs are mentioned below.

MNCs, it is claimed, help the host counties in the following ways:

1. MNCs help increase the investment level and thereby the income and employment in host country.
2. The transnational corporations have become vehicles for the transfer technology, especially to the developing countries.
3. They also kindle a managerial revolution in the host countries professional management and the employment of highly sophisticated management techniques.
4. The MNCs enable the host countries to increase their exports and decrease their import requirements.
5. They work to equalize the cost of factors of production around the world.
6. MNCs provide an efficient means of integrating national economies.
7. The enormous resources of the multinational enterprises enable them to have very efficient research and development systems. Thus, they make a commendable contribution to inventions and innovations.
8. MNCs also stimulate domestic enterprise because to support their own operations, the MNCs may encourage and assist domestic suppliers.
9. MNCs help increase competition and break domestic monopolies.

Demerits

MNCs have, however, been subject to a number of criticisms, like those mentioned below.

1. As Leonard Gomes points out, the MNC's technology is designed for world-wide profit maximization, not the development needs of poor countries, in particular employment needs and relative factor scarcities in these countries. In general, it is asserted, the imported technologies are not adapted to (a) the consumption needs, (b) the size of domestic markets (c) resource availabilities, and (d) stage of development of many of the LDCs.

2. Through their power and flexibility, MNCs can evade or undermine national economic autonomy and control, and their activities may be unfavorable to the national interests of particular countries.
3. MNCs may destroy competition and acquire monopoly powers.
4. The tremendous power of the global corporations poses the risk that they may threaten the sovereignty of the nations in which they do business. On Political involvement, MNCs have been accused on occasion of: supporting repressive regimes; paying bribes to secure political influence; not respecting human rights; paying protection money to terrorist groups; and, destabilizing national governments of which they do not approve.
5. MNCs retard growth of employment in the home country.
6. The transnational corporations cause fast depletion of some of the non-renewable natural resources in the host country and environmental problems
7. The transfer pricing enables MNCs to avoid taxes by manipulating prices on intra-company transactions.
8. They undermine local cultures and traditions, change the consumption habits for their benefit against the long term interests of the local community, promote conspicuous consumption, dump harmful products in the developing countries etc.

18.14 PERSPECTIVE

Future holds out an enormous scope for the growth of MNCs. The changes in the economic environment in a large number of countries indicate this. For instance, the number of bilateral treaties that promote and/or protect FDI has increased markedly in recent times.

A United Nation's report described several developments that points to a rapidly changing context for economic growth, along with a growing role for transnational corporation in that process. These include:

1. Increasing emphasis on market forces and a growing role for the private sector in nearly all developing countries.
2. Rapidly changing technologies that are transforming the nature of organization and location of international production.
3. The globalization of firms and industries

4. The rise of services to constitute the largest single sector in the world economy
5. Regional economic integration, which involve both the world's largest economies as well as selected developing countries.

18.15 CODE OF CONDUCT

It is widely felt that there must be a code of conduct to guide and regulate the MNCs.

According to the Brandt Commission, the principal elements of an international regime for investment should include:

1. A frame-work to allow developing countries as well as transnational corporation to benefit from direct investments on terms contractually agreed upon. Home countries should not restrict investment or the transfer of technology abroad, and should desist from other restrictive practices such as export controls or market, not restrict current transfers such as profits, royalties and dividends, or the repatriation of capital, so long as they are on terms which were agreed when the investment was originally approved or subsequently negotiated.
2. Legislation promoted and coordinated in home and host countries, to regulate the activities of transnational corporations in such matters as ethical behavior, disclosure of information, restrictive business practices, cartels, anti-competitive practices and labour standards. International codes and guidelines are a useful step in that direction.
3. Cooperation by Governments in their tax policies to monitor transfer pricing and to eliminate the resort to tax havens.
4. Fiscal and other incentives and policies towards foreign investment to be harmonized among host developing countries, particularly at regional and sub-regional levels, to avoid the undermining of the tax base competitive positions of host countries.
5. Measures affecting direct investment and the activities of transnational corporations.

The Code of Conduct for MNCs, drawn up by the Commission on Transnational Corporations, set up the UN's Economic and Social Council, required MNCs, inter alia, to:

- Respect the national sovereignty of host countries and observe their domestic laws, regulations and administrative practices.

- Adhere to host nations' economic goals, development objectives and socio-cultural values
- Respect human rights
- Not interfere in internal political affairs or in intergovernmental relations
- Not engage in corrupt practices
- Apply good practice in relation to payment of taxes, abstention from involvement in anticompetitive practices, consumer and environmental protection and the treatment of employees
- Disclose relevant information to host country governments.

According to the 1976 declaration of the OECD Code of Practice on MNC operations. MNCs should contribute positively to economic and social progress within host nations. Its main provisions were that MNCs should:

- Contribute to host countries' science and technology objectives by permitting the rapid diffusion of technologies
- Not behave in manners likely to restrict competition by abusing dominant positions or market power
- Provide full information for tax purposes
- Consult with employee representatives regarding major changes in operations, avoid unfair discrimination in employment and provide reasonable working conditions.
- Consider the host nation's balance of payments objectives when taking decisions.
- Regularly make public significant information on financial and operational matters, host countries themselves should, the Code insists, possess the absolute right to nationalize foreign-owned assets within their frontiers, but must pay proper compensation.

18.16 MULTINATIONALS IN INDIA

Comparatively very little foreign investment has taken place in India due to several reasons. A common criticism against the MNCs is that they tend to invest in the low priority and high profit sectors in the developing countries, ignoring the national priorities. However, in India the Government policy confined the foreign investment to the priority areas like high technology and heavy investment sectors of national importance

and export sectors. Firms which had been established in non-priority areas prior to the implementation of this policy have, however, been allowed to continue in those sectors.

An often heard criticism is that multinationals drain the foreign exchange resources of the developing countries. However, Aiyar's study indicates that, contrary to the popular belief, foreign companies are less of a drain on foreign exchange reserves than Indian ones. He also points out that the public sector has a higher propensity to use foreign exchange on a net basis than multinationals. In fact, the foreign exchange outgo of the public sector alone is greater than the entire trade deficit of the country.

It is not a right approach to estimate the net impact of multinationals on the foreign exchange reserves by taking the net foreign exchange outflow or inflow. If a multinational is operating in an import substitution industry, the net effect on the foreign exchange reserves could be favourable even if there is a net foreign exchange outflow by the company.

Multinationals in several developing countries make substantial contribution to export earnings. The performance in the case of India has, however, been very dismal. This is attributed mostly to the Government policy. "We have consistently followed policies in India that discriminate against export production and in favour of production for the local market. In this milieu it has not made sense for the Indian private sector or public sector to focus on exports. Naturally, it has not made sense for foreign companies either. In 1947, foreign companies did not have an anti-export image. Indeed, the most prominent ones were engaged in the export of tea and jute manufactures. Only after Jawaharlal Nehru decided to emphasise import substitution at the expense of exports did foreign (and Indian) companies shun exports.

Although export promotion has been pursuied since the Third Plan, the highly protected domestic market and the unrealistic exchange rate made the domestic market much more attractive than exports. However, since the mid 1980s with the economic liberalization that increased domestic competition and the steady depreciation of the rupee, exports began to become attractive and several foreign companies with foreign participation, as well as Indian Companies, have become serious about exports. This was reflected in the acceleration of the export growth.

The new policy is expected to give a considerable impetus for MNCs investment in India. However, foreign companies find the policy and procedural environment in India still so perplexing and disgusting that a multinational, Motorola, even shifted some

of the projects, originally earmarked for India to China where the Government environment is much more conducive.

Since the economic liberalization ushered in 1991, many multinationals in different lines of business have entered the Indian market. A number of multinationals which were in India prior to this have expanded their business.

18.17 SUMMARY

After its success in outsourcing, IT and IT enabled services, Indian pharma companies are now beginning to recognize the opportunity that outsourcing presents. The largest driver for outsourcing in pharma is the need to bring down costs. The untapped potential of the large pool of low-cost, English speaking technical manpower that India provides is now coming into the world view of the Big Pharma. The costs of manufacturing, conducting clinical trials and research are atleast 50% lower in India than those in the US. The pharma industry in India is said to be poised where the IT industry was 25 years ago. Indian companies have started looking at a space between full-time equivalence contract manufacturing (full time of a facility pledged to the client) and contract research (where a common pool of resources may be tapped). However, this is as yet, an emerging opportunity.

In order to ensure that outsourcing industry contributes in the maximal possible way to the growth of economy, the authorities must act as facilitators. This implies a stronger emphasis on IT in education, and integration in modern global knowledge-based economy.

Outsourcing provides the US and European countries with opportunities bigger than merely sending low value, labour-intensive activities abroad. While the operating savings are real, offshore companies, to which these countries outsource, can also deliver superior performance, even in highly skilled activities, lower prices, greater investment and new jobs. The ability of multinationals and companies in richer nations to offer better wages and jobs to those in the developing countries, is putting pressure on emerging market governments, to pursue liberal economic policies, especially spending more on education and maintaining open borders with the outside world, for trade and foreign investment.

The transnational corporations (TNCs), with their large number of foreign affiliates and a plethora of inter firm arrangements, spans virtually to all countries and economic activities, rendering it a formidable force in today's world economy.

MNC's have been spreading and growing across the globe very rapidly. Although the MNC's from the developed countries still dominate the scene, more and more MNCs are emerging from the developing countries.

The world's top 100 (non-financial) TNCs, based almost exclusively in developed countries, are the principal drivers of international production. The universe of TNCs, however, is quite diverse, and includes a growing number of small and medium –sized enterprises.

As a result of the liberalizations, MNCs have been spreading fast in the developing counties. Most of the foreign affiliates of the MNCs are in the developing countries are in the developing counties, China alone hosting about one-third of the total number.

MNCs help the host counties to increase domestic investment and employment generation, boost exports, transfer technology and accelerate economic growth.

While the host counties can reap several benefits from the MNCs, these giants pose many problems particularly to the developing countries. They may destroy domestic firms through unfair competition, acquire market dominance through acquisition of domestic firms of other means. The MNCs technology which is designed for worldwide profit maximization may not adapt to the consumption needs, the size of domestic markets, resource availabilities, and the stage of development of many of the developing countries. The transfer pricing may be so designed as to avoid or minimize taxes. All these emphasize the need for a code of conduct for the MNCs and an effective competition policy and law in the host countries. Several MNCs are also accused of political maneuvering and neglect of human rights.

The liberalization has paved the way for easy entry and growth of MNCs in India. At the same time a number of Indian firms have been becoming multinational.

18.18 KEY WORDS

Outsourcing

Repatriate

Subsidiary,

Multinational

18.19 SELF ASSESSMENT QUESTIONS

1. Define MNCs. What are the merits and demerits of MNCs?
2. Discuss the pros and cons of Global Outsourcing.
3. How did 'Global Outsourcing' process help in business in India?
4. Discuss about the sectors that got the benefit of outsourcing and the type of jobs created in India.

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UNIT -19 : FDI AND FTAs

Structure

19.0 OBJECTIVES

After studying this unit, you should be able to:

- explain international investments and their types
- analyse significance of international investments
- discuss actors affecting international investment
- find out role of FDI in Indian economy
- sketch out the 2013 FDI policy changes in India
- explain India's Free Trade Agreements

19.1 INTERNATIONAL INVESTMENTS

The economic liberalizations that swept across the world, particularly since the late 1980s, have very significantly changed the environment for international investments. At the same time, the surging international capital flows, in its turn, are substantially impacting the business environment.

As Peter Drucker in his Managing for the Future observers, "increasingly world investment rather than world trade will be driving the international economy. Exchange rates, taxes and legal rules will become more important than wage rates and tariffs."

19.2 TYPES OF FOREIGN INVESTMENT

Broadly there are two types of foreign investment, namely,

19.2.1 Foreign Direct Investment (FDI) and

19.2.2 Portfolio Investment.

19.2.1 Foreign Direct Investment (FDI)

FDI refers to investment in a foreign country where the investor retains control over the investment. It typically takes the form of starting a subsidiary, acquiring a stake in an existing firm or starting a joint venture in the foreign country. Direct investment and management of the firms concerned normally go together.

FDIs are governed by long term considerations because these investments cannot be easily liquidated. Hence factors like long term political stability, government policy, industrial and economic prospects etc. influence the FDI decision. However, portfolio investments are generally much more sensitive than FDIs. Direct investors have direct

responsibility with the promotion and management of the enterprise. Portfolio investors do not have such direct involvement with the promotion and management.

19.2.2 Portfolio Investment

If the investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad, it is referred to as portfolio investment. That is, in the case of portfolio investments, the investor uses his capital in order to get a return on it, but has no much control over the use of capital.

There are mainly two routes of portfolio investments in India, viz., by Foreign Institutional Investors (FIIs) like mutual funds and through Global Depository Receipts (GDRs), American Depository Receipts (ADRs) and Foreign Currency Convertible Bonds (FCCBs).

GDRs/ADRs and FCCBs are instruments issued by Indian companies in the foreign markets for mobilizing foreign capital by facilitating portfolio investment by foreigners in Indian securities. Since 1992, Indian companies, satisfying certain conditions, are allowed to access foreign capital markets by Euro issues.

Since the economic liberalization of 1991, there has been a surge in the FDI and portfolio investments in India.

19.3 SIGNIFICANCE OF FOREIGN INVESTMENT

Foreign capital and technology can play a very important role in the socio-economic development of a nation. They have very significantly contributed to the development of the developed countries. Foreign capital and technology have been playing a significant role in the development of a number of developing countries. A classic example is China.

Foreign investment is playing an increasing role in economic development. Economic reforms and the far-reaching political changes have resulted in very substantial changes in the international capital flows.

One of the ways by which foreign capital helps accelerate pace of economic growth is by facilitating essential imports required for carrying out development programmes, like capital goods, know-how, raw materials and other inputs and even consumer goods. The machinery, know-how and other inputs needed may not be indigenously available. Further the demand spurt created by large investments may necessitate import of

consumer goods. When the export earnings are insufficient to finance such vital imports, foreign capital could help reduce the foreign exchange gap.

Foreign investment may also help increase a country's exports and reduce the import requirements if such investments take place in export-oriented and import-competing industries. In the early years of the present decade, nearly half of the Chinese exports (which in absolute terms was about three times the total exports of India) were said to be the contribution of the foreign funded enterprises.

Following the analysis of Donald MacDougall and Paul Streeten, Gerald Meier observes that, from the stand point of national economic benefit, the essence of the case for encouraging an inflow of capital is that the increase in real income resulting from the act of investment is greater than the resultant increase in the income of the investor. If the value added to output by the foreign capital is greater than the amount appropriated by the investor, social returns exceed private returns. As long as foreign investment raises productivity, and this increase is not wholly appropriated by the investor, the greater product must be shared with others.

The important advantages of foreign direct investment are the following:

1. It helps increase the investment level and thereby the income and employment in the host country.
2. Foreign investment may increase the tax revenue of the government.
3. Foreign Direct investment facilitates transfer of technology to the recipient country.
4. It may kindle a managerial revolution in the recipient country through professional management and the employment of highly sophisticated management techniques.
5. Foreign capital may enable the country to increase its exports and reduce import requirements.
6. Foreign investments may stimulate domestic enterprise because, to support their own operations, the foreign investors may encourage and assist domestic suppliers and consuming industries.
7. Foreign investment may also help increase competition and break domestic monopolies.
8. If foreign investment improves the quality and reduces the cost of inputs, that would benefit the domestic industry.

9. If foreign investment is cost-reducing in a particular industry, consumers of the product may gain through lower product prices and the cusumers of the country will get the products at cheaper price.
10. If the investments is product-improving or product innovating, consumers benefit from better quality products or new products.
11. Foreign capital may bring in a number of indirect gains through the realization of external economies. For instance, if foreign investment in industrial and other sectors.

In the endogenous growth framework, the sources of growth attributed to capital flows comprise the spillovers associated with foreign capital in the form of technology, skills, and introduction of new products as well as the positive externalities in terms of higher efficiency of domestic financial markets, improved resource allocation and efficient financial intermediation by domestic financial institutions.

Further advantages of foreign capital are mentioned under Private Foreign Capital below.

As indicated in the opening paragraph, foreign investment is playing an increasing role in economic development.

The changes in the composition of the capital flows and the substantial increase in the magnitude of some of the flows, like FDI, have remarkably changed the balance of payments and foreign exchange reserves position of several countries. The debt creating flows as a percentage of total flows in the BOP of India averaged as much as 97 percent during the Seventh Plan (1985-90) but declined to less than 20 percent by mid 1990s. eventually, India began to experience a surplus on the BOP and a very remarkable improvement in the reserves position.

Foreign investment has assisted and is assisting the economic growth of many countries. As a World Bank report points out, for the developing countries FDI has the following advantages over the official development assistance (ODA):

1. FDI shifts the burden of risk of an investment from domestic to foreign investors.
2. Repayments are linked to profitability of the underlying investment, whereas under debt financing the borrowed funds must be serviced regardless of the project costs.
3. Further, it has also been observed that FDI is the only capital inflow that has been strongly associated with higher GDP growth since 1970.

The contribution of FDI to economic growth is highlighted by the fact that the ratio of FDI flow to domestic investment (gross capital formation) rose for most developed and developing countries in the past, Although the bulk of the FDI goes to developed countries, its share in their Gross Fixed Capital Formation (GFCF) is only about half of that in developing countries because of the massiveness of their GFCF.

19.4 LIMITATIONS AND DANGERS OF FOREIGN CAPITAL

The following criticisms are leveled against foreign capital:

1. Private foreign capital tends to flow to the high profit areas rather than to the priority sectors.
2. The technologies brought in by the foreign investor may not be adapted to the consumption needs, size of the domestic market, resource availabilities, stage of development of the economy, etc.
3. Through their power and flexibility, the multinational corporations can evade or undermine economic autonomy and control, and their activities may be unfavorable to the national interests of particular countries.
4. Foreign investment sometimes have unfavourable effect on the Balance of Payments of a country because the drain of foreign exchange by way of royalty, dividend, etc., is more than the investment may be the foreign concern.
5. Foreign capital sometimes interferes in the national politics.
6. Foreign investors sometimes engage in unfair and unethical trade practices.
7. Some times foreign investment can result in the dangerous situation of minimizing/ eliminating competition and the creation of monopolies or oligopolistic structures.
8. FDI can also potentially displace domestic producers by pre-empting their investment opportunities.
9. Often, several costs are associated with encouraging foreign investment. These costs may arise from special concessions offered by the host country, adverse effects on domestic saving, deterioration in the terms of trade, and problems of balance of payments adjustment.

19.5 FACTORS AFFECTING INTERNATIONAL INVESTMENT

The theories of foreign investment described above have indicated several possible reasons for foreign investment. This section is a further extension of the important factors affecting international investment.

19.5.1 Rate of Interest

One of the most important stimuli to international capital movements is the difference in the rate of interest prevailing at different places. Capital has a tendency to move from a country with a low rate of interest to a country where it is higher, other things being equal, interest rates or foreign exchanges rates.

19.5.2 Speculation

Short term capital movements may be influenced also by speculation pertaining to anticipated changes in the interest rates or foreign exchanges rates.

19.5.3 Profitability

Private foreign capital movement is influenced by the profit motive. Hence, other things being equal, private capital will be attracted to countries where the return on investment is comparatively higher.

19.5.4 Costs of Production

Private capital movements are encouraged by lower costs of production in foreign countries. As Kreinin points out, we may distinguish between two types of cost reducing investment. The first arises from the need to obtain raw materials from abroad. Such materials may be either unavailable at home or obtainable only at extremely high costs, but they are essential for the production and sale of final products at home or abroad. Without them profit opportunities would remain unexploited. Indeed, vast investments in the extractive industries are motivated by the fact that the capital must go where the resources are. The second type of cost-reducing investment pertains to costs of commodities other than materials, primarily labour.

19.5.5 Economic Conditions

Economic conditions, particularly the market potential and infrastructural facilities, influence private foreign investment. The size of the population and the income level of a country have an important bearing on the market opportunities.

19.5.6 Government Policies

Government policies, particularly towards foreign investment, foreign collaboration, remittances, profits, taxation, foreign exchange control, tariffs, and monetary, fiscal and other incentives, are important factors that may influence foreign investment in a country.

19.5.7 Political Factors

Political factors like political stability, nature of important political parties and relations with other countries also influence capital movements.

19.6 HOST COUNTRY ECONOMIC DETERMINANTS

Traditionally, the economic determinants of inward FDI have been grouped, for analytical convenience, into three clusters, each of them reflecting the principal motivations of investing in foreign countries:

3.6.1 Resources seeking

3.6.2 Market seeking and

3.6.3 Efficiency seeking.

19.6.1 Resources

Historically, the most important motivation of FDI has been the exploitation of natural resources. Dunning points out that in the nineteenth century, much of the FDI by European, United States and Japanese firms was promoted by the need to secure an economic and reliable source of minerals, primary products for the investing industrializing nations of Europe and North America. Up to the eve of the Second World War, about 60 percent of the world stock of FDI was in natural resources. The post war period, particularly since the 1960s and 1970s, witnessed a decline in the share of natural resources in the FDI. Besides the decline in the importance of the primary sector in world output, this decline was caused by factors such the development of the indigenous enterprises in this sector. In a number of developing economies the public sector came to play an important role in the resources based industries. Public sector efforts also included equity or technical collaborations with MNCs.

Although, the share of the primary sector in FDI has declined, there has been a substantial increase of the FDI in this sector in absolute terms.

19.6.2 Markets

Another important traditional determinant of FDI has been market seeking. Markets protected from international competition by high tariffs or quotas triggered tariff jumping FDI. Dunning points out that market access became the important motive for investing in the manufacturing sector of developed countries between the two world wars and of developing countries in the 1960s and 1970s, during the heyday of import substitution industrialization. This motive was paramount, for example, in the wave of United States investments in Europe, especially in the United Kingdom, during the early post war period and in Japanese investments in the United States after the mid 1980s, following voluntary export restrictions and the possibility of further protectionist measures in the automobile industry.

The lion's share of FDI flow to the developing countries goes to the larger markets with comparatively good infrastructure and political stability in general.

The growing importance of the service sector has also been resulting in increasing FDI because of the fact that most services are not tradable and, therefore, the only way to deliver them to foreign markets is through establishment abroad. However, the highly regulated nature of the services sector has been a deterrent to the FDI flow in its full potential.

19.6.3 Efficiency

Another important motivation of FDI is efficiency seeking. Low cost of production, deriving mostly from cheap labour, is the driving force of many FDIs in developing countries. Export processing zones have been developed by developing countries mostly to take advantage of the efficiency seeing FDI flows.

It may be noted that the presence of any of the three determinants mentioned above alone need not attract FDI. For example, even if a country has natural resources or abundance of cheap labour, FDI would not take place in the absence of required infrastructural facilities to develop the industry or trade. Besides, several other factors like the political environment, government policies, bureaucratic culture, social climate etc. are also important determinant of FDI.

19.7 GLOBAL INVESTMENT TRENDS

19.7.1 Cautious optimism returns to global FDI

In 2013, FDI flows returned to an upward trend. Global FDI inflows rose by 9 per cent to $1.45 trillion in 2013. FDI inflows increased in all major economic groups – developed, developing, and transition economies. Global FDI stock rose by 9 per cent, reaching $25.5 trillion.

UNCTAD projects that global FDI flows could rise to $1.6 trillion in 2014, $1.75 trillion in 2015 and $1.85 trillion in 2016. The rise will be mainly driven by investments in developed economies as their economic recovery starts to take hold and spread wider. The fragility in some emerging markets and risks related to policy uncertainty and regional conflict could still spoil the expected upturn in FDI flows.

As a result of higher expected FDI growth in developed countries, the regional distribution of FDI may still back towards the "traditional pattern" of a higher share of developed countries in the global inflows. Nevertheless, FDI share of developing economies will remain at a high level in the coming years.

19.7.2 Developing economies maintain their lead

FDI flows to developing economies reached a new high at $778 billion, accounting for 54 per cent of global inflows, although the growth rate slowed to 7 per cent, compared with an average growth rate over the past 10 years of 17 per cent. Developing Asia continues to be the region with the highest FDI inflows, significantly above the EU, traditionally the region with the highest share of global FDI inflows were also in the other major developing regions, Africa (up 4 per cent) and Latin America and the Caribbean (up 6 per cent, excluding offshore financial centres).

Although FDI to developed economies resumed its recovery after the sharp fall in 2012, it remained at a historically low share of total FDI flows (39 per cent), and still 57 per cent below its peak in 2007. Thus, developing countries maintained their lead over developed countries by a margin of more than $200 billion for the second year running.

Developing countries and transition economies now also constitute half of the top 20 economies ranked by FDI inflows. Mexico moved onto tenth place. China recorded its largest ever inflows and maintained its position as the second largest recipient in the world.

FDI by transnational corporations (TNCs) from developing countries reached $454 billion- another record high. Together with transition economies, they accounted for 39 per cent of global FDI outflows, compared with only 12 per cent at the beginning of the 2000s. Six developing and transition economies raked among the 20 largest investors in the world in 2013. Increasingly, developing- country TNCs are acquiring foreign affiliates of developed- country TNCs in the developing world.

19.7.3 Megaregional groupings shape global FDI

The share of APEC countries in global inflows increased from 37 per cent before the crisis to 54 per cent in 2013. Although their shares are smaller, FDI inflows to ASEAN and the Common Market of the South (MERCOSUR) in 2013 were at double their pre-crisis level, as were inflows to the BRICS (Brazil, the Russia Federation, India, China and South Africa).

The three megaregional integration initiatives currently under negotiation- TTIP, TPP and RCEP- show diverging FDI trends. The United States and the EU, which are negotiating the formation of TTIP, saw their combined share of global FDI inflows cut nearly in half, from 56 per cent pre-crisis to 30 per cent in 2013. In TPP, the declining share of the United States is offset by the expansion of emerging economies in the grouping, helping the aggregate share increase from 24 per cent before 2008 to 32 per cent in 2013. The Regional Comprehensive Economic Partnership (RCEP), which is being negotiated between the 10 ASEAN member States and their 6 free trade agreements (FTA) partners, accounted for more than 20 per cent of global FDI flows in recent years, nearly twice as much as the pre-crisis level.

19.8 INDIA FOREIGN DIRECT INVESTMENT

Foreign investments provide a great stimulus for growth to the Indian economy. The continuous inflow of foreign direct investments (FDI), which is now allowed across several industries, manifests the faith that foreign investors have in the country's economy.FDI inflows to India increased 17 per cent in 2013 to reach US$ 28 billion, as per a United Nations report.

The Government of India's wise policy regime and a healthy business environment have also ensured that foreign capital keep flowing into the country. The government has taken numerous initiatives in recent years. For instance, in 2013, the Centre relaxed FDI norms in sectors such as defence, PSU oil refineries, telecom, power exchanges and stock exchanges, among others. The same year, established global players such as Tesco,

Singapore Airlines and Etihad lined up to invest in India as the government opened more sectors to overseas investment.

Market size

India received cumulative FDI inflows (including equity inflows, re-invested earnings and other capital) of US$ 331,923 million during the period April 2000 to May 2014, according to data published by Department of Industrial Policy and Promotion (DIPP), Government of India.

Total FDI equity inflows in India (including amount remitted through RBI's-NRI Schemes) during April 2000 to May 2014 stood at US$ 222,890 million.

Singapore led the share of top investing countries by FDI equity inflows into India with US$ 5,985 million during FY 14, followed by Mauritius (US$ 4,859 million), the UK (US$ 3,215 million) and the Netherlands (US$ 2,270 million).

The services sector attracted the highest FDI equity inflows in FY14 with US$ 2,225 million, followed by the construction development(US$ 1,226 million) and telecommunication(US$ 1,307 million) industries.

19.9 2013 FDI POLICY CHANGES IN INDIA

Amendments in Indian FDI policy in the year 2013 opened a number of key business sectors to increased foreign investment and in several instances eliminate the need for foreign investors to obtain approval from the Indian government before investing. Additional 2013 policy changes that alter the legal definition of 'control' as pertaining to the determination of sectorial caps, as well as regulations for single and multi-brand retail trading are also important for foreign institutional investors (FII) and firms considering foreign direct investment (FDI).

FDI Routes and Forms

Foreign investment into India falls under one of two FDI routes:

- **Government Route**: For investment in business sectors requiring prior approval from the Foreign Investment Promotion Board (FIPB).
- **Automatic Route**: For investment in business sectors that do not require prior approval from the government, but the filing of a notification after the incorporation of the company and issue of initial shares.

Changes to FDI Caps and Approval Routes

A comparison of the previous and revised policies in key Indian business sectors are outlined in the chart below:

Changes in the Definition of 'Control'

A changed definition of 'control' is also expected to apply to FDI in sectors where a sectorial cap currently exists. Prior to the 2013 amendments, companies were considered to be 'controlled' by resident Indian citizens if Indian citizens held a 51 percent stake in the firm and had the power to appoint a majority of directors in that company.

Under the broadened definition of control introduced the year 2013, 'control' now includes not only the power to appoint a majority of directors, but also the ability to control the management or policy decisions via shareholding, management rights, shareholder agreements, or voting agreements. Indian citizens must exercise 'control' under all limbs of this new definition for a company to be considered domestically 'controlled'.

Consequently, companies previously considered to be 'Indian' may now be viewed as foreign controlled and subject to FDI caps and other restrictions on downstream investment.

Changes in Single and Multi-Brand Retail Trading

While previous FDI policy only permitted one non-resident entity with ownership of a brand (or rights to a brand) to invest in Indian companies engaged in the retail trading of that brand, policy changes now allow multiple non-resident entities to invest in Indian entities engaged in single-brand retail trading of that brand (as long as each own or have rights to the brand via a legally binding agreement).

Additionally, single-brand retail trading investment routes have been modified as follows:

Single- Brand Retail Trading

Sector/ Industry	Previous Policy		2013 Revised Policy	
	Investment Cap	**Approval route**	**Investment Cap**	**Approval route**
Commodity Exchanges	49% (FDI+FII) FDI Cap: 26% FII Cap: 23%	Government	49% FDI Cap: 26% FII Cap: 23%	Automatic
Power Exchanges	49% (FDI+FII) FDI Cap: 26% FII Cap: 23%	Government	49% FDI Cap: 26% FII Cap: 23%	Automatic
Asset reconstruction	74% (FDI+FII)	Government	Up to 49%	Automatic
			49% to 100%	Government
Insurance	26% (FDI)	Automatic	26% (FDI+FII)	Automatic
Telecom Services	Up to 49%	Automatic	Up to 49%	Automatic
	Above 49% and Up to 74%	Government	Above 49% and Up to 100%	Government
Courier Services	100%	Government	100%	Automatic
Test Marketing	100%	Government	100%	Automatic
Petroleum Refining by public sector undertakings	49%	Government	49%	Automatic
Defence production	26% (FDI)	Government	26% Above 26%	Automatic Government

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Single- Brand Retail Trading

Former position		Revised Position	
Cap	**Route**	**Cap**	**Route**
100%	Government	Up to 49%	Automatic
		Above 49% and Up to 100%	Government

In respect to multi-brand retail trading, changes made in 2012 permitted up to 51 percent FDI with prior government approval. Conditions for investment, however, required

companies to invest at least 50 percent of the total FDI proceeds into 'back-end infrastructure' such as manufacturing, processing, packaging, distribution, logistics, design improvements, quality control, warehouses, storage, and agriculture market produce infrastructure. Changes made in 2013 now clarify that at least 50 percent of the first US$100 million invested must be in 'back end infrastructure.'

Investing

The issuance of shares by Indian companies falls under the compliance guidelines outlined in the Foreign Exchange Management Act (FEMA). Companies seeking capital through the public route should base the issuance price on SEBI guidelines. Unlisted companies seeking capital may not issue private shares at a price less than fair value based on the discounted cash flow method, and price will be determined by a SEBI registered merchant or chartered accountant. The acquisition of unlisted shares by a non-resident from an Indian resident must be exchanged at market price based on the SEBI guidelines.

Units operating in SEZs may issue shares at a price based on the valuation against the import of capital goods. This valuation must receive approval from a Development Commissioner Committee and the appropriate customs officials. Shares must be officially issued within 180 days of receipt of invested capital, or the funds must be refunded to investors.

Upon the issuance of shares to foreign investors, the issuing company has 30 days to file Form FC GPR, which outlines the company's activities and relevant details, through the appropriate regional office of the RBI. A certificate declaring compliance with the Companies Act 1956 and Companies Act 2013, as applicable from time to time, shall be submitted at the same time. The issuing company shall also obtain a certificate confirming the price of issue is in line with the prescribed guidelines.

19.10 ROAD AHEAD

Foreign investment inflows are anticipated to more than double and breach the US$ 60 billion mark in FY 15 as foreign investors show more confidence in India's new government, as per an industry study.

The country will require around US $1 trillion in the 12th Five-Year Plan (2012-17), to fund infrastructure growth covering sectors such as highways, ports and airways. This necessitates substantial support in terms of FDI. In 2013, FDI was witnessed in

sectors such as automobiles, chemicals, computer software and hardware, construction development, pharmaceuticals, power, services, and telecommunications. France, Germany, Japan, Mauritius, the Netherlands, Singapore, the UK, and UAE invested in India during that year.

19.11 INDIA'S FREE TRADE AGREEMENT AND OTHER INTERNATIONAL TRADE AGREEMENTS

19.11.1 Association of South East Asian Nations (ASEAN) and India Free Trade Agreement (FTA) negotiations.

India's engagement with the Association of South East Asian Nations (ASEAN) started with its "Look East Policy" in the year 1991. ASEAN has a membership of 10 countries namely Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. India became a Sectoral Dialogue Partner of ASEAN in 1992 and Full Dialogue Partner in 1996. In November 2001, the ASEAN-India relationship was upgraded to the summit level.

The key elements of the Framework Agreement on Comprehensive Economic Cooperation between the ASEAN and India cover FTA in Goods, Services, Investment and other areas of Economic Cooperation. The Agreement also provided for an Early Harvest Programme (EHP) covering areas of Economic Cooperation and a common list of items for exchange of tariff concessions as a confidence building measure. However, due to difference of opinion on Rules of Origin, the EHP could not be implemented.

The India-ASEAN agreement for Trade in Services and Agreement on Investment has been concluded and legal scrubbing of the Agreements have been done and the text of the Agreements have been endorsed by Minister of Commerce and Industry and ASEAN Economic Ministers during AEM-India consultation held in Brunei on 21st August 2013.

19.11.2 India- Sri Lanka Comprehensive Economic Partnership Agreement (CEPA)

1. India-Sri Lanka Free Trade Agreement (ISLFTA), which was signed in 1998, has become operational in 2000.
2. Sri Lanka is India's largest trading partner country in the SAARC region. The bilateral trade between India and Sri Lanka has grown four times in the last nine years increasing from US $ 658 million in 2000 to US $ 2719 million in 2009.
3. The main Indian exports to Sri Lanka are Petroleum (Crude & Products), Transport Equipments, Cotton, Yarn Fabrics, Sugar, Drugs Pharmaceuticals & Fine Chemicals.

The main Sri Lankan exports to India are, spices, electrical Machinery except electronic, Transport Equipments, Pulp & Waste, Natural Rubber and Paper Board.

19.11.3 India-Thailand Comprehensive Economic Cooperation Agreement (CECA)

In November 2001, the Prime Minister of Thailand, Dr. Thaksin Shinawatra and the Prime Minister of India had agreed to set up a Joint Working Group (JWG) to undertake feasibility study of a Free Trade Agreement (FTA) between India and Thailand. The JWG had observed that the policy regimes in both the countries were favorable to more intensive bilateral economic integration and a FTA could prove to be a building block for other sub-regional, regional and global economic integration processes of which both countries are a part. Having observed rich potential of trade expansion, the JWG has concluded that the proposed FTA between India and Thailand is feasible, desirable and mutually beneficial. Accordingly, a Joint Negotiating Group (JNG) was set up to draft the Framework Agreement on India – Thailand FTA.

2. During the visit of Indian Prime Minister to Thailand, a Framework Agreement for establishing Free Trade between India and Thailand was signed by the Commerce Ministers of the two sides on 9th October, 2003 in Bangkok, Thailand. The Framework Agreement covers FTA in Goods, Services and Investment and other areas of Economic Cooperation. The Framework Agreement also provided for an Early Harvest Scheme (EHS) for elimination of tariff on a fast track basis on 82 items of export interest to the sides.

3. The tariff concessions on 82 items of EHS list began from 1.9.2004 and have become zero for both sides from 1.9.2006.

4. The India-Thailand Trade Negotiating Committee (TNC) has been constituted to negotiate a comprehensive FTA covering Trade in Goods, Trade in Services, Investment, Rules of Origin, Dispute Settlement Mechanism etc. So far, 28 meetings of the TNC have been held".

19.11.4 Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) Free Trade Agreement (FTA) negotiations

The initiative to establish Bangladesh-India-Sri Lanka-Thailand Economic Cooperation (BIST-EC) was taken by Thailand in 1994 to explore economic cooperation on a sub regional basis involving contiguous countries of South East & South Asia grouped around the Bay of Bengal. Myanmar was admitted in December, 1997 and the initiative was renamed as BIMST-EC. The initiative involves 3 members of SAARC (India, Bangladesh & Sri Lanka) and 2 members of ASEAN (Thailand, Myanmar). BIMST-EC is

visualized as a 'bridging link' between two major regional groupings i.e. ASEAN and SAARC. BIMST-EC is an important element in India's "Look East" strategy and adds a new dimension to India's economic cooperation with South East Asian countries.

19.11.5 India-Gulf Cooperation Council (GCC) Free Trade Agreement (FTA)

A Framework Agreement on Economic Cooperation between Republic of India and Gulf Cooperation Council was signed on 25th August, 2004. The Framework Agreement provided that both the parties shall consider ways and means for extending and liberalizing the trade relations and also for initiating discussions on the feasibility of a Free Trade Agreement between them.

Accordingly, negotiations commenced with GCC. Two rounds of negotiations have been held so far in 2006 and 2008. Third round has not taken place as GCC has deferred its negotiations with all countries and economic groups and is currently reviewing its negotiations with all countries and economic groups. Efforts are being made at various bilateral/multilateral forums for early resumption of the negotiations.

19.11.6 India-SACU Preferential Trade Agreement (PTA) negotiations

South African Customs Union (SACU) comprises of South Africa, Lesotho, Swaziland, Botswana and Namibia. So far, 5 rounds of negotiations of India-SACU PTA have been held. The 1st round of technical discussions for India-SACU PTA took place in Pretoria on 5th–6th October, 2007. The 2nd round of PTA negotiations was held at Walvis Bay, Namibia on 21-22 February, 2008 while 3rd round was held at New Delhi on 25th–27th November, 2008 During the 3rd round of negotiations, a Memorandum of Understanding (MOU), was signed on 26th November, 2008 by the representatives of India and SACU to facilitate negotiations. 4th round of negotiations was held at Pretoria on 7th – 8th October, 2009.

2. The 5th round of negotiations was held during 7th – 8th October, 2010. During this round of negotiations, SACU has presented a revised text of the PTA as a working document. Further, both sides have agreed on the following:-

(i) The text on 'Dispute Settlement Procedures'

(ii) To use the text proposed by India on 'Customs Cooperation and Trade Facilitation' and TBT as the working text

(iii) To use the text on 'SPS' proposed by SACU as the working text.

19.11.7 India-Chile Preferential Trade Agreement (PTA)

A Framework Agreement to promote economic cooperation between India and Chile was signed on January 20, 2005 which envisaged for a Preferential Trade Agreement (PTA) between the two countries as a first step.

2. The India-Chile PTA was signed on 8th March, 2006 and has become operational on September, 2007. Expansion of the PTA - During the 1st meeting of the Joint Administrative Committee (JAC), which was held in New Delhi in February, 2009 to review the implementation of India-Chile PTA, both sides agreed to initiate the process of deepening and widening of the agreed lists of the existing India- Chile PTA. The 1st Meeting on negotiation on expansion of India-Chile PTA was held in Santiago on 28-29 January, 2010 in which both sides exchanged their wish list to each other. In the 2nd meeting on expansion of India-Chile PTA, which was held in August, 2010, The 3rd meeting on expansion of India-Chile PTA was held in 30 June- 1 July, 2011 in Chile

19.11.8 MERCOSUR Preferential Trade Agreement (PTA) Negotiations

MERCOSUR is a trading bloc in South America region comprising of Argentina, Brazil, Paraguay and Uruguay. It was formed in 1991 with the objective of free movement of goods, services, capital and people and became a customs union in January 1995. MERCOSUR's role model is European Union. It is the third largest integrated market after the European Union (EU), North American Free Trade Agreement (NAFTA).

2. A framework Agreement was signed between India and MERCOSUR on 17th June 2003 at Asuncion, Paraguay to create conditions and mechanisms for negotiations by granting reciprocal tariff preferences in the first stage and, in the second stage, to negotiate a free trade area between the two parties

3. As a follow up to the said Framework Agreement, a PTA between India and MERCOSUR was signed in New Delhi on January 25, 2004 and five annexes to this Agreement were signed and incorporated on March 19, 2005. The first two Annexes of the PTA relate to the list of products on which the two sides have agreed to give fixed tariff preferences to each other. The remaining three Annexes relate to the Rules of Origin, Preferential Safeguard Measures and Dispute Settlement Procedures respectively. By this PTA, India and MERCOSUR have agreed to give tariff concessions, ranging from 10% to 100% to the other side on 450 and 452 tariff lines respectively. The India-MERCOSUR PTA has become operational with effect from 1st June, 2009.

19.11.9 India-Pakistan Trading Arrangement

India and Pakistan have no formal trade agreement. India has granted Most Favoured Nation (MFN) Status to Pakistan, whereas Pakistan maintains a List of Importable Items from India called 'Positive List' which now consists of 1938 items.

19.11.10 India-EU Broad Based Trade and Investment Agreement (BTIA) negotiations

On 28th June 2007, India and the EU began negotiations on a broad-based Bilateral Trade and Investment Agreement (BTIA) in Brussels, Belgium.

2. These negotiations are pursuant to the commitment made by political leaders at the 7th India-EU Summit held in Helsinki on 13th October 2006 to move towards negotiations for a broad-based trade and investment agreement on the basis of the report of India-EU High Level Technical Group.

The negotiations cover Trade in Goods, Trade in Services, Investment, Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Trade Remedies, Rules of Origin, Customs and Trade Facilitation, Competition, Trade Defence, Government Procurement, Dispute Settlement, Intellectual Property Rights & Geographical Indications, Sustainable Development. So far, 15 rounds of negotiations have been held alternately at Brussels and New Delhi. The last meeting was held in the week of 13th May, 2013 in New Delhi

19.11.11 Global System of Trade Preferences (GSTP)

The Agreement establishing the Global System of Trade Preferences (GSTP) among Developing countries was signed on 13th April, 1988 at Belgrade following conclusion of the First Round of Negotiations. The GSTP came into being after a long process of negotiations during the Ministerial Meeting of the Group of 77, notably at Mexico City in 1976, Arusha in 1979 and Caracas in 1981. The Ministers of Foreign Affairs of the Group of 77 in New York set up the GSTP Negotiating Committee in 1982. The New Delhi Ministerial meetings, held in July 1985, gave further impetus to the GSTP negotiation process. The Brasilia Ministerial Meeting held in May 1986 launched the First Round of GSTP Negotiations. At the conclusion of the First Round in April 1988 in Belgrade, the GSTP Agreement was signed on 13 April 1988. The Agreement entered into force on 19th April 1989. Forty-four countries have ratified the Agreement and have become participants. The GSTP establishes a framework for the exchange of trade concessions among the members of the Group of 77. It lays down rules, principles and procedures for conduct of negotiations and for implementation of the results of the negotiations. The coverage of the GSTP extends to arrangements in the area of tariffs,

para-tariff, non-tariff measures, direct trade measures including medium and long-term contracts and sectoral agreements. One of the basic principles of the Agreement is that it is to be negotiated step by step improved upon and extended in successive stages

A Ministerial Meeting of the GSTP Negotiating Committee was held on 15 December,2010 in Foz do Iguacu, Brazil for signing of the "Final Act Embodying the Results of the Sao Paulo Round" and the "Sao Paulo Round Protocol on the Agreement on GSTP". The Ministers or Head of the Delegations of Members who have submitted their final schedules namely Cuba, Egypt, India, Indonesia, Korea, Malaysia, Mercosur and Morocco would be signing the two documents. India was represented by H.E. Mr. B.S. Prakash, Ambassador of India to Brazil.

19.11.12 Asia Pacific Trade Agreement (APTA)

The Asia-Pacific Agreement (APTA), previously named theBangkok Agreement signed in 1975 as an initiative of ESCAP, is a preferential tariff arrangement that aims at promoting intra-regional trade through exchange of mutually agreed concessions by member countries. APTA has five members namely Bangladesh, China, India, Republic of Korea, Lao People's Democratic Republic and Sri Lanka. ESCAP functions as the secretariat for the Agreement.

Under the 4th Round, the Standing Committee of Participating States has finalised framework agreements in the areas of (i) trade facilitation, (ii) trade in services and (iii) promotion and liberalisation of investments. Offers of further tariff liberalisation in goods have also been exchanged.

6. The Standing Committee is also considering a framework agreement on non-tariff measures and a revision of the APTA rules of origin.

19.11.13 India -New Zealand Free Trade Agreement / Comprehensive Economic Cooperation Agreement.

Based on the recommendation of the Joint Study Group (JSG) and subsequent approval of Trade and Economic Relations Committee (TERC) headed by the then Prime Minister of India on 21.01.2010, India is negotiating with New Zealand Comprehensive Economic Cooperation Agreement (CECA) covering trade in goods, services, investment and related issues. 9 rounds of Negotiation have been held so far. The 9th Round of negotiation was held during July, 2013 at Wellington (New Zealand) followed by an intersessional discussion on 9-10th December, 2013 in New Delhi.

19.11.14 India-Canada Comprehensive Economic Partnership Agreement (CEPA)

In September 2008, the India-Canada CEO Round Table recommended that India and Canada would benefit enormously from CEPA by elimination of tariffs on a substantial majority of the bilateral trade. CEPA would cover trade in goods, trade in services, rules of origin, sanitary and phytosanitary measures, technical barriers to trade and other areas of economic cooperation. A Joint Study was conducted and report came in September 2010 strongly recommending the benefits of CEPA for both the countries. Accordingly, the announcement of launch of India-Canada CEPA negotiations was made by PMs of both the countries in Seoul in November 2010 and the negotiations were formally launched by CITM and Canadian Trade Minister Van Loan on 16 November 2010 in New Delhi.

2. In a Joint Statement issued during the visit of Canadian PM Mr. Stephen Harper in November 2012, both the PMs have desired to conclude CEPA by the end of 2013.

3. Eight rounds of negotiations have already taken place. The 8th Round was held in Ottawa, Canada from 24th to 26th June, 2013.

19.11.15 India-Australia Comprehensive Economic Cooperation Agreement (CECA)

Based on the recommendation of the Joint Study Group (JSG) in 2010 and subsequent approval of The Trade and Economic Relations Committee (TERC) headed by the then Prime Minister of India on 29.04.2011, India is negotiating with Australia Comprehensive Economic Cooperation Agreement (CECA) covering trade in goods, services, investment and related issues.

Five rounds of negotiations for India Australia CECA negotiations have been held so far. The 1st round held in July, 2011 and the last i.e. 5th round was held on 20-21 May, 2013in Canberra (Australia).

19.11.16 India-Indonesia Comprehensive Economic Cooperation Agreement (CECA)

Commencement of negotiations on India-Indonesia CECA was announced on 25th January, 2011 during the visit of Indonesian President to New Delhi. During the CITM's visit to Indonesia on 3-4 October 2011, both sides held India-Indonesia CECA pre-negotiation consultations.

Joint Study on the India- COMESA (Common Market for East and Southern Africa) Joint Study Group Report to examine the feasibility of a Preferential Trade Agreement (PTA)/ Free Trade Agreement (FTA) between India and COMESA

Common Market for East and Southern Africa (COMESA) is Africa's largest economic community comprising of 19 member states namely Burundi, Comoros, DR Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Swaziland, Sudan, Uganda, Zambia and Zimbabwe.

A Joint Study Group (JSG) has been set up to examine the feasibility of a FTA between India and COMESA.

The 1st meeting of the India-COMESA JSG was held in Lusaka on 30-31st July, 2012.

It was decided during the 1st meeting of the JSG that the India-COMESA JSG will produce a joint report, containing its recommendations for consideration by the Government of India and the COMESA Secretariat.

19.11.17 India-Israel Free Trade Agreement (FTA) Negotiations

India and Israel are negotiating a Free Trade Agreement.

First round of negotiation was held in New Delhi on 26th May, 2010. Eight Rounds have been held since. The eighth round of negotiations was held in Israel from 24th to 26th November, 2013.

19.12 SUMMARY

Foreign capital now contributes a significant share of the domestic investment, employment generation, industrial production and exports in a number of economies, including India and China.

Broadly there are two types of foreign investment:

The first one is Foreign direct investment (FDI) where the investor has control over/ participation in the management of the firm. And the second one is Portfolio investor has only a sort of property interest in investing the capital in buying equities, bonds, or other securities abroad. In the case of portfolio investments, the investor uses his capital in order to get a return on it, but has no much control over the use of the capital. The major portfolio investment in the Indian capital market is by the foreign institutional investors (FIIs).

Broadly there are three economic motives of FDI, viz., resource seeking (e.g.; exploiting the natural resources of the host country); market seeking (i.e., to exploit the market opportunities of the host countries) and efficiency seeking (like low cost of production deriving from cheap labour).

The presence of any (or even all) of these determinants alone need not attract FDI. Several other factors like the political environment, government policies, bureaucratic culture, social climate, infrastructure facilities ect. Are also important determinants factors of FDI.

Although the international capital flows to the developing countries have increased substantially in the last one decade or so, they are still predominantly between the developed countries. A small number of countries account for the lion's share of the international capital inflows to the developing world.

Encouraged by the favourable business environment fostered by the global liberalization, the international private cash flows have been increasing rapidly. During the year 2013 global FDI flow was $1.45 trillion. FDI flows to developing economies reached a new high at $778 billion, accounting for 54 per cent of global inflows. India is also emerged as one of the important countries which attract FDI. Because of its wise economic policies and its liberalization policy during the year 2013 India was able attract huge amount of FDI.

The encourage its trade India has also entered with number of countries across the globe.

19.13 KEY WORDS

Portfolio

Investment

Speculation

Costs

Efficiently

Brand

19.13 SELF ASSESSMENT QUESTIONS

1. What FDI? What are the advantages and disadvantages of foreign capital?
2. Explain various factor affecting international investments.
3. Discuss the current trends in the global investments.
4. Explain the role of FDI in the Indian economy.
5. Explain the key changes in the 2013 FDI policy of India.
6. Explain the implications SAARC agreement.

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UNIT-20 : CONTEMPORARY ISSUES; FINANCIAL CRISIS, SOVEREIGN DEBT CRISIS AND GLOBAL ETHICS AND VALUES

Structure

20.0 OBJECTIVES

After studying this unit you should be able to:

- explain the reasons for the financial crisis
- analyse sovereign debt crisis and its impact on Indian economy
- discuss the global ethical values

20.1 FINANCIAL CRISIS

Recession can be defined as a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters. A recession would be indicated by a slowing of a nation's production, rising unemployment and falling interest rates, usually following a decline in the demand for money. A popular distinction between recession and depression is: 'Recession is when your neighbors lose his job; depression is when you lose yours.

Till present, the world has seen a number of economic recessions that brought the trade market and various economic states to a standstill and left the economists and analysts with valuable lessons to be learnt for future and calculating ways to move out.

20.*1.1 Prior to the start*

like all previous cycles of booms and busts, the seeds of the subprime were sown during unusual times. In 2001, the U.S. economy experienced a mild, short-lived recession. Although the economy nicely withstood terrorist attacks, the bust of the dotcom bubble, and accounting scandals, the fear of recession really preoccupied everybody's minds

To keep recession away, the Federal Reserve lowered the interest rate 11 times - from 6.5% in May 2000 to 1.75% in December 2001 - creating a flood of liquidity in the economy. Cheap money, once out of the bottle, always looks to be taken for a ride. It found easy prey in restless bankers - and even more restless borrowers who had no income, no job and no assets (NINJA loans). These subprime borrowers wanted to realize their life's dream of acquiring a home. For them, holding the hands of a willing banker was a new ray of hope. More home loans, more home buyers, more appreciation in home prices. It wasn't long before things started to move just as the cheap money wanted them to.

This environment of easy credit and the upward spiral of home prices made investments in higher yielding subprime mortgages look like a new rush for gold. The Fed continued slashing interest rates, emboldened, perhaps, by continued low inflation despite lower interest rates. In June 2003, the Fed lowered interest rates to 1%, the lowest rate in 45 years. This led to flood of irresponsible mortgage lending in America. Loans were doled out to "subprime" borrowers with poor credit histories who struggled to repay them. The whole financial market started resembling a candy shop where everything was selling at a huge discount and without any down payment. "Lick your candy now and pay for it later" - the entire subprime mortgage market seemed to encourage those with a sweet tooth for have-it-now investments. Unfortunately, no one was there to warn about the tummy aches that would follow.

These risky mortgages were passed on to financial engineers at the big banks, who turned them into supposedly low-risk securities i.e., collateralised debt obligations (CDOs) by putting large numbers of them together in pools. Pooling works when the risks of each loan are uncorrelated. The big banks argued that the property markets in different American cities would rise and fall independently of one another. But this proved wrong. Starting in 2006, America suffered a nationwide house-price slump. Investors bought the safer tranches because they trusted the triple-A credit ratings assigned by agencies such as Moody's and Standard & Poor's. This was another mistake. The agencies were paid by, and so beholden to, the banks that created the CDOs. They were far too generous in their assessments of them.

To make things merrier, in October 2004, the Securities Exchange Commission (SEC) relaxed the net capital requirement for five investment banks - Goldman Sachs (NYSE:GS), Merrill Lynch (NYSE:MER), Lehman Brothers, Bear Stearns and Morgan Stanley (NYSE:MS) - which freed them to leverage up to 30-times or even 40-times their initial investment. Everybody was on a sugar high, feeling as if the cavities were never going to come.

20.*1.2 The Beginning of the End*

But, every good item has a bad side, and several of these factors started to emerge alongside one another. The trouble started when the interest rates started rising and home ownership reached a saturation point. From June 30, 2004, onward, the Fed started raising rates so much that by June 2006, the Federal funds rate had reached 5.25% (which remained unchanged until August2007).

20.1.3 Declines Begin

There were early signs of distress: by 2004, U.S. homeownership had peaked at 70%; no one was interested in buying or eating more candy. Then, during the last quarter of 2005, home prices started to fall, which led to a 40% decline in the U.S. Home Construction Index during 2006. Not only were new homes being affected, but many subprime borrowers now could not withstand the higher interest rates and they started defaulting on their loans.

This caused 2007 to start with bad news from multiple sources. Every month, one subprime lender or another was filing for bankruptcy. During February and March 2007, more than 25 subprime lenders filed for bankruptcy, which was enough to start the tide. In April, well-known New Century Financial also filed for bankruptcy.

20.1.4 Investments and the Public

Problems in the subprime market began hitting the news, raising more people's curiosity. Horror stories started to leak out.

According to 2007 news reports, financial firms and hedge funds owned more than $1 trillion in securities backed by these now-failing subprime mortgages - enough to start a global financial tsunami if more subprime borrowers started defaulting. By June, Bear Stearns stopped redemptions in two of its hedge funds and Merrill Lynch seized $800 million in assets from two Bear Stearns hedge funds. But even this large move was only a small affair in comparison to what was to happen in the months ahead.

20.1.5 August 2007: The Landslide Begins

It became apparent in August 2007 that the financial market could not solve the subprime crisis on its own and the problems spread beyond the United State's borders. The inter bank market froze completely, largely due to prevailing fear of the unknown amidst banks. Northern Rock, a British bank, had to approach the Bank of England for emergency funding due to a liquidity problem. By that time, Central banks and governments around the world had started coming together to prevent further financial catastrophe.

20.1.6 Multidimensional Problems

The subprime crisis's unique issues called for both conventional and unconventional methods, which were employed by governments worldwide. In a unanimous move, central banks of several countries resorted to coordinated action to provide

liquidity support to financial institutions. The idea was to put the inter bank market back on its feet.

The Fed started slashing the discount rate as well as the funds rate, but bad news continued to pour in from all sides. Lehman Brothers filed for bankruptcy, Indy Mac bank collapsed, Bear Stearns was acquired by JP Morgan Chase (NYSE:JPM), Merrill Lynch was sold to Bank of America, and Fannie Mae and Freddie Mac were put under the control of the U.S. federal government.

By October 2008, the Federal funds rate and the discount rate were reduced to 1% and 1.75%, respectively. Central banks in England, China, Canada, Sweden, Switzerland and the European Central Bank (ECB) also resorted to rate cuts to aid the world economy. But rate cuts and liquidity support in itself were not enough to stop such a widespread financial meltdown.

The U.S. government then came out with National Economic Stabilization Act of 2008, which created a corpus of $700 billion to purchase distressed assets, especially mortgage-backed securities. Different governments came out with their own versions of bailout packages, government guarantees and outright nationalization.

20.1.7 Crisis of Confidence after All

The collapse of Lehman Brothers, a sprawling global bank, in September 2008 almost brought down the world's financial system. It took huge taxpayer-financed bail-outs to shore up the industry. Even so, the ensuing credit crunch turned what was already a nasty downturn into the worst recession in 80 years. Massive monetary and fiscal stimulus prevented a buddy-can-you-spare-a-dime depression, but the recovery remains feeble compared with previous post-war upturns. GDP is still below its pre-crisis peak in many rich countries, especially in Europe, where the financial crisis has evolved into the euro crisis, we will discuss in detail in the later section. The effects of the crash are still rippling through the world economy: witness the wobbles in financial markets as America's Federal Reserve prepares to scale back its effort to pep up growth by buying bonds.

20.1.8 Recession and its impact on Indian economy

India is a different economy and known as one of the most promising economies in terms of growth and investment. India, with $1.1 trillion or the second largest GDP among the world's developing economies is treading on the right path of sustained progress and development. While most Western economies were faced recession, the Indian GDP growth is likely to witness a slowdown from 9 percent to 6.5 / 7.5 percent during the

time of recession at rest of the world. The Indian economy is immune to the global mortgage crisis, failures of banks in the West and liquidity crisis.

"Indian economy is based on robust fundamentals and enjoys the status of one of the most dynamic and growing economies in the world with over 9 percent GDP last year."

India itself is a biggest consumer market with 300 million of middle class and the lowest debt ratio of 22 percent of the GNP. The country enjoys the highest savings rate of 28 percent of the GDP. Here in India the software and other few sectors were partly affected by the recession. Hence we can conclude by saying that India was not impacted largely by the US recession, simply because India is not which it was in the '80s-'90s. but the truth is that Indian economy 'faced slowdown not recession'.

The financial crisis of 2007-08 has taught us that the confidence of the financial market, once shattered, can't be quickly restored. In an interconnected world, a seeming liquidity crisis can very quickly turn into a solvency crisis for financial institutions, a balance of payment crisis for sovereign countries and a full-blown crisis of confidence for the entire world. But the silver lining is that, the world economies of almost all countries have been recovering.

20.2 SOVEREIGN DEBT CRISIS

After the American subprime crisis that began with the bursting of the US housing bubble, the Euro zone crisis is the next big cause of concern for global economies.

Sovereign debt means money owed by a government. Also called national debt, public debt, and government debt. Sovereign debt crisis can be defined as, a period of time in which several European countries faced the collapse of financial institutions, high government debt and rapidly rising bond yield spreads in government securities. The European sovereign debt crisis started in 2008, with the collapse of Iceland's banking system, and spread to primarily to Greece, Ireland and Portugal during 2009. The debt crisis led to a crisis of confidence for European businesses and economies.

20.2.1 Bonds, borrowing, and debt

When governments spend more money than they take in, they borrow money by selling bonds to investors. The more stable the country's economy, the less interest it needs to offer. Countries in economic turmoil—Greece and Italy, for example—have to offer high rates of interest.

20.2.2 A brief overview of Europe's debt crisis

Having gotten themselves deep in debt in recent years, Greece, Ireland and Portugal all needed to borrow billions of dollars in 2010 and 2011, to keep their governments functioning and to make payments on the interest.

To qualify for these bailouts, governments have had to cut their spending (by laying off government workers and reducing pensions) and increase their revenues (by raising taxes). These austerity measures haven't solved the problem, though. Greece's economy is contracting, its debt keeps growing, and some economists believe it will eventually default on its loans.

Meanwhile, Spain and Italy were also facing high debt levels, with no prospect of economic recovery in the short term. Because their economies are much bigger than Greece's, their struggles could threaten the stability of the euro, a currency used by 17 European countries. If investors decide that a collapse of the euro is inevitable, that may become a self-fulfilling prophecy.

The crisis has produced political tensions within the bailed-out countries and among the states of the European Union. In Germany, there was resistance to bailing out countries that were seen as having behaved irresponsibly. In Greece, there was anger at the government and at more prosperous countries, which have required Greece to impose job cuts that have left more than 16% of the workforce unemployed.

As a result of the debt crisis, ruling political parties in Ireland and Portugal have fallen from power, and two Prime Ministers (Papandreou of Greece and Berlusconi of Italy) have resigned from office.

Many European countries hold other countries' debt—that is, they have purchased other governments' bonds. If Greece or another country defaults, the losses will affect all of these countries' economies.

Will the euro survive as a common currency? Will Greece be expelled from the Eurozone? Allowing the economies of Greece and other states to collapse would have serious consequences for all of Europe (and the rest of the world), and leaders are doing everything they can to avoid that outcome. But various events (a disorderly default by Greece or another country; depositors demanding their money from banks that are short of cash; or a popular revolt against austerity measures) could easily trigger an economic catastrophe.

20.2.3 Background

After centuries of war between European nations, and especially after the two world wars of the 20th century, Europe's leaders attempted to prevent future conflicts through economic unity. (The idea of a united Europe had been proposed many times, by many thinkers such as William Penn, Immanuel Kant, Jeremy Bentham, and novelist Victor Hugo, who wrote, "A day will come when there will be no battlefields but markets opening to commerce and minds opening to ideas.")

In 1951, six countries (including France and West Germany) formed the European Coal and Steel Community, (ECSC), pooling their coal and steel production so that no one country could gain a dangerous advantage in these raw materials for war.

The ECSC evolved into the European Economic Community (EEC), or "Common Market," whose member states worked to align their economic policies.

The EEC later became the European Union, or EU, which now includes 27 nations. EU policies promote the free movement of people, products, services, and money across national borders.

A common currency, the euro, was first used by businesses in 1998; the euro became legal tender for consumers in 2002. Seventeen countries now use the euro.

The strategy of peace through economic integration has worked well so far: there has not been a major war in Europe since World War II.

20.2.4 Trouble

In 1992, the members of the European Union signed the Maastricht Treaty, under which they agreed to limit their deficit spending and debt levels. But some of these countries dodged the treaty's requirements. Low interest rates and a strong euro led to excessive borrowing and government spending, especially in Greece, during the decade leading up to 2009. (More specifically, observers blame Greece's troubles on generous public-sector salaries and benefits, construction of highways and hospitals, a large military, low taxes, and widespread tax-cheating.)

Let us see what happened at various countries of euro zone.

Greece: Greece had a debt load of over 100 percent of GDP in 2001, when it joined the euro. But joining the euro lowered interest rates on its debt, because the bond markets no longer worried about inflation or a devalued currency. The result was an economic boom fueled by low interest rates, and ever-increasing debt due to a lower cost of borrowing. Greece heired Wall Street firms, most notably Goldman Sachs, to

help hide its debt so as not to run afoul of E.U. rules. In October 2009, the conservative government was voted out, and the new socialist government announced that deficits were more than double previous estimates. Greek debt was immediately downgraded. The situation worsened in February 2010, when institutional bondholders started selling off Greek debt and ratings agencies kept downgrading it. Greece responded with a round of austerity measures.

In April 2010, Greek Prime Minister Georges Papandreou asked the International Monetary Fund and the EU to put together a rescue package. This was quickly followed by S&P downgrading Greek debt to junk status (junk bonds are risky bonds); a few months later, Moody's did the same. The European Central Bank moved to shore up Greece, and the E.U. and IMF settled upon a $145 billion bailout, conditioned on Greece adopting austerity measures worth a staggering 13 per cent of GDP. The E.U. also created the European Stability Facility (EFSF), a body intended to streamline future country bailouts.

The bailout/austerity package was a failure , leading to plummeting growth that actually worsened Greece's financial situation. This past June, S&P reduced its rating of Greek debt yet again to CCC, the lowest rating of any government in the world. As it was being debated, France and Germany hashed out another bailout package, which was finalized by the E.U. that provided another $145 billion and encourage private bondholders to help out. Moody's responded by downgrading Greek debt yet again, and declaring that default was "virtually 100 percent" certain.

Ireland: Unlike Greece, Ireland had a balanced budget before the crisis hit. However, it also had a huge real estate bubble even larger than the one in the United States. Before the crisis, 25 per cent of its economy was involved in home construction compared with less than 10 percent in normal economies. When the financial crisis hit in September 2008, the bubble burst and the government announced it would cover all banks' losses, in an attempt to calm the markets. The promise turned out to be disastrous, as the banking sector continued to implode. In January 2009, Ireland nationalized one of its major banks, and in October 2010 conducted a bailout of some others. At this point, its budget deficit had grown to 32 percent of GDP. The following month, the E.U. and IMF launched a $90 billion bailout of Ireland. The government was swept out of power, and the new government pledged to reduce the interest payments required under the E.U./IMF bailout, a promise they made good on in July, 2011. On July 12, 2011, Moody's downgraded Irish debt to junk.

Portugal: Unlike Ireland and Greece, Portugal had one of the best recovery records during the first part of the economic crisis. However, panic due to the Greek debt crisis hit the country in late 2009 and early 2010, due largely to concern that the country could not grow over the long term, as well as higher deficit forecasts. It has below-average productivity, a legal structure some condemn as outdated, and strict labor market regulations that some say hobble growth. By November 2010, the market had pushed interest rates to a point where the country was under pressure to ask for a bailout. Concern increased when the parliament failed to pass budget cuts in March, and European leaders met to discuss the possibility of a rescue package. Finally, the Portuguese government requested an E.U. bailout in April 2011. It was approved in May 2011 and totaled $116 billion. Portugal's center-right party came to power in elections in June 2011 and remains committed to the bailout. In the month of July, Moody's downgraded Portugal to junk status, saying there was a high risk of a second bailout.

Spain: Like Ireland, Spain experienced a real estate bubble leading up to the crisis, which hurt its growth despite the country's unusually safe financial sector. Facing higher than expected deficits, Spain adopted austerity measures in May 2010. Fitch responded by downgrading its debt a notch from AAA, out of fear these measures would hurt growth. Moody's followed suit . In March 2011**,** Spain announced it had met its deficit reduction target for the previous year. Moody's downgraded again, citing concern over slow growth. In recent days, as fears of Greek default have increased, borrowing costs for Spain have spiked, spurring fears that it may require a bailout that other European governments cannot afford. Spanish leaders say they are considering more austerity, and Moody's has put Spanish debt on warning for another downgrade.

Italy: Due to its huge debt load and slow growth, fears that Italy would develop a debt crisis have circulated for months, but they grew more pronounced after S&P downgraded its outlook on Italian debt in May 2011. In June 2011, Moody's also threatened a downgrade, citing rising borrowing costs. Italian Prime Minister Silvio Berlusconi, pushed through an austerity package intended to stave off a crisis as investors started selling off bonds. During 2011July and August, interest rates had shot up amid fears that a Greek default would cause a domino effect, causing Spain and Italy to fall as well. The EFSF probably has enough funds to support Spain for a short time, but Italy, the euro zone's third largest economy, would be incredibly expensive and perhaps impossible to bail out.

20.2.5 What it means for the euro zone

Many experts argue that the E.U.'s model, which concentrated monetary policy in the European Central Bank (ECB) while leaving fiscal policy to individual member states, is inherently unsustainable, as it denies member states monetary policy levers with which to help their recoveries. This also makes deficit-funded fiscal stimulus harder, as monetary policy can be used to keep borrowing costs low. When different countries are hit differently by a recession, as has happened now, the common monetary authority will act in ways that help some countries but not others. The ECB has pursued tight monetary policy that may prevent inflation in high-growth states like Germany but could also be worsening the recession in Greece, Spain, and other struggling states.

India's exports and imports to euro zone from 2006 to 2011-12 is as follows

India EU Trade

India EU Trade		
Exports ($ million)		**%Growth**
2006-07	26,831	15.51
2007-08	34,535	28.71
2008-09	39,351	13.95
2009-10	36,028	-8.45
2010-11	46,819	29.95
2011-12*	26,421	-
Imports ($ million)		**%Growth**
2006-07	29,856	14.86
2007-08	38,450	28.78
2008-09	42,733	11.14
2009-10	38,433	-10.6
2010-11	44,540	15.89
2011-12* * Aug- Sep	24,473	-

European leaders are interpreting stabilization of economic activity and stable borrowing costs as evidence that the debt crisis is over.

The reality is that since mid-2012, the European financial crisis has been in remission, with the symptoms of the underlying disease temporarily suppressed. As treatment is discontinued and drugs lose efficacy, there is a high probability of a relapse.

For Europe, it is now a case of NWO (no way out), as without strong growth its debt problems may prove intractable. The ECB has repeatedly stated that its ability to respond to pressures is "adequate". Unlike in July 2012, it is not clear whether it response will be "enough" this time around.

The best summation of the situation was provided by Spanish Prime Minster Rajoy when responding to a question of his country's economic status, he stated that: the recession is over, but the crisis continues.

20.3 ETHICS IN GLOBAL BUSINESS

It is said that one's actions will be judged according to the norms of the environment in which it takes place, which may not be true always in all the cases. In many circumstances, we pressure that as right way and the other alternatives are not acceptable to us.

Consider what you would think or do if the only way to obtain a certain permit or contract is to offer a bribe and that all others also do it. A firm may contend that if it does not act similar to firms local to that country, it may lose business and it has to bundle up and leave the country. Does that make it acceptable? Everyone knows that bribery is wrong or unethical because it allows certain parties to obtain a privilege not afforded to others. Many competing firms do not believe it is wrong or unethical to eat meat; individuals in other countries may consider eating meat is wrong and unethical. In India and even USA, men are generally restricted to one wife. Whereas in other countries that is considered as unthinkable and humiliating. Who is right? Who should answer that question? Are there any objective rights and wrongs? Both western and non-western values may have a great deal in common. E.g., Donaldson links the western values of individual liberty and human rights to the values of other regions.

The integrative social contracts theory as per Donaldson and Thomas Dunfie suggests that one can differentiate between those values which are fundamental across culture and theory (hypernorms) and those values which are determined with moral 'free space' and not hypernorms. One has to look to the convergence of religious, cultural

and physiological beliefs around certain core principles as a clue to the identification of hypernorms. Example of hyper norms are freedom of speech, the right to personal freedom, the right to physical movement and informed consent, when you consider these far reaching rights, do you believe that all reasonable thinkers would agree to their predominance and worthiness of a protection.

Donaldson's and Dunfee's effort is to propose a means by which to apply ethical standards across borders. The proposed codes of conduct include:

- US Model Business Principles
- Caux Round Table Principles

One has to judge the similarities and differences between the proposed models of business behavior.

If differences found, do these difference in themselves evidence the face that there is no general agreement regarding business conduct.

By creating a model code of conduct for a global firm, would it resemble any of these codes?

Firms complain that adhering to these codes of conduct is costly imposing higher costs on than those imposed on firms in other countries. Adherence to the codes tends them to be at a competitive disadvantage in comparison to firms in a less regulated countries.

In addition to compliance to a central code of business behavoiur, firms must be sensitive to cultural differences in those countries in which they do business. The flavors, the type of products preferred by the community, the packaging concept, the mode of advertisements ect. All have a bearing related to culture suited to that country. Challenges to this cultural sensitivity are strong. If one culture's standards seriously violate a norm that is generally accepted by many other cultures, can you take the majority as right?

How can one determine right from wrong in the global arena? Is the most significant question. Right and wrong depends on the standards by which you are judging the act or decision. As the national boundaries within our world market become increasingly blurred, so too do the cultural differences.

20.4 SUMMARY

Recession can be defined as a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters. The reduction in the interest rates by Federal Reserve is the root cause for the 2007-08 recession. Availability of cheaper cost of loan made US citizens to borrow home loans even though they did not have repayment capacity. Once the real estate reached its declining stage and the Federal interest start increasing the defaults of payment of loans were increased, this is the starting point for the recession. In the inter connected global markets most of the countries were affected by the recession. End of the day after all recession there has to be recovery, global economy is recovering now.

Sovereign debt crisis can be defined as, a period of time in which several European countries faced the collapse of financial institutions, high government debt and rapidly rising bond yield spreads in government securities. A common currency, the euro, was first used by businesses in 1998; the euro became legal tender for consumers in 2002. Seventeen countries now use the euro. In 1992, the members of the European Union signed the Maastricht Treaty, under which they agreed to limit their deficit spending and debt levels. But some of these countries dodged the treaty's requirements. Low interest rates and a strong euro led to excessive borrowing and government spending, especially in Greece, during the decade leading up to 2009. (More specifically, observers blame Greece's troubles on generous public-sector salaries and benefits, construction of highways and hospitals, a large military, low taxes, and widespread tax-cheating.). The European sovereign debt crisis started in 2008, with the collapse of Iceland's banking system, and spread to primarily to Greece, Ireland and Portugal during 2009. The debt crisis led to a crisis of confidence for European businesses and economies. The reality is that since mid-2012, the European financial crisis has been in remission, with the symptoms of the underlying disease temporarily suppressed. As treatment is discontinued and drugs lose efficacy, there is a high probability of a relapse.

While doing business out side the home country certain ethical dilemmas will arise. What is ethical for one country may be unethical at another country. The integrative social contracts theory as per Donaldson and Thomas Dunfie suggests that one can differentiate between those values which are fundamental across culture and theory (hypernorms) and those values which are determined with moral 'free space' and not hypernorms. One has to look to the convergence of religious, cultural and physiological beliefs around certain core principles as a clue to the identification of hypernorms. Example of hyper norms are freedom of speech, the right to personal freedom, the right

to physical movement and informed consent, when you consider these far reaching rights, do you believe that all reasonable thinkers would agree to their predominance and worthiness of a protection.

20.6 KEY WORDS

Recession

Bonds

Debt

Euro

Ethics

20.5 SELF ASSESSMENT QUESTIONS

1. Explain the reasons for 2007-08 recessions.
2. Briefly discuss the causes for the sovereign debt crisis.
3. Explain the impact of sovereign debt crisis and global recession on Indian economy.
4. Why ethical dilemmas arise in the global business?

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