CHAPTER 30

THE SERVICES SECTOR IN INDIA

Chapter Outline :

- Introduction
- Nature and Types of Services
  - Goods Versus Services
  - Alternative Service Classifications
- Trend and Pattern of Growth
- Factors of Growth
- Industrial Growth as a Determinant of Services Sector Growth
- Services Tax Regime
- Service Exports
  - Latest EXIM Policy for Services Export Development
- Conclusion

INTRODUCTION

The services sector is, at present, the largest contributor to India's **gross domestic product** (GDP) or **national income.** According to the data of **Central Statistical Organisation,** services sector accounted for about 49 per cent of the country's GDP in the year 2001. The share was 36 per cent in 1980 and about 40 per cent in 1990. In comparison, the shares of agriculture and industry in 2001 were about 25 per cent and 26 per cent respectively.

Table 30.1 gives the comparison of India's services sector with that of select Asian countries. Among the less developed countries, India has comparatively higher share of the services sector. In 2001 this share was about 40 per cent in less-developed countries (excluding India and China), about 58 per cent for middle-income countries and 68 per cent for high-income countries. At the global level, the share of services stood at about 63 per cent in 2001. The share of services is above 70 per cent in USA, UK, Austria, Belgium, Australia, Hong Kong, France, Italy, Norway, Poland, Panama and Singapore. According to the projections of the Ninth Five-Year Plan, employment opportunities in the year 2000 were 57 million in the transport sector, 5 million in finance and insurance, 45 million in the social services and 17 million in construction as compared to 49 million in the manufacturing sector.

Table 30.1: **Share of the Services Sector in India and Selected Asian Countries, 2001**

Country	% Share in GDP
India	48.8
China	33.6
Indonesia	37.1
Korea	54.1
Malaysia	41.9
Pakistan	52.0
Philippines	53.3
Thailand	49.3

Source: Asian Development Bank (2002), *Key Indicators.*

NATURE AND TYPES OF SERVICES

Compared to goods, services are relatively complex in nature. With the growth of the service sector in a number of economies, the range of services produced has multiplied at an amazing pace creating taxonomical problems. ***It must be understood that services, like goods, are products and require inputs, both tangible and intangible, for their production.***

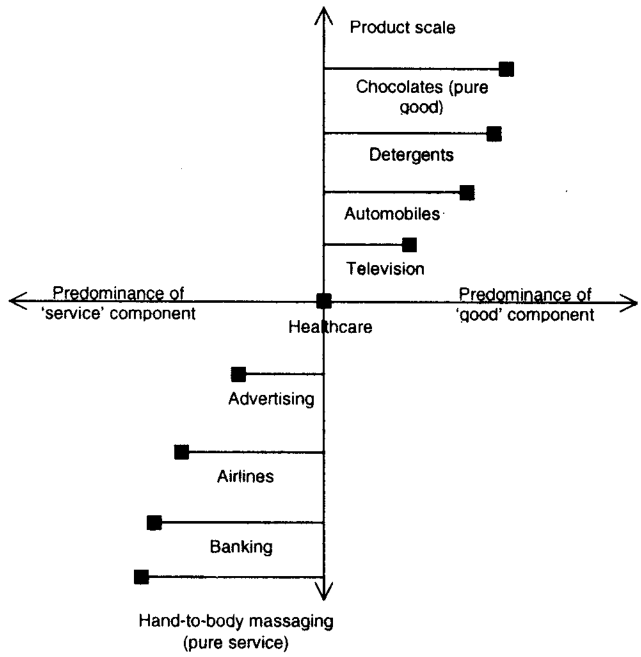
GOODS VERSUS SERVICES

In fact the distinction between goods and services is not perfect. ***Most of the services are delivered or received through goods so that goods are purchased for the services they render.*** For example, cars are purchased for transportation, computers for data processing, TVs for education or entertainment services, vacuum cleaners for cleaning and refrigerators for cooling. Then, there are products which come wrapped with services and it can be quite difficult to isolate the service components from the total package consisting of goods plus services. For example, it is difficult to find out how much is charged or paid for food and hospitality services separately in a hotel or restaurant. Similarly, a passenger travelling in an aeroplane or train makes payment for the composite package of transportation, food, security and hospitality and a buyer of automatic washing machine pays for after-sale services, the charges of which are inseparably included in the price of the product.

However, it is easier to identify whether, in a product, it is the good or the 'service' component which is predominant. The 'good' component may be identified by the attribute of tangibility (and hence service by intangibility). Thus, it is possible for us to build a scale on which products may be classified on the basis of the fact whether it is tangibility or intangibility that predominates. The scale is exhibited in **Figure 30.1**. At one end of the scale we have **pure goods** like chocolates where no service and intangibility is perceived. On the other end, we may have **pure services** which are such products as hand-to-body massage, where no tangibility of product is observed. In between, we have an array of products in declining order of tangibility or, equivalently, rising order of intangibility.

FIGURE 30.1

Products arranged according to the good-service mix



Source: Adapted from Shostack, G.L. (1977), 'Breaking Free from Product Marketing', *The Journal of Marketing, April, p.77*

It is now easy to understand the contrasting features of goods and services (**Table 30.2**).

Table 30.2: **Contrasting attributes of goods and services**

Goods	Services
1. Manifested in objects, devices and things	1. Manifested in deeds, efforts and performances
2. Tangible	2. Intangible
3. Grown, Processed, Fabricated or manufactured	3. Generally performed
4. Patentable	4. Generally, not patentable
5. High barriers to entry	5. Relatively low barriers to entry
6. Storable	6. Not storable
7. Can be sampled before purchases	7. Can't be sampled (in most cases)
8. Generally, supplier moves the product to the customer	8. Generally customer moves to the supplier to avail service
9. Buyer has the full right to use the product the way he likes	9. Buyer has limited right to use (like internet, medical service)
10. Ownership transferable	10. Ownership is often not transferable
11. Capital requirements for production are high	11. Capital requirements are generally lower

ALTERNATIVE SERVICE CLASSIFICATIONS

There are different ways in which services can be classified. These classifications help in understanding the composite structure of the services sector. The various criteria on which services can be classified relate to tangibility, types of customer and service providers, mode of delivery, extent of customisation and relation between the buyer and the seller. The major classification criteria are given in **Table 30.3**.

Table 30.3: **Alternative Classification Criteria for Services**

Classification criteria	Service types	Examples
1. **Scope**	• Macro-economic services	Defence; public administration, judiciary; satellite services; national broadcasting; railways
	• Micro-economic services	Beauty parlours; health care; road transport; laundering
2. **Degree of tangibility**	• Services from owned and rented goods	Food processors; TVs, computers, washing machines, vacuum cleaners
	• Services from nongoods	Internet
3. **Service Direction**	• Services directed at people's bodies	Healthcare; passenger transport; hotelling; health clubs
	• Services directed at people's mind	Education; entertainment; information services

Contd...

	• Services directed at peoples' physical goods or possessions	Laundry; sanitation; freight transport; repair and maintenance
4. **Origin**	• Factor services	Services of labour, capital, land and entrepreneurship
	• Non-factor services	Banking; insurance; information
5. **Skill level of the service provider**	• Professional services	Advertising; consultancy; interior decoration
	• Non-professional services	Vehicle repairs; shoe repairs;
6. **Labour intensity**	• Labour intensive services	Massaging; hair cuts; vehicle repairs, education
	• Capital-intensive services	Medical diagnostic services; material testing; transportation; telecasting
7. **Relation with the customer**	• Membership-based continuous or regular services	Health clubs; cable TV; banking; insurance; telephone subscription
	• No formal relation	Broadcasting; police services; road transport; pay phones; hotelling.
8. **Degree of customisation**	• Highly customised services	Interior decoration; beauty parlours; healthcare; legal services; advertising
	• Standardised services	Passenger transport; distance education; street lighting; newspapers

There can be many other ways of describing service categories depending upon the purpose of classification. It can be seen that these categories are not mutually exclusive. Any particular service can be classified in a number of ways. Nevertheless, these categories enable a better understanding of the structure of the services sector.

TREND AND PATTERN OF GROWTH

It is a common trend in less developed countries that as an economy grows, first the share of industry and subsequently the share of services in national output increases. **Table 30.4** shows the pattern over the last 20 years. The Table shows that the share of industry first rose from 25.9 percent in 1980 to 29.3 per cent in 1990 and later fell to 26.4 per cent in the year 2001. Correspondingly, the share of services in GDP rose from 36.0 per cent in 1980 to 39.7 per cent in 1990 and further to 48.8 per cent in 2001. In the process of structural change, the share of agriculture in GDP has been consistently declining. ***It may be concluded that between 1980-90 agriculture lost its share both to industry and services and during 1990-2001 both agriculture and industry lost their share to services.***

Table 30.4: **Comparative shares of agriculture, Industry and services in India,**

	Share in GDP (%)		
Year	Agriculture	Industry	Services
1980	38.1	25.9	36.0
1990	31.0	29.3	39.7
2001	24.7	26.4	48.8

Source: Extracted from Govt of India, *Economic Survey 2002-03, Table 1.5, p. 11*

Simply stated, the rising share of services is equivalent to saying that the growth rate in the services sector has been faster compared to that in agriculture and industry. **Table 30.5** provides evidence pertaining to recent years. It can be seen that over the period 1995-2003, the services growth rate has been generally higher and more consistent. Comparatively, industrial growth rate has been less stable though in the positive range. Agricultural performance has been unstable – fluctuating between positive and negative values. This behaviour of the growth rate is basically due to the inherent uncertainty facing the sector. Except the year 1996-97, services growth rate has been higher than the **GDP** growth rate during the period 1995-2003.

Table 30.5: **Growth of the services sector vis-à-vis industry and agriculture, 1995-2003**

Year	Growth rate[1]			
	Agriculture[5]	Industry	Services	GDP
1995-96	–0.9	11.6	10.5	7.3
1996-97	9.6	7.1	7.2	7.8
1997-98	–2.4	4.3	9.8	4.8
1998-99	6.2	3.7	8.4	6.5
1999-2000	0.3	4.8	10.1	6.1
2000-01[2]	–0.4	6.6	5.6	4.4
2001-02[3]	5.7	3.3	6.8	5.6
2002-03[4]	–3.1	6.1	7.1	4.4

Notes: [1] Measured as % change in output over the previous year (at factor cost)

[2] Provisional estimates

[3] Quick estimates

[4] Advance estimate

Source: Central Statistical Organisation

Within the services sector, different services command different shares and show different growth rates. **Table 30.6** show the growth rates of different service groups and their share in national income in recent years (1995-2002).

Table 30.6: **Growth rates of different service groups and their share in GDP (at factor cost), 1995-2002**

Year	Growth rate[1] of service group			% share in GDP, of service group		
	I[2]	II[3]	III[4]	I[2]	II[3]	III[4]
1995-96	13.3	8.2	7.9	20.9	11.4	11.5
1996-97	7.8	7.0	6.3	20.9	11.3	11.4
1997-98	7.8	11.6	11.7	21.5	12.1	12.2
1998-99	7.7	7.4	10.4	21.8	12.2	12.6
1999-2000	8.5	10.6	12.2	22.2	12.7	13.4
2000-01(P)	6.9	3.5	5.6	22.8	12.6	13.5
2001-02 (Q)	8.7	4.5	5.6	23.5	12.5	13.5
2002-03(A)	7.8	6.5	6.4	–	–	–

P = Provisional; Q = Quick estimate; A = Advance estimate

Notes: [1] Measured as % change in GDP over previous year

[2] Includes trade, hotels, transport and communications

[3] Includes financial, real estate and business services

[4] Includes community, social and personal services

Source: Calculated from CSO data

It can be seen that the variability in the growth rate of Group II and Group III services has been higher as compared to that in Group I services. In Group I services, except for the year 1995-96, the growth rate consistently remained between 7 to 9 per cent approximately. So far as the share of individual service groups is concerned, Group I slowly enlarged its share from 20.9 per cent to 23.5 per cent over the period 1995-2002. Similarly Group III enlarged its share by two percentage points. The growth in the share of Group II services has been the least. Nevertheless, it is found that the overall growth in the share of service sector in GDP has been spread over all the three groups of services. ***At present, the output of Group I services is coming almost to the level of aggregate output of the industrial sector.***

Table 30.7 provides a more detailed picture of the trend of the share of individual service categories in India's GDP in recent years. ***It is worth noting that the shares of construction, transportation, real estate, public administration and defence in GDP has been almost stagnant over 1993-2002 meaning thereby that these segments have grown almost at the same rate at as GDP while trade, hotels and restaurants, banking and insurance, community social and personal services have marginally increased their share.*** Within transport segment, the share of railways has marginally declined from 1.23 per cent to 1.10 per cent over the period. ***Trade and communication have been relatively fast growing segments and have enlarged their share in GDP.***

Table 30.7: Trends in the share of different service segments in GDP

Service Segment		Share (%) in GDP								
		93-94	94-95	95-96	96-97	97-98	98-99	99-00	00-01	01-02
1.	Construction	5.2	5.1	5.1	4.8	5.0	5.0	5.1	5.2	5.2
2.	Trade	11.9	12.3	13.1	13.1	13.4	13.5	13.6	13.6	14.0
3.	H&R[1]	0.8	0.8	0.9	0.9	0.9	1.0	1.0	1.0	1.1
4.	Railways	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1
5.	Other Transport	4.0	4.1	4.2	4.2	4.3	4.2	4.2	4.3	4.3
6.	Storage	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
7.	Communication	1.2	1.3	1.5	1.5	1.7	2.0	2.0	2.7	3.0
8.	Banking & Insurance	5.3	5.4	5.6	5.7	6.4	6.5	7.0	6.6	6.4
9.	Real Estate	6.2	6.0	5.9	5.7	5.7	5.7	5.7	6.0	6.0
10.	CSP[2] Services	12.0	11.5	11.6	11.4	12.2	12.6	13.4	13.5	13.5
11.	Public admn. & defence	5.6	5.3	5.2	5.1	5.5	5.8	6.1	6.0	5.9
12.	Other Services	6.4	6.3	6.4	6.4	6.7	6.9	7.2	7.5	7.6

Notes: [1] Hotels and restaurants.
[2] Community, social and personal services.
Source: Computed from CSO data

FACTORS OF GROWTH

It is now widely observed and accepted that as the process of economic growth takes place, the importance of agriculture declines and that of industry increases. As growth further proceeds, services sector grows faster than industry (as well as agriculture) so that the share of services in GDP rises. This has already been witnessed in the Indian case in the preceding sections. The phenomenon of services sector overtaking the industrial sector is sometimes referred to as **de-industrialisation** (the term must not be misinterpreted as negative growth in industry). In India, services sector appears to be the biggest beneficiary of economic reforms. (**Table 30.5 and 30.6**). The leading factors behind the growth of the services sector are the following.

Growth of Disposable Income

As pointed out in **Box 30.1**, as **personal disposable income** increases, first the demand for industrial goods relative to agricultural goods rises and later demand for services relative to industrial goods increases. Increasing demand for services is associated with lifestyle changes and is due to high **income elasticity of demand** for various services such as education, entertainment, personal transport, communication, healthcare, and the like.

BOX 30.1

The link between the level of development and the share of services – what economists said 40 years ago

Economists observe a close link between the level of economic development and the structure of an economy. There have been two independent and celebrated works by Hollis Chenery (1960) and Simon Kuznets (1969) in which the relation has been traced. According to their findings, in more developed countries, the share of the primary sector in labour force is low and that of the secondary and the tertiary sectors is high while the opposite is the case in less developed economies. These economists have found that the share of primary sector is inversely related to the level of GDP while that of the secondary and tertiary sector is positively related to it. There are basically four reasons for the rising share of services.

- With rise in per capita income, the demand for services like transport, communication and recreation rises at a faster pace.
- Capital-intensive production in the industrial sector requires matching transportation, communication, managerial and technical skills and a widespread network of distribution and trade.
- As personal disposable income rises, demand for consumer durables increases which subsequently increases demand for maintenance and repair services. Changing lifestyles cause demand for entertainment and recreational services, tourism, healthcare and education to rise.
- As the country moves from industrial to super-industry economy, urbanisation levels rise and the role of macro-economic services like policing, administration, legislation and regulation increases.

Sources: Chenery, Hollis (1960), 'Economic and Structural Change' *American Economic Review, September and* Kuznets, Simon *(1959), Six Lectures on Economic Growth,* Free Press.

Compulsions of Industrialisation

Industrialisation requires continuous support of various services like transport, communication, market research, advertising, consultancy, distribution, trade finance, banking and insurance. The demand for such services, therefore, is bound to rise as industrialisation proceeds. Industrialisation also creates additional pressure on demand for government services like industrial security, legislative services and administrative and regulatory services.

Growing Professionalism and Specialisation

With industrialisation, competition and growth of technical education, there has been prolific growth of professionalism in various areas of the service economy of the country. A large number of technical professionals are now specialising in diverse fields. The sector, in fact, offers immense scope for innovation and creativity which provides an excellent basis for its growth. Some of the leading professional and specialisation areas that have emerged in a big way include IT-enabled services, telecommunications, engineering and management consultancy, clearing and forwarding agents, non-life insurance, travel agencies, outdoor catering, rental services and computer hardware maintenance.

Employment

Service sector in the country has emerged as a leading provider of employment. With increase in the share of the sector in GDP, the new employment opportunities are also shifting to this sector.

Part of the growth of the sector is attributed to the fact that it attracts creative people to it which innovate and introduce new marketable products on a continuous basis. A huge segment of the service economy is in the **informal sector** which is greatly heterogeneous and absorbs labour both in urban areas and that migrating from rural areas.

Capital-light

Most of the service units are easy to establish as these depend on labour and skills and require relatively low capital investment. Most of the service producing units are in the small scale sector and are easy to establish provided the relevant skills are available. Because of low capital requirement, **exit costs** are also low.

Tax Advantages

At present, a large number of service activities are outside the tax dragnet. Those within the tax net are subject to low rates of service tax. A large part of the service sector which is in the informal sector, is practically exempted from taxes. A large number of service units being in the SSI category enjoy many incentives and concessions from the government.

INDUSTRIAL GROWTH AS A DETERMINANT OF SERVICE SECTOR GROWTH

It must be appreciated that the industry and services sectors are complementary in a large number of areas. This complementarity highlights interdependence of the two sectors. Industrial sector provides a large number of inputs particularly machinery and equipments which are important in generating a wide range of professional and non-professional services. The services sector correspondingly produces a wide range of services like information, communication, transport, data processing, advertising, designing, consultancy, market research and trading which are indispensable for industrial growth. The symbiotic relationship in fact calls for balanced growth of the two sectors. Industrial growth also generates income which supports demand for various services. The state plays an important role in the provision of various services particularly at the macro-economic level and the extent of these services has to be kept in tune with the industrialisation trends.

Sectors like trade, hotels and restaurants, financing, insurance and real estate are heavily reliant on industrial development and growth. Poor industrial growth in the recent years has been responsible for slow growth of a number of such service segments. During 2002-03, the service sector grew at a rate of about 7.1 per cent but there are signs of its faltering performance. In 2001-02, service sector growth was lower at 6.8 per cent – second lowest growth rate since 1993-94 which followed 3.5 per cent growth in industrial output.

SERVICE TAX REGIME

Services are least-taxed in India. The number of services taxed as well as the rates of tax are low in the country. In fact service tax is of recent origin in the country and most of the organisations that pay service tax are in the organised sector. The units which are providing taxable services are required to get themselves registered with jurisdictional Central Excise and are required to pay service tax at the rate of 5 per cent on the amount realised by them for the services rendered. In January 2003, there were 51 identified services as listed below, on which service tax is leviable.

1. Advertising
2. Air Travel Agents
3. Architects
4. Authorised service stations
5. Auxiliary insurance services
6. Auxiliary services relating to life insurance
7. Banking and financial services
8. Beauty parlours
9. Broadcasting services
10. Clearing and forwarding agents
11. Cable operators
12. Cargo handling services
13. Consulting engineers
14. Conventions
15. Couriers
16. Credit card agencies
17. Custom house agents
18. Dry-cleaning services
19. Event Management
20. Fax services
21. Fashion Designers
22. Health club and fitness centres
23. Insurance services
24. Interior decorators
25. Leased circuit services
26. Management consultants
27. Manpower recruitment agencies
28. Mandap keepers
29. Market research agencies
30. Online information and database services
31. Pager services
32. Photography services
33. Port services
34. Practising chartered accountants
35. Practising company secretaries
36. Practising cost accountants
37. Private security agencies
38. Rail travel agents
39. Real estate agents and consultants
40. Rent-a-lab operators
41. Scientific testing and consultancy services
42. Sound recording services
43. Steamer agents
44. Stock brokers
45. Storage and warehouse services
46. Telegraph services
47. Telephone services
48. Telex services
49. Tour operators
50. Underwriting agencies
51. Videotape production services

Government of India, by virtue of **Entry 97 of the Union List of Constitution of India** (levies) taxes selected services. In 1994-95, when service tax was introduced, only three services viz. stock broking, general insurance and telephone services were subjected to service tax. Since then the service tax base has gradually expanded to include additional areas as listed above. Some of the important legislative changes relating to service tax include:

- Enhancing the time limit for issue of notice of recovery of service tax
- Allowing credit of service tax paid on inputs for payment of service tax on output services provided both input and output services fall in the same category
- Enhancing the limit of penalties.

Further legislative changes are under consideration to empower both central and state governments to levy and collect service taxes. Simultaneously, the service tax regime has been made taxpayer-friendly. A separate **Directorate General of Service Tax** exists for the effective management of the tax. The revenue from service tax has risen substantially from just Rs 407 crore in 1994-95 to Rs 3301 crore in 2001-02 and is estimated to be Rs 6026 crore in 2002-03.

SERVICE EXPORTS

India is both an exporter and importer of services which are recorded in the **invisibles account** of the **balance of payments.** The country, at present, enjoys a surplus position in trade in services and the surplus has been increasing in recent years. In the year 2001-02, net invisibles inflows were of the order of $14 billion – a figure that has been highest over the last decade. India's growth rate in the receipts of services is much higher than that of Asia and of the world as a whole and the situation matches with the place of the sector in the economy.

The major items in the invisibles account of the **balance of payments** are:

1. Foreign travel;
2. Transportation;
3. Insurance;
4. Investment income (including dividend and interest and debt amortisation flows);
5. Transfer payment (private and on government account);
6. Other government related inflows; and
7. Miscellaneous invisible receipts.

Of these, items (1), (2), (3), (4) and (7) are **market-related service receipts.** Item (5) covers private inward remittance by non-resident Indians and this part predominates the item. Though theoretically, private inward remittances may be termed as 'labour export proceeds' but more logically these are **transfer payments** for which no service products are exported. In a strict commercial sense, items (1) to (4) and, to a good extent, item (7) would qualify as marketable services. **Table 30.8** provides figures on service export trends in recent years.

Table 30.8: **India's service exports, 1996-2002**

Service Segment		Share (%) in GDP								
		93-94	**94-95**	**95-96**	**96-97**	**97-98**	**98-99**	**99-00**	**00-01**	**01-02**
1.	Construction	5.2	5.1	5.1	4.8	5.0	5.0	5.1	5.2	5.2
2.	Trade	11.9	12.3	13.1	13.1	13.4	13.5	13.6	13.6	14.0
3.	H&R[1]	0.8	0.8	0.9	0.9	0.9	1.0	1.0	1.0	1.1
4.	Railways	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1
5.	Other Transport	4.0	4.1	4.2	4.2	4.3	4.2	4.2	4.3	4.3
6.	Storage	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
7.	Communication	1.2	1.3	1.5	1.5	1.7	2.0	2.0	2.7	3.0
8.	Banking & Insurance	5.3	5.4	5.6	5.7	6.4	6.5	7.0	6.6	6.4
9.	Real Estate	6.2	6.0	5.9	5.7	5.7	5.7	5.7	6.0	6.0
10.	CSP[2] Services	12.0	11.5	11.6	11.4	12.2	12.6	13.4	13.5	13.5
11.	Public admn. & defence	5.6	5.3	5.2	5.1	5.5	5.8	6.1	6.0	5.9
12.	Other Services	6.4	6.3	6.4	6.4	6.7	6.9	7.2	7.5	7.6

Notes: [1] Includes dividend receipts and debt service receipts. This flow represents factor service exports.
[2] Includes miscellaneous services such as professional services, software agency charge etc.
[3] Includes remittances (private and official) and grants
[4] Figures in brackets show % share of service exports in respective rows.
Source: RBI data.

It can be seen from the data that the total service (factor plus nonfactor) exports (excluding inward remittances from NRIs) rose about 2.5 times during 1996-2002. As a result their, share in total invisible receipts (including NRI remittance, grants etc) rose from about 40 per cent to 64 per cent over the period. Service exports which were about one-fourth of the country's total merchandise exports in 1996-97, were about one-half of the same in 2001-02, thus doubling their share. The growth of service exports in the country, as already pointed out, is commensurate with the trend in the share of the sector in GDP.

However, service exports have a narrow base. Nonfactor service exports are predominantly based on foreign travel, transportation and insurance and this base has to be widened for sustained growth of service exports in future. In recent years, software exports have also made a significant surge. During 2001-02, software exports increased by about 13 per cent in spite of marked slowdown in the IT market the world over.

LATEST EXIM POLICY FOR SERVICE EXPORT DEVELOPMENT

Keeping in view the export potential of the services sector, Export-Import Policy for the year 2003-04 specially focuses on it. The new policy allows for duty-free import of consumables, office and professional equipment, spares and furniture upto 10 per cent of the average foreign exchange export earnings in the previous three years. The facility is even extended to newcomers in export activity on the basis of bank guarantees of similar value and subject to **actual-user condition**. The scheme is expected to help the health sector in particular which has already been identified as a thrust area in the Union Budget 2003-04. The tourism sector which already enjoys benefits under the **Export Promoting Capital Goods Scheme (EPCGS)** has been extended the facility of **Advance Licensing Scheme**. These schemes are briefly discussed in **Chapter 34.**

Hotels enjoying three-star and higher status as well as registered service providers in this area have been allowed duty-free import of consumables and spares upto 5 per cent of their average **foreign exchange** earnings of the previous three years subject to actual user condition.

Another landmark development in the policy is that it, for the first time, recognises the need for reliable statistics on service exports. The policy provides for the establishment of a group consisting of representatives of the Department of Commerce, Central Statistical Organisation, Reserve Bank of India, Director-General of Foreign Trade and Director-General of Commercial Intelligence and Statistics to formalise a system of collection and maintenance of data relating to service exports.

International market for professional services is large and growing. **World Trade Organisation** under **General Agreement on Trade in Services** (GATS) has developed the first-ever set of multilateral, legally enforceable rules concerning international trade in services. Under GATS, the following four dimensions of international trade in services based on the modes of services supply are specified:

- Cross-border supply of services (e.g. international telephone calls);
- Consumption abroad (e.g. tourism of foreign study);
- Commercial presence (e.g. foreign branch or subsidiary); and

- Cross-border movement of service-providing persons (e.g. doctors, consultants, counselors and negotiators)

EXIM policy of the country needs to be so designed as to take advantage of the facilitating provisions of GATS.

CONCLUSION

It must be emphasised that though services account for the largest share of GDP (and are still growing), the growth of the sector can't be sustained unless there is a matching development of the industrial and agricultural sectors. For a more solid and durable growth of the sector, it is important to increase the formal or registered segment of the sector, raise the standard of competition, foster the growth of entrepreneurship and professionalism and take serious steps to promote service exports. ***If GDP growth rate remains stagnant faster growth in the service sector would cause further shrinkage in the share of industrial sector which in the subsequent round of effects might pull back the growth of the services sector itself. The best policy for service sector growth is, in fact, balanced development and an enabling policy environment.*** Unfortunately while we have industrial and agricultural policies, we don't have a comprehensive and a separate policy for this largest segment of the economy.

Key Terms

Balance of payments (BOP)	De-industrialisation	Personal disposable income
General Agreement on Trade in Services (GATS)	Income elasticity of demand	Transfer payments
Gross Domestic Product (GDP)	Informal sector	Foreign exdhange
	National income	

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Long Questions

1. What is the significance of services sector in the Indian economy? Account for the rising share of the sector in the country's GDP.
2. Explain the structure of the services sector. Discuss the trend and pattern of growth of the services sector of the country in recent years.
3. What are the implications of the rising share of the services sector in India's GDP for its industrial sector? Is faster growth of the services sector helpful or harmful for the industrial sector?
4. Identify leading segments of India's services sector. Should services sector be taxed at par with the industrial sector?
5. Discuss the export contribution of the services sector. How does this contribution match with the size of the sector in the economy? Suggest measures for the development of the services sector.

Short Questions

1. Explain the basic nature of services.
2. Name 10 products in which services are implicit in goods.
3. What is the significance of difference between goods and services?
4. Give three main reasons for the rising share of services in India's GDP.
5. Mention three ways in which:
   a. Industrial sector supports services sector; an
   b. Services sector supports industrial sector
6. Should services be taxed?
7. Suggest five points for the further development of the services sector in the country.
8. What are professional services?

Practical Assignments

1. Hold a group discussion on the following statement:

   'Service sector can't be the growth dynamo of the economy in the absence of matching industrial growth'.

   Prepare a written report on the outcome of the discussions and circulate the same among selected manufacturing and service firms for comments. Discuss the comments in the class.
2. Hold a symposium on:

   'Can India be a Service Economy?'
3. Conduct a survey of about 25 households belonging to educated middle class and find out:
   a. The proportion of services in their total expenditure
   b. Demand for services in declining order of importance
   c. Consumer expectations and the level of satisfaction from the major types of services consumed.
4. Conduct a sample survey of about 10 manufacturing and service organisations and find out which types of services have good potential for growth in the country in near future.

CHAPTER 31

INFRASTRUCTURE DEVELOPMENT AND POLICY

Chapter Outline :

- Introduction
- What is Infrastructure?
  - Social Infrastructure
  - Economic Infrastructure
  - Technical Characteristics
- Recent Trends in Infrastructure Development and Policy
  - Coal
    - Reserves, Output and Distribution
    - Coal Policy
  - Power
    - Institutional Set-up
    - Installed Capacity and Power Generation
    - Plant Efficiency and Power Quality
    - Power Sector Losses
    - Power Policy
  - Telecommunications
    - Growth Trends and the Present Status
    - Institutional Set up
    - New Telecommunication Policy, 1999
  - Posts
    - The Size of Operations
    - Mail Channels
    - Modernisation of Mail Transmission and Processing
    - Agency Functions
  - Roads and Road Transport
    - National Highway Development Project
  - Port Infrastructure
    - Cargo Handled
    - Private Sector Participation
    - Civil Aviation
- Conclusion

INTRODUCTION

Infrastructure is an important determinant of the overall rate of growth of an economy. It supports, directly or indirectly, the productive activities and lack of infrastructure can be a serious constraint on economic growth. Inadequacy or poor quality of infrastructure discourages investment and lowers its productivity. The investment requirements for various types of infrastructure like transport, communication, power, roads, education and healthcare are enormous and the risk involved is large. For this reason, the role of the government in this vital field has been leading and predominant. In recent years, governments have been initiating measures and policies for the involvement of private enterprise and financing to complement public resources for infrastructure development. ***The trend has been due to fiscal compulsion as well as out of the need to enlarge the area of private enterprise of national development.*** The major benefits flowing from infrastructure development are the following:

- Fuller utilisation of existing growth potential;
- Support to directly productive activities;
- Employment generation and poverty reduction;
- Balanced regional development;
- Free movement of goods, services and factors of production;
- Coping with increasing pressure of population;
- Product diversification;
- Expansion of domestic and international trade;
- Environmental improvement; and
- Overall improvement in the quality of life.

WHAT IS INFRASTRUCTURE?

Infrastructure is an umbrella term connoting a physical framework of facilities through which a variety of goods and services are commonly provided to the public. Infrastructure can be broadly divided into two classes, viz., ***Social infrastructure*** and ***economic infrastructure***.

SOCIAL INFRASTRUCTURE

Social infrastructure is important from the point of view of social welfare and improvement in productivity and quality of life of the people. It refers to a set of physical and other institutional facilities mainly for:

- Poverty alleviation;
- Better education and training;
- Promoting labour welfare and employment;

- Raising participation level of women in economic activities;
- Promoting better childcare and preventing child labour;
- Developing healthcare, nutrition and sanitation systems;
- Protecting forests and natural environment;
- Empowering socially disadvantaged groups; and
- Protection against epidemics, natural calamities and other emergencies.

In many countries, provision of social infrastructure is a constitutional obligation. Social infrastructure improves the quality of human resources which, in turn, are instrumental in raising productivity in the economic sectors. ***Social infrastructure is extremely important from the point of view of social development and economic welfare and justice. Indifference towards this sector can generate social tensions and lower human development index producing negative effects for industrial peace and progress.***

ECONOMIC INFRASTRUCTURE

Economic infrastructure refers to a physical framework of facilities which directly support productive activities. According to the World Bank definition, it consists mainly of three categories:

1. ***Public Utilities.*** These are the industries or enterprises which supply public services to the market and often enjoy considerable **monopoly power**. Main public utilities are electricity, gas, telephones, postal services, water supply, sanitation and sewerage, solid waste disposal and railways.
2. ***Public Works.*** These mainly include roads, bridges, dams, canals works, earth leveling and drainage.
3. ***Other Transport Sectors.*** These include urban inter-city or local transportation systems, ports, waterways and airports.

Infrastructure services go into final consumption as well as are used as intermediate inputs by the business sector. The prices at which these services are provided to the business sector affect cost, efficiency and competitiveness of the business units. The price of infrastructure services itself depends upon the productivity and efficiency of infrastructure investment.

TECHNICAL CHARACTERISTICS

Though the different categories of social and economic infrastructure differ from one another in many important respects, still it is possible to list some common technical features of infrastructure, which are as follows.

- Huge front-end investment and fixed costs;
- Long **gestation period** and **pay-off period**;
- Large **risk**;
- High **capital-labour and capital-output ratios**;

- Wide scope for **economies of scale;**
- Dominant presence of **public sector;**
- Welfare considerations in public infrastructure service pricing;
- Positive as well as negative **spill-over effects** (or **externalities**);
- Basic nature as public goods;
- Creation of continuous conditions for future productive investment and innovations; and
- Need for regulation.

These characteristics are shared in different degrees by various infrastructure segments.

RECENT TRENDS IN INFRASTRUCTURE DEVELOPMENT AND POLICY

The performance of the various infrastructure segments in recent years has been mixed. **Table 31.1** gives the growth rates of the major infrastructure segments and industries vis-à-vis GDP growth in the recent years.

Table 31.1: Trends in the growth rates of various infrastructure sectors, 1997-2002

	Item	Growth rate (%)				
		1997-98	1998-99	1999-00	2000-01	2001-02
1.	Coal production	3.6	–2.1	3.1	3.5	4.2
2.	Electricity generated	6.6	6.6	7.2	3.9	3.1
3.	Petroleum refinery throughput	3.7	5.2	25.4	20.3	3.8
4.	Steel	6.3	1.4	15.0	6.5	2.5
5.	Cement	9.1	5.7	14.2	–0.9	7.4
6.	Railways goods traffic revenue	5.0	–2.0	8.4	3.7	4.0
7.	Cargo handled at ports	10.7	Nil	8.0	3.4	2.3
8.	New telephone connections[1]	27.1	16.4	29.7	27.2	23.9
9.	Civil aviation–export cargo	6.2	–3.9	10.3	4.9	–0.2
10.	Civil aviation–domestic passengers	–1.8	0.9	6.9	8.8	–5.8
11.	GDP[2]	4.8	6.5	6.1	4.4	5.6

Notes: [1] Direct exchange Lines. [2] GDP at factor cost.
Source: CSO data.

It can be observed that among various infrastructure segments, telecommunication has been the fastest growing segment. The rate of growth in terms of new telephone connections (direct exchange lines) has varied between 16-27 per cent per annum over the period 1997-2002.

In other areas, performance has been widely varying from year to year. Development and policy with regard to various infrastructure segments is discussed in the following sections.

COAL

Reserves, Output and Distribution

Coal is among the principal sources of energy and accounts for about two-thirds of the country's industrial and commercial needs. It is an important input in steel and carbon-chemical industries. According to the statistics of the **Geological Survey of India**, the total estimated reserves of coal (down to the depth of 1.2 Kms), including proved, indicated and inferred availability, are 234 billion tonnes at present (year 2003) out of which proved reserves are only 87 billion tonnes. The production of coal depends upon:

- Industrial and commercial requirements;
- Mineral extraction and mining policy of the government;
- Availability of alternative sources of energy;
- Mining technology;
- Conservation needs; and
- Environmental and geological considerations.

In the year 2001-02, total coal production in the country was about 322 million tonnes which is less than 0.5 per cent of the proved reserves. **Coal India Ltd (CIL)**, having seven subsidiaries, produces about 90 per cent of the country's total production, the rest being produced by **Singareni Collieries Company Ltd (SCCL)** and a few captive collieries of TISCO, IISCO, DVC and Bengal Emta. The offtake of coal to the major sectors of the economy is given in **Table 31.2**. As seen, power sector is the highest consumer of coal in the country which consumes 75-80 per cent of total raw coal produced in the country.

Table 31.2: **Distribution of the off take of raw coal according to major**

Industry	Coal off take (m.t.)	
	2000-01	2001-02
Power	237	262
Steel	20	18
Cement	10	11
Fertilisers	3	3
Others	48	33
Total	**318**	**327**

Source: CIL

Coal Policy

Under the **Colliery Control Order 2000**, the price and distribution of all grades of coal have been deregulated with effect from January 1, 2000. Short-term linkages with important sectors like power, steel and cement are decided on a quarterly basis by the **Standing Linkage Committee** set up by the government under the Department of Coal. The matters relating to linkage with non-core sectors are decided by **Coal India Ltd.**

Coal projects costing upto Rs 100 crore are sanctioned by CIL and those upto Rs 50 crore by selected subsidiaries of CIL subject to the condition that the project is included in the approved five-year and annual plans and the funds are raised through the internal resources of the company. Projects costing more than Rs 100 crore are sanctioned directly by the government. From 1973 (when coal industry was nationalised) to December 2001, the total number of projects sanctioned (each costing Rs 2 crore and above) was 469 involving a total investment of about Rs 24,000 crore. Out of the 469 projects, 365 have been completed (including those where coal reserves have been exhausted) and the rest are in various stages of implementation. After the completion of these projects, the total coal production in the country is expected to rise to 370 million tonnes per annum.

Under the **Coal Conservation and Development Act, 1974, excise duty** is levied on coal dispatches to meet expenditures on such activities as conservation of coal, development or introduction of new technology in coal mining, mine safety and assistance in mining operations. **Standing Scientific and Research Committee** guides and supervises research and development activities in the sector.

POWER

Electric power is a very important infrastructure component which provides energy to the various sectors of the economy. There are three basic sources or types of power generation viz hydro-electric, thermal and nuclear. Electricity is a concurrent subject at Entry 38 in List III of the Seventh Schedule of the Constitution of India. **Ministry of power** is the apex authority for the development and regulation of electric energy in the country. For various technical and economic matters, the ministry is assisted by **Central Electricity Authority (CEA)** which is established under the **Electricity (supply) Act, 1948.**

Institutional Set-up

The task of construction and operation of generation and transmission projects is entrusted to the following power corporations in the central sector.

- National Thermal Power Corporation (NTPC)
- The National Hydro-electric Power Corporation (NHPC)
- The North-Eastern Electric Power Corporation (NEEPCO)
- Power Grid Corporation of India Limited (PGCIL)

Power Grid Corporation of India is responsible for forming the **National Power Grid** and for all the transmission projects in the central sector. In addition, there are other power institutions engaged in allied aspects of power development. The major ones are the following:

Power institution	Main function
• Rural Electrification Corporation Ltd (REC)	Providing financial assistance to rural electrification programmes
• Power Finance Corporation (PFC)	Providing term finance to power sector projects
• Central Power Research Institute (CPRI)	Assisting research & development activities in power sector
• National Power Training Institute (NPTI)	Providing techno-managerial training to power sector executives
• Bureau of Energy Efficiency (BEE)	Promoting efficiency in power generation distribution and consumption
• Power Trading Corporation (PTC)	Supporting mega power projects in private sector by acting as a single entity to enter into power purchase agreements

In addition, the country has **Damodar Valley Corporation (DVC)**, the first multipurpose river valley project of the Government of India set up in 1948 which, in addition to generation, transmission and distribution of electrical energy (both hydro-electric and thermal), has additional objectives like flood control, irrigation water supply, drainage and afforestation in the Damodar Valley region covering the states of West Bengal and Jharkhand. Bhakra-Beas Management Board has the responsibility to deliver power and water to beneficiary states and administers, maintains and operates **Bhakara Nangal Project** including transmission lines and grid sub-stations.

Installed Capacity and Power Generation

Corresponding to the growth of the economy, there has been gradual expansion of installed power generation capacity in the country. The capacity which was just 1400 MW at the time of Independence, stood at 1,21,000 MW at the end of the year 2001-02 (**Table 31.3**). ***Utilities still predominate capacity installation, accounting for about 87 per cent of the total installed capacity in the country. However, non-utilities have gradually increased their share in capacity installation from 9.0 per cent in 1980-81 to 11.5 per cent in 1990-91 and further to 13.3 per cent in 2001-02.*** Within utilities segment, thermal plants claim the largest share in installed capacity, followed by hydro-electronic and nuclear segments. Since 1995-96, capacity addition has been highest in the thermal sector, low in the hydro-electric segment, and negligible in the nuclear segment. During 1995-2002, total installed capacity rose from about 95 BW to 121 BW.

Similar pattern is seen in power generation. During 1995-2002, non-utilities have marginally increased their share in total power generation from 9.1 per cent to 10.1 per cent. Total power generation (gross) in the country rose from about 418 billion Kwh to 573 billion Kwh during the period. Thermal sector predominates power generation. ***It is interesting to find that though capacity expansion in the nuclear segment has been marginal during 1995-2002, the segment more than doubled its power output during the period signifying tremendous improvement in its efficiency.***

Table 31.3: **Composition of installed plant capacity and pattern of** Power Generation, 1995-02

Power Segment	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
A. Installed Capacity ('000 MW)							
I Utilities	83.3	85.8	89.1	93.3	97.9	101.6	104.9
i) Hydro	21.0	21.7	21.9	22.4	23.9	25.1	26.3
ii) Thermal	60.1	61.9	65.0	68.7	71.3	73.6	75.9
iii) Nuclear	2.2	2.2	2.2	2.2	2.7	2.9	2.7
II Non-utilities	11.8	12.1	13.2	14.1	14.7	15.4	16.1
Total (I + II)	95.1	97.9	102.3	107.4	112.6	117.0	121.0
B. Power generation (Billion Kwh) (Gross)							
I. Utilities	379.9	395.9	421.7	448.5	480.7	499.5	515.2
i) Hydro	72.6	68.9	74.6	82.9	80.6	74.5	73.9
ii) Thermal	299.3	317.9	337.0	353.7	386.8	408.1	422.0
iii) Nuclear	8.0	9.1	10.1	11.9	13.3	16.9	19.3
II Non-utilities	38.2	40.8	44.1	48.4	51.5	55.0	58.0
Total (I+II)	418.1	436.7	465.8	496.9	532.2	554.5	573.2
C. Thermal Plant Load Factor (PLF) (%)			64.7	64.6	67.3	67.7	69.9

Source: Ministry of Power Data

Plant Efficiency and Power Quality

The **Plant Load Factor (PLF)**, which is an important indicator of operational efficiency of power plants, has gradually increased from 64.7 per cent to 70 per cent over the period 1997-2002. ***It is interesting to note that the PLF has been highest in the private sector plants, lower in the Central Sector and least at the level of state electricity boards. Again, it is interesting to note that the plant efficiency has been least in North-Eastern region (PLF varying between 16-21 per cent) and highest in the south-based thermal plants (PLF verying between 77-85 percent) during the period.***

However, power output in the country has not been adequate in relation to demand. In 2003, the energy and peak shortages have been estimated around 7.5 per cent and 12.1 per cent respectively. At the same time there are problems relating to the **quality** of power. Some of the major problems of the power sector are:

- Technological obsolescence of power generation equipment;
- Substantial transmission and distribution losses;
- Power thefts;

- Frequent load shedding, power cuts, burnouts and blackouts;
- Voltage fluctuations or incorrect voltages; and
- Mounting losses or state electricity boards.

These problems have been responsible for higher costs, lower efficiency and capacity underutilisation of various business firms resulting in reduced competitiveness. Over the next 10 years (covering 10th and 11th five-year plans), the government plans to almost double the existing generation capacity by adding another 1,00,000 MW requiring additional investment of about Rs 8,00,000 crore (nearly 40 per cent of current GDP). This implies massive business opportunities in the power sector. The thrust of future expansion is planned to be in the hydro-electric-sector due mainly to low costs and environment considerations. The share of hydel generation has already dropped from 38 per cent to 25 per cent over the last 20 years and it is estimated that only 17 per cent of the total hydel potential of the country has been tapped.

Power Sector Losses

One of the major problems haunting the sector has been that of financial losses. According to **Planning Commission** estimates, commercial losses (excluding subsidy) in 2001-02 were of the order of Rs 24,000 crore, as a result of which state utilities have defaulted in payment to NTPC, NHPC, Coal India Ltd., Power Grid Corporation and Railways. ***Transmission and distribution losses (a situation in which electricity is produced but not paid for) lie at the heart of the financial crisis of state electricity boards. Another major factor is the inadequate recovery of cost. In other words, user charges do not fully cover the cost of supply. The gap between the supply cost and average power tariff which was 23 paise per unit, stood at 110 paise per unit in 2001-02. At present, less than 70 per cent of the supply cost is being recovered.***

Power Policy

The main authority for the development of policy for growth and regulation of the power sector is **Central Electricity Authority (CEA)** which was established as a part-time institution in 1951 and made a full-time body in 1975. It actively assists **Ministry of Power** in all technical, financial and economic matters. It is particularly entrusted with the responsibility for developing a sound and uniform power policy and formulate short and long-term plans for power development. At present the other responsibilities of the CEA are:

- Monitoring, construction and operation of power plants and power system schemes;
- Monitoring power reforms;
- Signing MOUs with states, unbundling of SEBs and constitution of State Electricity Regulatory Commission; and
- Issuing tariff orders.

In order to evolve a mechanism for supporting power sector reforms in the states, the **Ministry of Power** has signed **MOU** with a number of states to undertake reforms in a time-bound manner. Under the **Accelerated Power Development and Reforms Programme (APDRP)** the central government provides assistance to support upgradation of transmission and distribution including energy accounting, metering and renovation of power plants. It also supports addition to installed capacity and assists in obtaining finance from **Power Finance Corporation** and other outside agencies like **World Bank** and **Asian Development Bank**.

In order to encourage the growth of mega power projects and to optimise the utilisation of available resources, the government has the policy of transferring power from surplus to deficit states. Power Trading Corporation of India Ltd, established with equity participation from PSUs and others, acts as the nodal agency for exchange of power. As a single entity, it enters into power purchase agreements with independent power producers for purchase of power and with state electricity boards and other users for sale of the same. It also undertakes similar arrangements with neighbouring countries.

Under a private power policy announced in 1991, the government allows private sector in power generation and transmission. The process of project award is through invitation of **tenders** under the international competitive **bidding** route. In certain cases, project proposals based on MOU or negotiation are also considered. So far (upto January 2003), 55 power projects involving 14,600 MW capacity have been given techno-economic clearance by CEA.

Under the present power policy, a number of states have already established **State Electricity Regulatory Commissions (SERCs)** and have passed **State Electricity Reforms Acts** which provide for:

- Establishment of SERCs
- Unbundling or corporatisation of state electricity boards
- Signing MOUs with the central government

The Electricity Bill 2001 seeking to replace existing Acts, viz., **The Indian Electricity Act 1910, The Electricity (Supply) Act 1948** and **Electricity Regulatory Commission Act 1998** is making progress in the direction of becoming an Act.

TELECOMMUNICATIONS

Growth Trends and the Present Status

In terms of growth, telecommunications has been among the best performing sector in recent years. *Teledensity (defined as the number of phone lines per 100 population) in India over the period 1995-2001 had a compound average growth rate of 22.3 per cent, compared to 17 per cent in Brazil, 14 per cent in Indonesia, 6 per cent in Pakistan and about 6 per cent in the world as a whole.* Teledensity which was just 1.1 in 1995, stood at 3.6 (4.89 including fixed, cellular and wireless in local loop, WLL) in 2001. *In recent years, there has been a major shift of demand from fixed (landline) to cellular connections.* Share of the cellular connections in new connections created during April-December 2003 was 63 per cent compared to 43 per cent over the corresponding period of 2001 (**Table 31.4**).

It is interesting to find that cellular phones recorded a growth of about 74 per cent over 2001-02 whereas the number of new basic telephone connections fell by about 25 per cent implying that cellular phone market has grown at the cost of the basic segment. Of the total 5.2 million new connections, 2.9 million were created in the private sector.

Table 31.4: **New telephone connections established, 2001-02**

Type	New connections (million)	
	2001[1]	2002[1]
Basic telephone connections (incl WLL)	2.6	1.9
Cellular mobile phones	1.9	3.3

Note: [1]April-Dec. data
Source: TRAI

At present, public sector predominates the fixed line and private sector predominates the cellular mobile phone market. As on March 31, 2002, there were about 45 million connections in all, public sector accounting for 38.2 million connections (38m fixed + 0.2m cellular) and private sector for 6.8 million (6.2 cellular + 0.6 fixed). The total number of cellular phone subscribers which was only 0.3 million on March 31, 1997, stood at 6.4 million on March 31, 2002. Among neighbouring countries, India however lags behind China and even Sri Lanka where compound annual growth rate in teledensity during 1995-2002 were 27 per cent and 25 per cent respectively. Some of the major factors behind the growth of the telecommunications sector are:

- Support of an enabling and progressive telecommunication policy;
- Technological development particularly in information technology;
- Development of the telecommunication sector around the world;
- Opening up of the sector to private enterprise;
- Fast growth of the cellular phone market; and
- Sustained fall in telecom tariffs. Leading to sustained increase in demand.

At present, India has one of the largest telecommunication networks in Asia comprising more than 35000 telephone exchanges with over 45 million fixed line telephones and over 6 million cellular phones. The long-distance transmission network has about 2 lakh route- km of microwave system (BSNL and MTNL) and about 3.2 lakh route-km of optical fibre systems (BSNL and MTNL). In international communication, the country has made rapid strides through satellite communication and submarine links.

For cellular services, the country is divided into 20 **Circles of Service Areas** and four metro cities. Till January 2003, more than 80 licenses had been issued to 26 companies catering to 24 service areas covering about 1500 cities and towns. The major telecom services provided in the country are the following:

- Basic Services;
- National Long Distance (NLD) Service;
- International Long Distance (ILD) Service; and

- Value-Added services (including cellular mobile telephony; voice mail service; unified message service; Public Mobile Radio Trunk Service (PMRTS); Global Mobile Personal Communication by Satellite service and Internet service.

Institutional Setup

In addition to players in the private sector there exist a number of institutions operating in different areas of telecommunications which are listed in **Table 31.5** below.

Table 31.5: **The telecommunications Infrastructure of India**

Institution	Basic Functions
1. **Bharat Sanchar Nigam Ltd.** (BSNL) (Incorporated: Oct 1, 2000)	• To provide all kinds of telecommunication service throughout the country (except Delhi and Mumbai).
2. **Mahanagar Telephone Nigam Ltd.** (MTNL) (Estd. April 1, 1986)	• Management, control and operations of telecom services in metropolitan limits of Delhi and Mumbai.
3. **Videsh Sanchar Nigam Ltd.** (VSNL) (privatised: Feb 13, 2002)	• To provide international telecom services.
4. **Indian Telephone Industries Ltd (ITI)** (Estd. 1948)	• Production of telecom equipment including switching, transmission and subscriber premises equipment. • Providing customised business support and IT – enabled services.
5. **Hindustan Teleprinters Ltd (HTL)**	• Providing teleprinting products and services.
6. **Telecommunications and Consultants India Ltd.** (TCIL), 1978	• Providing solutions from concept to competition in such areas as network projects, software support, switching and transmission systems, cellular services, rural telecommunications and optical fibre based backbone networks.
7. **Telecommunication Engineering Centre (TEC)**	• Standardisation, framing of Generic Requirements and Interface Requirements (GR&IR) for telecom products, equipments, systems and networks. • Technology forecast and assessment. • Evaluation of new systems, including products and equipments. • Technical and engineering support to Telecom commission and other public sector organisations.
8. **Telecom Quality Assurance Wing (1979)**	• To define quality parameters and establishing quality assurance (QA) procedures. • Resolving quality-related problems relating to equipments, networks and products.

Contd...

9. **Centre for Development of Telematics (C-DOT)** 1984	• Developing a new generation of switching systems relevant to Indian conditions. • Development of transmission systems. • Developing cost-effective products with upgradability and ruggedness suited to Indian conditions.
10. **Wireless Planning and Coordination Wing** (WPC) 1952	• Coordinating and regulating radio spectrum usages in the country. • Dealing with all matters relating to International Telecommunication Union. • Assigning frequencies for various terrestrial and satellite networks.

New Telecommunication Policy (NTP), 1999

The two basic objectives of the new telecommunication policy are:

- Delivery of low-cost voice telephony to the largest possible number of persons; and
- Delivery of low-cost high speed computer networking to the largest number of firms.

Under the new policy, the telecom task is entrusted to private and public sector companies and the **Department of Telecom** and the **Telecom Commission** have refocussed on policy formulation, licensing, wireless spectrum management, R&D, standardisation and monitoring of PSUs. The regulatory function under the present policy is performed by the **Telecom Regulatory Authority of India (TRAI)**. Major initiatives under the new policy are the following:

- The international long distance segment has been opened up to the private enterprise without restrictions.
- VSNL has been privatised to end its monopoly over International Long Distance (ILD) Service.
- A large number of villages have been given telecom facility in the WLL (wireless in local loop) mode.
- In order to respond to the dynamically changing needs of the telecom operators in the liberalised environment, the allocation of **Radio Frequency Spectrum** has been modernised and automated.
- Under the **Telecommunications Tariff Order 1999** of the TRAI, there has been ongoing process of tariff rationalisation involving increase in monthly rentals and fall in STD and ISD rates. Till March 2002, STD and ISD tariffs fell by 56 per cent and 47 per cent respectively.
- Private companies are being given licenses to offer basic services.
- The regulatory mechanism of TRAI is being simplified and rationalised.

As a result of these liberalisation measures, there has been a steady inflow of **foreign direct investment (FDI)** in the sector. During 1991-2002, 831 proposals for FDI involving an investment of Rs 56,226 crore were approved of which, however, FDI worth Rs 9528 crore materialised.

POSTS

Size of Operations

The country has one of the largest postal networks in the world with more than 1.55 lakh post offices spread all over the country. In terms of geographical and population coverage, India is even ahead of USA, in addition to China, Indonesia and Malaysia (**Table 31.6**). Indian postal system provides as many as 38 services which can be divided into three groups, viz., communication (including postcards, letters and newspapers), transportation (including parcels, money orders etc) and other services (like banking and insurance).

Table 31.6: **India's post network in relation to other countries, 2001**

Country	Per post office	
	Population covered	Area (Sqkm) covered
India	6,568	21
USA	7,471	246
China	22,490	168
Malaysia	18,489	269
Indonesia	10,806	96
Sri Lanka	4,192	14
UK	3,377	14

Source: Website of the Universal Postal Union (UPU)

The **Department of Posts** is running into losses due mainly to inefficiency in service operation. First class mail viz. post cards, inland letters and envelopes are lifted by air between stations connected by air without any additional charge. In 2000-01, the department handled about 1420 crore pieces of mail out of which 1209 crore pieces constituted first-class mail. In addition, the department handled about 11 crore money orders worth Rs 5852 crore.

Mail Channels

In order to improve mail transmission, mail is divided into different categories as local mail, non-local mail, household mail, official mail, corporate mail, patrika and periodical mail, packets and parcels. The following six channels exist for speedy disposal of mail in cities and large towns.

1. ***Rajdhani Channel.*** It is used to transmit first-class mail between Delhi and state capitals.
2. ***Metro Channel.*** The channel is meant for inter-metro first class mail between Delhi, Mumbai, Chennai, Calcutta, Hyderabad and Bangalore.
3. ***Green Channel.*** It consists of special arrangements in all major cities for speedy delivery of local mail.

4. ***Business Channel.*** It is meant for first-class unregistered mail posted by corporate bodies including government and semi-government institutions at the counters of designated post offices.

5. ***Bulk Mail Channel.*** This channel is earmarked for registered and unregistered bulk mail. There are separately designated corporate post offices which receive bulk mail (at least 250 registered mail and 2000 unregistered mail articles).

6. ***Periodical Channel.*** This channel is available for newspapers and periodicals which are in bulk, time-sensitive and require speedy clearance.

Modernisation of Mail Transmission and Processing

With new developments in information technology and growing need for safe and speedy mail transmission, the postal infrastructure has been considerably modernised and upgraded. The major characteristics of the modernised set up are the following:

- ***Satellite Network.*** Over 150 high speed V-SATs (Very Small Aperature Terminals) have been added to the existing 77 systems through which money orders are efficiently handled to the remote parts of the country.

- *Automatic Mail Processing.* These centres are being created at metropolitan towns using state-of-the-art letter sorting machines.

- ***Post Office Computerisation.*** About 500 post head offices have been fully computerised. In addition, more than 2000 post offices have computerised counter operations.

- *E-post Services.* More than 200 post offices in the country in a number of states have e-post services. A major service in this category is **Web-based e-Bill *Service*** through which customers can pay various bills (like telephone bill, electricity and water bills etc) at one window.

- *Premium Products.* With the establishment of **Business Development Directorate** in February 1996 to market and promote premium products for specific consumer segments, nine services viz. Speed Post, Express Parcel Post, Business Post, Media Post, Satellite Post, Retail Post, Greeting Post, Data Post and Speed Net have been introduced.

- *International Mail.* To handle international mail efficiently and effectively, a number of arrangements like **Surface Air Lift, International EMS** and foreign post offices exist.

Agency Functions

The post infrastructure is also used to provide various agency functions. The major agency functions are:

- *Post Office Saving Bank* with a customer base of 16 crore, branch network of 1,54,000 post offices and annual deposits exceeding Rs 78,000. The total outstanding value of deposits under various **National Saving Schemes** stood at Rs 2,53,374 crore in January 2002.

- *International Money Transfer Service* under which money transfers can be received from almost all the countries of the world.

- *Mutual Funds and Securities Distribution* is undertaken by the postal network with such partners as Prudential ICICI, SBI Mutual Funds, ICICI capital, Stockholding Corporation of India and IDBI.
- *Electronic Fund Transfer* facility is provided through VSAT connectivity for providing cash management services to banks and corporates.
- *Postal Life Insurance*, one of the oldest services, is offered to government and semi-government employees through five standard policies. Recently, **Rural Post Life Insurance** has also been introduced.

ROADS AND ROAD TRANSPORT

Roads and road transport are the lifelines of the economy. India has about 3.3 million Km of road length which is among the largest road networks in the world. The road network consists of national highways, state highways, district roads, rural roads and special purpose roads for use by military, ports etc. National highways covering about 58,112 kms meet about 45 per cent of the total road transport demand. In the tenth Fiver Year Plan, outlay for central sector roads is Rs 59,000 crore.

National Highway Development Project (NHDP)

It is an ambitious programme taken up in 1999 by the **National Highway Authority of India (NHAI)** which has the target of 4-6 laning of 13,000 km of national highways. The programme is expected to be completed by the year 2007 involving a total capital outlay of Rs 54,000 crore. The programme has two components:

i. *Golden Quadrangle*, comprising national highways connecting four metropolitan cities viz. Delhi, Mumbai, Chennai and Kolkata with a total route length of 5846 kms (scheduled to be completed by December 2003).

ii. *North-South Corridor* from Srinagar to Kanyakumari and *East-West Corridor* from Silchar to Porbandor involving a total length of 7300 kms (scheduled to be completed by December 2007).

The finances for NHDP are raised from **Central Road Fund** (createled from addition excise duty on petrol and high speed diesel), multilateral financing agencies including World Bank, Asian Development Bank and Japan Bank for International Cooperation, market borrowings and private sector contribution. Funds are also raised through **cess, annuities** and toll-charge. **Table 31.7** shows the composition of funding arrangements for the first phase of NHDP. For funds, the dependence on toll is least though its future potential is substantial. ***The annual toll potential for National Highways under NHDP is estimated at Rs 8000 crore if toll collection machinery is efficient.*** Annuity is an innovative concept on which eight projects for Rs 740 crore had been awarded till January 2003. (See **Box 31.1**). Till November 2002, more than 20 projects costing around Rs 7000 crore were taken under **build-operate-transfer (BOT) scheme**. Recently, control of **National Highways (Land and Traffic) Bill** 2002 has been passed which seeks to:

- Prevent unauthorised occupation of highway land;

- Control access points to national highways and regulate traffic on them;
- Establish Highway Administrations to enforce the law and set up tribunals to hear appeals against the orders.

Table 31.7: **Sources of funds for National Highway Development Project (Phase I)**

	Source	Funds (Rs crore)	Percent distribution
1.	Cess/market borrowing	16,846	55.6
2.	External assistance	7,862	26.0
3.	Annuity	2,000	6.6
4.	Toll charges	1,690	5.5
5.	SPVs[1]	1,902	6.3
	Total	**30,300**	**100.00**

Note: [1]Special purpose vehicle.
Source: Govt of India, *Economic Survey*, 2002-03, P. 194

Box 31.1

What is the Annuity Concept in Highway Financing?

Annuities is one of the innovative concepts used in road financing. Under this method of financing, the developer, under a contractual agreement, is paid the annuity over the concession period after an independent engineer certifies that quality of service available to road users is in accordance with the concession agreement. The mechanism for contracting is attractive for two reasons. ***First***, the annuity based contract balances the incentives of the developer to build and maintain the road well so as to be able to earn revenue from tolls. ***Secondly***, when a number of methods of road financing are available, the annuity-based mechanism provides a market-based method. Under this method, an open auction can be conducted in which developers submit bids to the government specifying the minimum acceptable annuity they would require to build a certain section of a road. By generating competition among developers, the annuity sums can be minimised to save public resources.

Source: Government of India, *Economic Survey*, 2002-03, (New Delhi: Govt of India), p.194.

State highways, district and rural roads are the responsibility of the state governments. Rural roads are built under the **Minimum Needs Programme** and are built to link villages with a minimum population of 1500 to all weather roads. The roads of strategic importance are developed by **Border Roads Organisation (BRO)**. It has so far surfaced more than 35,000 km of roads. Most of the roads have been build on northern and north-eastern borders.

PORTS INFRASTRUCTURE

Cargo Handled

Ports play an important role in international trade. Efficient port infrastructure enables faster cargo movement, reduces transaction costs and increases cargo safety. India has about 5600 kms of coastline having 12 major and 18 other ports (called minor or intermediate ports) (**Table 31.8**).

Table 31.8: **India's major ports**

East coast ports	West coast ports
• Kolkata/Haldia	• Mumbai
• Paradip	• Nhawa Shewa (Jawahar Lal Nehru Port)
• Visakhapatnam	• Kandla
• Chennai	• Mormugao
• Ennore	• New Mangalore
• Tuticorin	• Cochin

The aggregate cargo handling capacity of Indian ports as on March 31, 2002 was estimated at 344 million tonnes (MT). By the end of the Tenth Five Year Plan, it is expected to rise to 470 MT. During 2001-02, major ports of the country handled about 288 MT of cargo. All the cargo, however, is not meant for foreign trade. Of the total cargo handled, about 70 per cent is for international trade, of which 30 per cent constitutes exports only.

Private Sector Participation

In order to expand port infrastructure and to improve efficiency, productivity and services of ports, the government allows private enterprise in this vital sector. Private sector participation is also expected to upgrade technology and management quality of ports. The main areas identified for private sector participation are the following:

- Leasing out of existing port assets;
- Construction of additional assets;
- Leasing of equipment for port handling ;
- Leasing of floating crafts from the private sector; and
- Pilotage and captive facilities for port-based industries.

The government allows 100 per cent foreign direct investment in ports but the investment in the sector is yet to be realised on a significant scale. In order to encourage private (domestic and foreign) investment in the sector, the government is streamlining and improving bid documents, bidding procedure transparency and selection criteria. Under the private sector participation scheme, more than 40 projects involving capital expenditure of Rs 10,800 crore and capacity addition of 161 million tonnes per annum were in various stages of evaluation and implementation till January 2003.

As a result of various policy measures, port efficiency in terms of standard parameters, had improved in recent years. ***The average turnaround time came down from 4.1 days in 2000-01 to 3.7 days in 2001-02. In the same way, average output per ship-berth-day increased from 6701 tonnes to 6972 tonnes during the period. However productivity indicators widely vary from port to port.***

Civil Aviation

Organisational Aspects: It is another important constituent of the transport sector which carries both passengers and cargo. The sector has three basic functional divisions viz. regulatory, infrastructural and operational. Domestic air services are provided by Indian Airlines, Alliance Air, private scheduled airlines and air taxes. Pawan Hans Helicopters Ltd provides services to ONGC in its offshore operations. Air India provides international air services.

At present, there are two private scheduled airlines operating on domestic network and 38 companies holding non-scheduled air taxi operators permit. In this sector, private enterprise was allowed in April 1997. **Ministry of Civil Aviation** is responsible for the overall development and regulation of the sector. It also oversees the provision of airport facilities, air traffic services and carriage of goods and passengers. The regulatory authority for enforcing civil air regulation is **Directorate General of Civil Aviation.** It coordinates all regulatory functions with the **International Civil Aviation Organisation.** The responsibility for providing safe, efficient air traffic and aeronautical communication services belongs to the **Airports Authority of India.** It manages 124 airports including 11 international, 86 domestic airports and 27 civil enclaves at defence airfields. It controls the entire Indian air space as per norms of the **International Civil Aviation Organisation.** In order to bring Indian airports to international standards and improve managerial efficiency, the government has already formulated a policy for private sector participation in restructuring of airports. New airports of international standards are being planned for Bangalore, Hyderabad and Goa with private sector participation. The country has bilateral air service agreements with 97 countries.

During 2001-02, Air India carried more than 3 million passengers. The number of passengers availing private sector air services increased from just 1500 to 6.7 million in 2001. At present, there is a lot of competition between different airlines for passenger and cargo traffic. Under the **Airport Infrastructure Policy 1997,** private equity participation is allowed for port development. The four metro airports viz. Delhi, Mumbai, Chennai and Kolkata are being restructured to bring them up to world standards. At present, privatisation of Air India and Indian Airlines is being considered.

CONCLUSION

Infrastructure is a critical factor of economic growth. It is both the quantum and the quality of infrastructure that matters. One of the biggest challenges of infrastructure development in India has been that of financing. The post-reform period has been typically characterised by the gradual withdrawal of the government from direct production activity and its confinement itself to the regulatory role. This calls for prudent and strategic policy action to attract private investment, both domestic and foreign, to infrastructure development. Inadequacy and poor quality of infrastructure are among the leading barriers to foreign direct investment in the country.

Key Terms

Social infrastructure
Economic infrastructure
Public utilities
Gestation period
Pay-off period
Capital-labour ratio
Capital output ratio
Economics of scale
Public sector
Spillover effects (or externalities)
Plant Load Factor (PLF)
Tender
Bidding
Foreign direct investment (FDI)
Teledensity
Cess
Build-operate-transfer
Annuity

Supplementary Readings

3i Network (2002), *India Infrastructure Report* (New Delhi: Oxford University Press)

Godbole, Madhav (2000), 'A Right to Information: A Longway to go', *National Centre for Advocacy Studies*

Joshi, Piyush (2001), *Law Relating to Infrastructure Projects* (New Delhi: Butterworths)

Long Questions

1. How does infrastructure affect business environment? Comment upon the present state of infrastructure in the economy.
2. Give a critical review of recent trends in infrastructure development and policy in India. Is infrastructure adequate in relation to the country's development requirements?
3. What are the leading problems of the power sector? Comment upon the policy concerning private sector participation in the sector.
4. What is the importance of roads and road transport in national development? How does the quality of transport infrastructure services affect competitiveness of the business sector?
5. Identify the main reasons for low level of private participation in the country's infrastructure development. What measures would you suggest to attract private investment to the sector?
6. What are the major challenges in expansion and modernisation of infrastructure in the country? Do you think private sector participation is the sure way of modernisation and upgradation?

Short Questions

1. What are the technical attributes of infrastructure?
2. What is the difference between social and economic infrastructure?
3. Distinguish between public works and public utilities.
4. Give three leading reasons for the rapid growth of the India's telecommunication sector.
5. Why is thermal power the leading source of electric energy in the country?
6. What are the basic functions of Power Trading Corporation?
7. Give three factors affecting the utilisation of installed capacity in the power sector.
8. Identify five leading problems of the transport sector.
9. What is the significance of port infrastructures?

Practical Assignments

1. Survey a leading newspaper over the last one quarter and collect instances of social or economic disturbances the source of which can be traced back to deprivation of social infrastructure in specific locations. Find out how such disturbances have produced negative effect on the business life of the affected regions. Discuss
2. Identify infrastructural constraints to industrial development in your region. Keeping in view the financial constraints develop a set of priorities for infrastructure development to realize the industrial potential of your state.
3. Select five different medium or small enterprises in your region and prepare a list of infrastructure bottle necks facing them. Obtain suggestions from the industry managers as to how to remove the bottlenecks. Discuss the suggestions in the class.

CHAPTER 32

Labour Environment

Chapter Outline :

- Introduction
- Labour Environment: The Basic Concept
- Current Employment Scenario in India
- Current State of Labour Reforms, Legislation and Environment
  - Payment of Wages and Bonus
  - Contract Labour
  - Industrial Dispute Settlement
    - Causes of Disputes
    - Industrial Relations Machinery
  - Trade Unions
  - Worker Safety and Social Security
  - Women Labour
  - Workers' Education, Training and Vocational Guidance
- The Issue of Jobless Growth
- Special Group on Employment in the Tenth Five Year Plan
- The Second National Commission on Labour
- Conclusion

INTRODUCTION

Labour is an active and impoɣtant factor of production. In a wider sense of the term, it embodies both physical and mental labour and covers all the levels of hierarchy from top management to the workers at the shop floor level. However, in practical usage, the term has the definitional bias towards the lower rather than higher levels of hierarchy. In the field of management, 'human resources' is a preferred expression than labour through the content is fundamentally the same.

Labour, with its conventional and definitional bias towards the lower levels of hierarchy, has its formal lines of relationship with management (higher levels of hierarchy) the average state of which is often referred to as **industrial relations.** Industrial relations is, in fact, much a wider term covering not only labour-management but also management-to-management and labour-to-labour relations. However, among these dimensions of industrial relations, labour-management relation is the most dynamic aspect and occupies the centrestage. ***Industrial relations is the resultant of a number interacting set of factors relating to labour, management and organisations in the diverse field of economic activities and these relations are a key factor in the overall labour environment.***

LABOUR ENVIRONMENT: THE BASIC CONCEPT

Labour environment refers to the average state of conditions that determine and affect the working environment of labour and management and the relationship between the two. The environment is greatly conditioned by the socio-economic and cultural factors, labour laws and the government regulations in force. The environment is not merely of academic interest; it has a powerful impact on the productivity, efficiency and competitiveness of business organisations as well as the socio-economic conditions of the society as a whole. The more labour-intensive are the production processes, the greater is the role of the labour environment in determining the growth of the productive sectors of the economy. A congenial labour environment:

- Promotes domestic and foreign investment;
- increases efficiency, productivity and competitiveness of business organizations;
- increases the level of motivation and work satisfaction;
- results in better utilisation of productive assets;
- promotes employment;
- promotes industrial peace resulting in fall in number of mandays lost;
- increases the role and status of workers in society;
- promotes work culture; and
- promotes the growth of the economy.

A congenial work environment is not easy to establish. It requires a number of enabling conditions which are often difficult to realise.

It must be realised that the essential nature of labour-management relationship is both that of cooperation and conflict. The cooperation between the two is essential for qualitative and smooth flow of production. The conflict arises because of the inherent endeavour of the modern and professional managements to draw maximum output from a specific labour cost. The perpetual endeavour of labour is to maximise current compensation and career prospects from a given quantum of labour input. The differing perceptions on labour compensation and output often result in conflict situations which subsequently may cause reduction in the level of workers enthusiasm or even in extreme situation like strikes and violence. Labour environment is basic built and affected by:

- Working conditions;
- Rate of employment or unemployment;
- Remuneration rates;
- Industrial relations;
- Labour welfare;
- Dignity of labour;
- Employers' general attitude towards workers;
- State of labour union and collective bargaining;
- Motivation and work satisfaction;
- Labour productivity and efficiency;
- Social and economic status of workers; and
- Workers' attitude towards work and responsibility.

CURRENT EMPLOYMENT SCENARIO IN INDIA

The state of labour environment is greatly affected by employment conditions in an economy. Employment or (unemployment) basically depends upon the rate of new investment causing increase in the demand for different categories of workers and the supply of workers in those categories. ***Skill mismatches create serious shortages of workers, spread unemployment and eventually inhibit new investment. Orientation of education (general and technical) towards actual industrial requirements is an essential pre-requisite of employment. Worker supply is also affected by rates of remuneration and working conditions in business organisations. Remuneration rates are generally determined by the availability of labor in relation to the required workforce as well as its productivity and efficiency.***

According to the **Fourth Economic Census in 2001**, there were 30.35 million enterprises in the country of which 28.87 million were in the non-agricultural (infrastructure, industry and services) sectors. Total employment provided by all the enterprises was 83.30 million. Of the total enterprises, 21.38 million did not have any regular hired workers while the rest engaged 43.29 million hired workers. **Table 32.1** presents a detailed picture.

Table 32.1: India's employment scenario, as per Economic Census, 2001

Category	No. of Persons
1. Total population	102.5
2. Total workers	40.3
a. Marginal workers	8.9
b. Main workers	31.3
i) Cultivators	12.8
ii) Agricultural labourers	10.7
iii) Household industry workers	1.6
iv) Other workers	2.9
3. Employment in organised sector	2.8
a. Public sector	1.9
b. Private sector	0.9
i) Organisations with 25 or more workers	0.8
ii) Organisations employing 10-24 workers	0.1
4. Total persons on the live registers of employment exchanges	4.2

Note: Figure may not exactly match or add due to rounding.
Source: Economic Census 2001 data (Website: www.nic.in/stat).

The following are the major highlights of the country's employment scenario:

- Agriculture alone provides employment to more than one-half of the total workforce.
- Organised sector accounts for a small fraction of total employment implying that the largest section of the workforce is in the unorganised or informal sector.
- ***Within the organised sector, the share of private sector in employment is about one-third, the rest (two-thirds) being provided by the public sector. So, by employment, public sector may be regarded as twice as large as the private sector.***
- Within private organised sector, the employment contribution of smaller enterprises (employing less than 10 workers each) is marginal (about 11 per cent).
- ***At the country level, the rate of unemployment as evidenced from the registers of employment exchanges is about 10 per cent. Actual employment level can be much larger keeping in view the fact that all unemployed persons do not get registered in employment exchanges.***

According to the survey carried out by **National Sample Survey Organisation** ***in the year 1999-2000, the total employment in the country was 39.7 crore of which 36.9 crore (about 93 per cent) was in the unorganised sector. Here, it deserves mention (though a digression) that a large part of output and income generated in the sector goes unaccounted or unrecorded causing huge loss of tax revenue to the government.*** Out of the total 36.9 crore workers in the unorganised sector, 23.7 crore were engaged in agriculture, 1.7 crore in construction, 4.1 crore in manufacturing and 3.7 crore were in trade, transport, communication and other services.

CURRENT STATE OF LABOUR LEGISLATION, REFORMS AND ENVIRONMENT

Labour in India is often considered to be heavily protected by legislation. At present, there are about 165 labour laws seeking to protect labour and promote its welfare. Whether labour is over protected in the country is being widely debated and has already raised a controversy. Some of these aspects are raised in the subsequent sections of the Chapter. However, in the wake of economic liberalisation started in the nineties, a number of issues relating to labour have come up. Most of these issues relating to contract labour, job security and voluntary retirement schemes have come up in the process of **restructuring** of business enterprises **privatization** and rationalisation of human resource requirements. In order to make labour laws compatible with new economic policy, a process of labour reforms, including labour legislation, has already been initiated. **The Trade Union Act 1926** has already been amended and a number of other important Acts including **Industrial Disputes Act, 1947, Payment of Wages Act, 1936, Factories Act, 1948** and **Mines Act 1952** are being revised. The government has already set up the **Second National Commission on Labour (1999)** to suggest rationalisation of existing labour laws and to bring out an **umbrella legislation** to protect labour in the unorganised sector.

All these development point to the fact that the labour environment, at present, is in a state flux. However, in the years to come, labour reforms characterised by liberalisation and flexibility in labour legislation can be expected. The major aspects of present labour reforms and legislation, as key factors in labour environment, are discussed under the following heads.

PAYMENT OF WAGES AND BONUS

There are at present three pieces of labour legislation relating to remuneration of workers, viz., **Minimum Wages Act, 1948, Payment of Wages Act 1936** and **Payment of Bonus Act, 1965.** The Minimum Wages Act provides for fixation, review, revision and enforcement of minimum wages of workers engaged in scheduled appointments of both central and State governments. The total number of scheduled employments in the central and state governments are 45 and 1232 respectively. In January 2002, the minimum wage rates for mine workers in the central sectors were revised under the Act. To protect wages against inflation, the central government introduced **Variable Dearness Allowance (VDA)** which is linked to **Consumer Price Index** and is revised twice a year in April and October. About 22 states and UTs have adopted VDA to revise minimum wages from time to time. As there is no uniform national minimum wage, the government, in 1996, introduced **National Floor-Level Minimum Wage** linked to price index. In the year 2000, the minimise wage was Rs 45 per day.

The **Payment of Wages Act, 1936,** seeks to ensure that payable wages to persons covered under the Act are disbursed within specified time limits and that no unauthorised deductions are made from the wages. The Act, at present, applies to those whose average wage is less than Rs 1600 per month. The central government administers the Act in railways, mines, oilfields and air transport services while the state governments administer it in factories and other industrial establishments.

The **Payment of Bonus Act, 1965,** provides for the payment of bonus to employees as defined under the Act. The bonus is payable subject to certain wage limits (**Box 32.1**). The government is already considering abolition of wage ceilings in view of a series of litigations in recent years. Such a step involves substantial financial implications for the employers.

Box 32.1

Who is Eligible to Receive Bonus under the Payment of Bonus Act, 1965?

Under the Act, all the workers are not eligible to receive bonus and this has been a major irritant with labour unions. An eligible employee is a person (other than apprentice) employed on a salary or wage not exceeding Rs 3500 per month in any industry to do any skilled, unskilled, manual, supervisory, managerial, administrative, technical or clerical work for hire or reward. According to **Section 12** of the Act, the bonus is payable to employees whose salary or wage exceeds Rs 2500 per month and has to be calculated as if his salary or wage were Rs 2500 per month. The above ceilings were last revised in the **Payment of Bonus Amendment (ordinance) 1995** but was made effective retrospectively from April 1, 1993. This generated a lot of criticism and a number of business organisations moved courts against the Ordinance. The wage and salary limits for the purpose of payment of bonus are being reviewed.

CONTRACT LABOUR

Contract labour or appointment system is widely prevalent in almost all the developed countries of the world. Contract labour is commonly seen in agricultural operations and service organisations particularly where the work is of a seasonal nature. The system has both merits and demerits. ***The merit is that it enables the employer to keep the workforce size compatible with business requirement and obtain the skills that are relevant to current technologies. Workers remain acutely conscious of their standards and performance targets and strive to produce expected results. However, the major demerit of the system is that workers, particularly in conditions of widespread unemployment and lack of alternative employment opportunities, get exposed to exploitation by the employer which can take such forms as unremunerative compensation packages or unsustainably large work for same compensation.*** There is thorough job uncertainty and workers are often unable to develop loyalty with the organisation under the fear of retrenchment or dismissal.

In order to regulate the employment conditions of contract labour, the government enacted **Contract Labour (Regulation and Abolition) Act, 1970** which followed the observations of the Supreme Court in the case of Standard Vacuum Refinery Company vs. their workmen. Under this Act:

- There is provision for constitution of central and state advisory **Contract Labour Boards** to advise the respective governments on matters relating to the implementation of the Act.
- The central and state governments are empowered to prohibit employment of contract labour in any establishment and grant exemptions in cases of emergency.
- **Central Industrial Relations Machinery** (CIRM) has been established with the responsibility of enforcing the provisions of the Act.

In a recent landmark judgment of the Supreme Court (case of Steel Authority of India Ltd vs. National Union of Waterfront Workers and others), it has been held that the provisions of the Act do not expressly or by necessary implication provide for automatic absorption of contract labour so that the employer in an organisation can't be ordered to absorb contract labour in his organisation. The government is currently reviewing the Act to modify it in accordance with the economic policy reforms.

INDUSTRIAL DISPUTE SETTLEMENT

The legal arrangement for the settlement of industrial disputes is provided in the **Industrial Disputes Act, 1947**. Dispute settlement is essential for industrial harmony and for avoiding sudden work disruption by labour. The main objectives of the Act include:

- Promotion of measures for securing good relations between management and workmen;
- Investigation and settlement of disputes between labour and employers, workmen and workmen and between employers and employers;
- Prevention of illegal strikes and lockouts; and
- Providing relief to workmen adversely affected by **retrenchment** and **layoff**.

Causes of Disputes

As already pointed out, there is an inherent conflict between the objectives and aspiration of employers and workmen. There can be multiple sources of disputes, conflicts or tensions, the major ones, being the following:

- *Economic causes*, relating to wages, bonus, overtime payments, job security and other facilities.
- *Working conditions*, covering work environment, hours of work and leisure, occupational hazards, industrial accidents, factory pollution, work safety.
- *Labour welfare*, including medical facility, housing, home travel, recreation, canteen facility, education of workers' children, etc.
- *Situational factors*, like ill-treatment, sexual harassment, misbehaviour and the like.
- *Management or Administration*, including irrational HR policies, out-of-turn promotions, discrimination among workers, false implication in cases, irrational work allocation and indifferent attitude towards workers' grievances.

Industrial disputes vitiate industrial relations and tend to snowball if left unattended. Deteriorating industrial relations are reflected in mandays lost in **strikes, lockouts** *etc, reduced* **productivity**, *increasing wastages, increase in court cases and litigation expenses. Indirect indicators of deteriorating relation are lack of enthusiasm towards work, increase in* **employee turnover rate** *and increasing tendency of workers to search outside jobs. Table 32.2* reflects the industrial relations scenario in the country. Since 1999, the number of mandays lost have recorded a step fall. The total number of mandays lost, which were 77 million in 1982, were 34 million in 1991 and are estimated to be just 3 million in 2002.

Table 32.2: Mandays lost in strikes and lockouts, 1998-2002

Year	Mandays lost (million)
1998	9.4
1999[1]	10.6
2000[1]	12.0
2001[1]	5.6
2002[2]	3.0

Note: [1] Provisional
[2] Estimated
Source: Labour Bureau, Shimla

Industrial Relations Machinery

Under the **Industrial Dispute Act 1947**, elaborate legal arrangements exist for the prevention and settlement of industrial disputes. The arrangement is based on three pillars viz. **conciliation, arbitration** and **adjudication.** Under the conciliation mechanism, all establishments employing 50 or more workers are required to provide for **Grievance Settlement Authority (GSA).** All labour disputes, initially, have to be referred to it. If its decision is not acceptable to all the concerned parties, then it is referred to a conciliation officer appointed by the Central or state government (depending upon jurisdiction) for the purpose. If a settlement is arrived, the officer sends his report with the **Memorandum of Settlement** (signed by all the parties to the dispute) to the government. If not, the reasons for non-settlement are recorded. Then it may refer it to the **Board of Conciliation, Court of Enquiry, Labour Court, Industrial Tribunal,** or National Tribunal depending upon the nature of the case Labour courts, industrial tribunals and National Tribunal are known as the **three tiers of the adjudication mechanism.** In the **arbitration** mechanism, the concerned parties, by mutual agreement, can refer the dispute to arbitration before it has been referred for adjudication. The arbitration process is less time consuming, convenient, cheaper and is based on the spirit of goodwill, trust, confidence and cooperation.

Before reference is made to arbitration, the following four conditions must be satisfied under the Industrial Disputes Act:

1. The industrial dispute must exist or is apprehended;
2. the agreement must be in writing;
3. the reference must be made before it has been referred to a Labour Court, Tribunal or National Tribunal; and
4. the name of the arbitrator(s) must be specified.

In addition to the above three tiers, there also exist a number of non-statutory voluntary procedures and institutions, the most important of which are the following:

- *Joint Management Councils.* These have representations both from labour and management which seek to promote cordial industrial relations through consultation, information exchange and sharing of responsibilities.
- *Code of Discipline.* It was approved at the 16th **Indian Labour Conference** (1958) and was ratified by the central organisation of employers and workers. Under the Code, employers and workers agree for (a) appropriate settlement of disputes; (b) no strike or lockout without notice; (c) avoiding litigation; (d) promoting constructive cooperation; (e) establishing mutually agreed grievance procedure; and (f) not resorting to unilateral or arbitrary action in case of a grievance or dispute.
- *Tripartite Consultative Machinery.* It takes such forms as **Indian Labour Conference, Standing Labour Advisory Committee** and **Industrial Committee** which has representatives of employers, workers and the government which seek to facilitate enactment and implementation of central legislation on labour, promote consistency and uniformity in labour legislation and to promote industrial harmony.

The Act, as amended to date, contains special provisions relating to lay off, retrenchment and closure which are applicable to establishments employing not less than 100 workmen on an average working day. The Act provides for compensation against retrenchment. It further provides for advance notice of 12 months before effecting retrenchment to workers who have completed 240 days of continuous service. The Act is being reviewed by the government to make it more effective and flexible.

TRADE UNIONS

Trade unions are the associations or organisations of workers to protect their collective interests through collective bargaining and other means. There is a multiplicity of trade unions in the country. In order to provide a legal instrument for regulating the activities of trade unions and making them more purposeful in the interest of the society, the government enacted the **Trade Union Act in 1926** which provides for the registration of trade unions of both employers and workers. With effect from January 2002, the following provisions have come into force.

- In order to be eligible for registration, a trade union must have, at the time of registration, a minimum membership of 100 or 10 per cent of the total workmen (whichever is less) employed in the establishment or industry with which it is connected. In any case, the minimum strength of a trade union should not be less than 7. The union must continue to have at least the minimum prescribed strength.
- In case of non-registration or restoration of registration, an appeal can be filed before a labour court or industrial tribunal.
- All office bearers of a registered trade union (except not more than 1/3 of the total number of office bearers or five whichever is less) shall be the persons actually engaged in employed in the establishment or industry with which the union is connected.

At present, the major trade unions in the country are Indian **National Trade Union Congress (INTUC), Hind Mazdoor Sabha (HMS), Bhartiya Mazdoor Sangh (BMS), All** ***India Trade Union Congress (AITUC), The United Trade Union Congress (UTUC), Centre of***

Indian Trade Unions (CITU), The United Trade Union Congress-Lenin Sarini (UTUC-LS), National Front of Indian Trade Unions (NFITU), The National Labour Organisation (NLO) and Trade Union Coordination Centre (TUCC). These unions have evolved over a long period of trade union history in the country and have large memberships. Historically, the trade union movement in the country was greatly spurred by the world wars, influence of political leaders, formation of **International Labour Organisation** (**ILO**), the Russian Revolution and the enactment of the **Trade Unions Act** in the country. Some of the major problems faced by the trade unions are:

- Migratory character of a large number of workers leading to their indifference towards trade unions;
- lack of unity among workers due to regional and cultural diversity;
- poverty and illiteracy of workers which are obstacles to the understanding of the role of trade unions;
- external Political influence and interference;
- multiplicity of unions and inter-union rivalry;
- antagonist attitude of the employers towards worker unions;
- slow and protracted process of labour justice;
- gradual erosion in the credibility of union representatives;
- shortage of funds and less attention to labour welfare activities; and
- erosion of public sympathy for the unions.

Unless these problem are squarely addressed, the role of trade unions in protecting and promoting labour interests will remain diminished.

WORKER SAFETY AND SOCIAL SECURITY

The principal legislative instrument for regulating various aspects relating to worker safety, health and welfare is the **Factories Act, 1948**. Though it is a central enactment, the framing of the rules under the Act and their enforcement is done by the states and UTs through their **Factory Inspectorates**. The advisory body for the states and the UTs in this regard is the **Directorate-General, Factory Advice Service and Labour Institute** (**DGFASLI**) under the **Ministry of Labour**. The Directorate-General also reviews the position regarding implementation and enforcement of the Act. The Act was amended in 1987 imposing a general duty on employers to ensure the health and safety of workers and a new chapter for regulating safety and health of the workers in hazardous industries was added to the Act. The Act, as at present, provides for the following:

- Prescription of a maximum 48 hour week for adult workers.
- Ban on the employment of children below the age of 14.
- Prescription of minimum standards of lighting, ventilation, safety and welfare services which employers must provide to their workers.

- Requirement of providing a crèche for the children of women workers if their number in the organisation is above 30.
- Provision of shelters, rest rooms, and lunch rooms by employers employing more than 150 workers.
- Requirement of employment welfare officers in establishments employing over 250 workers.

There are separate pieces of legislation for workers in docks and mines as these categories of workers are exposed to different and more serious types of risks. These legislations are **Dock Workers (Safety, Health and Welfare) Act 1936** and **Mines Act, 1952**, the responsibility for the enforcement of which lies with DGFASLI and **Directorate-General of Mine Safety (DGMS)** (both under the **Ministry of Labour**) respectively. The Directorate for the safety of mine workers has the following functions:

- Inspection of mines;
- investigation of serious and fatal accidents ;
- grant of permission for various mining operations;
- approval of safety equipment for mines; and
- undertaking measures for the promotion of mine safety.

In order to promote safety consciousness among workers to prevent accidents, **National Safety Council** exists since in 1966. The government runs the scheme of **National Safety Awards** under which awards are given to organisations that excel in safety promotion.

For the welfare of workers, the government has elaborate legislative arrangements for social security. The major pieces of legislation are the following:

- *Workmen Compensation Act, 1923.* The Act provides for compensation to workers and their dependents against injury, accidents or even occupational diseases arising in the course of employment and leading to disability or death. The compensation for permanent total disability and death ranges from Rs 90,000 to Rs 5.48 lakh and Rs 80,000 – Rs 4.56 lakh respectively depending upon age and wages of the workmen.
- *Maternity Benefit Act, 1961.* The Act provides benefits to women workers before and after child-birth working in mines, factories, industry, circus, plantations, shops and establishments employing 10 or more persons. The coverage of the Act can be extended by the state governments. The benefits are not available to employees covered under **Employees State Insurance Act.**
- ***Employees State Insurance Act.*** The Act seeks to provide medical care in kind and cash benefits in the event of sickness, injury or maternity for pension and/or dependents in case of death of a worker due to employment injury. The Act is applicable to non-seasonal factories using power and employing 10 or more persons and non-power using factories employing 20 or more persons. It is being extended to new establishments. ***The Act at present covers more than one crore workers and medical facilities are provided through 140 ESI hospitals, 43 ESI Annexes and about 1500 dispensaries throughout the country.***

- *Payment of Gratuity Act, 1972.* It covers a large number of establishments and provides for gratuity at the rate of 15 days' wages for each completed year of service subject to the maximum amount of Rs 3.5 lakh. For seasonal employment, the criterion is seven days wages for each season.
- *Employees' Pension Scheme, 1995.* The scheme introduced for industrial workers in 1995 provides for pension at the rate of 50 per cent of pay on retirement or superannuation on completion of 33 years of service, subject to minimum 10 years of service for entitlement. The scheme also provides for family pension.

WOMEN LABOUR

According to the **Census of India** data, about 23 per cent of the female population is identified as workers. In rural areas, about 87 per cent of the women workforce is engaged in agriculture and in urban areas about 80 per cent are employed in nonformal or unorganised sector like petty trade, services and household industries. ***In March 2000, employment of women in the organised sector stood at about 5 million, constituting about 17.6 per cent of the total organised sector employment in the country.*** The basic thrust of government policies towards women labour is to:

- Remove the handicaps and limitations under which women work;
- enhance their bargaining power;
- increase their wages and working conditions;
- improve their skills; and
- provide better job opportunities to them.

The Maternity Benefit Act 1961 (as already mentioned above) and **Equal Remuneration Act, 1976**, seek to protect the interests of women labour. Under **Equal Remuneration Act,** remuneration payable to women has to be the same as that for men for the same or similar nature of work. In the same way, women can not be discriminated against in matters of recruitment or service conditions. There exists a separate committee in the government which advises the government on providing increasing opportunities of employment and reviewing effective implementation of the Act. Similar committees exist in states and union territories. Another cell, viz. **Women Labour Cell,** exists in the **Ministry of Labour** to address the problems of women labour. Under Article 141 of the Constitution, the Supreme Court in 1997 issued guidelines for the prevention of sexual harassment of women which have been thoroughly implemented by the government.

WORKER EDUCATION, TRAINING AND VOCATIONAL GUIDANCE

A number of institutional arrangements exist in this regard and the government has taken measures to promote welfare and job prospects in this area. In order to spread general awareness among workers, **Central Board of Workers' Education** was established in 1958 which is engaged in implementing various educational programmes at national as well as regional levels. The Board has a network of 49 regional and 10 sub-regional centres throughout the country. National level programmes are conducted at the **Indian Institute of Workers' Education, Bombay.** ***The***

Board has so far conducted more than three lakh training programmes training about one crore workers.

In order to enable the youth to avail employment opportunities, the **Directorate General of Employment and Training (DGE&T)** provides various training programmes, mainly the following:

- *Craftsmen training* in various engineering and non-engineering trades through a network of about 4500 institutes.
- *Crafts Instructors' Training* providing training to crafts instructors through Advanced Training Institutes set up at various metropolitan locations.
- *Advanced Vocational Training Scheme* to further train skilled workers in advanced technology and skills at selected modernised industrial training institutes.
- *Women's Vocational Training Programme* to provide job-oriented training to women through a network of 231 women industrial training institutes.
- *Apprenticeship Training Programme* providing for obligation of the employers to provide apprenticeship training for duration of 1-4 years.

In addition, there exists a network of about 1000 **employment exchanges** and **Universities Employment Information and Guidance Bureaux** throughout the country facilitating employment for various categories of persons.

THE ISSUE OF JOBLESS GROWTH

One of the salient characteristics of the country's labour environment is that the rate of job generation has been much less than the rate of output growth – a situation popularly referred to as 'jobless growth'. According to the data of **National Sample Survey Organisation,** *growth rate of employment declined from 2.7 per cent per annum during 1983-94 to 1.07 per cent per annum during 1993-2000 in comparison to increase in the average annual growth of GDP from 5.2 per cent to 6.7 per cent respectively during the two periods.* The trend is also corroborated by the census data according to which the growth of main workers fell from 2.34 per cent per annum during 1981-91 to just 0.81 per cent per annum during 1991-2001.

The diminishing job market in the country is also evidenced by the rising trend of emigration abroad. During 1998-2002, more than 14 lakh workers emigrated, 3.7 lakh being during 2001-02 only. However, the brighter side of the issue is that the inward flow of remittances from expatriate population which was just Rs 9400 crore in 1992 rose to a staggering Rs 57,800 crore in 2002. *The issue of jobless growth can be seen in terms of its analytical parameters. The* **output elasticity of employment** *(measured as per cent change in employment caused by 1 per cent change in GDP) has been declining. From the data of* **Census of India** *and the* **National Sample Survey Organisation,** *it can be calculated that during 1980s one per cent growth in GDP was associated with 0.52 per cent rise in employment in 1980s; the figure fell to just 0.16 per cent in the 1990s. This trend is inspite of the fact that labour productivity rose by about 5.6 per cent annually during the 1990s.*

One of the major reasons for slow growth of employment in relation to output is **gradual induction of modern technology** in productive processes and the resulting **increase in capital-labour ratio** in the modern segment of the organised sector. **Near-stagnant conditions in agriculture** have also prevented the job trend from rising significantly. A predominant part of the job growth has occurred in the **informal** on **sectors** the employment conditions of which are largely unregulated.

The tardy pace of employment growth is also often attributed to the **complexity and multiplicity of labour laws** and the **general tendency of the organisations to go in for labour-saving technologies.** At present there are about 165 different labour laws which restrict the freedom of employers in labour management. The **huge structure of labour legislation** is also often cited as one of the major reasons deterring the inflow of foreign direct investment. **Over-protected labour** is considered by a large number of organisations as an obstacle in the way of implementation of measures to raise worker productivity and efficiency in tune with the requirements of domestic and international competition.

SPECIAL GROUP ON EMPLOYMENT IN THE TENTH FIVE YEAR PLAN

The Tenth Five Year Plan has the target of creating 10 million employment opportunities per year. For this purpose a special group was constituted by the Planning Commission. The major recommendation of the Group are the following:

- For measuring employment levels, **current daily status**, rather than **usual status**, should be used as the yardstick. It is a better measure as it is net of the varying degrees of **under-employment.**
- In addition to the employment generated in the process of present structure of growth, there is a need to promote certain identified labour-intensive activities, such as small and medium industries, agriculture and allied activities, information technology, construction, tourism, financial sector and education.
- Policies and programmes of employment creation should enable the skill levels of the workforce to match those required for the new jobs to be created.
- As labour laws are on the concurrent list, state governments may be allowed to make amendments to these laws. However, while making any amendment, adequate safety nets must be provided.
- To maintain parity or proportion in regulatory contracts, labour reforms should not be confined to the large or the organised sector only. The present system of documentation under labour laws may be replaced by self-certification.
- Special quasi-judicial tribunals operated by labour department offices may be established to hear cases where conciliation efforts fail.
- To improve employment standards in tiny or micro enterprises, the potentiality of the concept of cluster development may be fully explored.

During the plan, the maximum additional employment is expected to be created in agriculture, allied sectors and the services.

THE SECOND NATIONAL COMMISSION ON LABOUR

In order to bring out comprehensive labour reforms and legislation, the government setup **Second National Commission on Labour** in October 1999 under the chairmanship of Ravinder Varma. The basic terms of reference of the commission are:

- To suggest rationalisation of existing labour laws in the organised sector;
- to suggest an umbrella legislation for the welfare of workers in the unorganised sector; and
- to take into account opening up of the economy, international competitiveness and the demands of the future labour market.

The recommendations of the Commission are expected to be widely debated and it will take quite some time before serious legislative changes are made in the light of these recommendations. The Commission submitted its report in June 2002 and is being considered by the government in its various aspects. The report of the Commission was discussed at the 38th **Indian Labour Conference** held in September 2002. The **Ministry of Labour** is working on draft legislation for workers in the unorganised sector so as to provide them benefits and protection comparable to that available to the organised sector workers. However, a considerable time is expected to elapse before the proposed comprehensive legislation is passed by the Parliament.

A few efforts, however, have already begun in this direction. The Labour Ministry has already prepared Draft **Labour Relations Management Bill** amalgamating the **Industrial Disputes Act, 1947, Industrial Employment (Standing Orders) Act, 1946** and **Trade Unions Act, 1926**. The Draft Bill contains more stringent provisions for **strikes** and **lockouts**. Existing provision for strike ballot has been scrapped. The Bill also proposes a few new institutions like Grievance Redressal Committee, Lok Adalat, Arbitrator and Cenral and State Labour Relations Commission.

CONCLUSION

Labour environment is a serious concern of all business enterprises as labour is an integral part of all types of production. Labour environment affects employment, productivity, labour-management relations and ultimately output and competitiveness of business organisations. In the present phase of economic liberalisation, there is a widespread opinion that labour laws too need to be made flexible and favourable for business investment. As already pointed, rigid conditions of labour and employment force entrepreneurs and managers to opt for capital-intensive techniques of production which lead to fall in employment rate and may lower consumer income and demand in subsequent rounds. It is important for business organisations to comply with the requirements of labour legislation both for social responsibility and survival. The human resource strategies and technological choices have to be adjusted in the light of the changes in labour environment.

Key Terms

Restructuring
Privatisation
Industrial Relations
Strike
Employee turnover rate
Layoff
Arbitration
Retrenchment
Adjudication
Output elasticity of employment
Under-employment

Supplementary Readings

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Long Questions

1. What are the determinants of labour environment? Comment on the general state of labour environment in the country.
2. How does labour environment affect business enterprises? What suggestion would you give to improve the environment so that corporate competitiveness is enhanced?
3. Comment upon the current state of employment in the country. Do you think labour reforms can improve employment situation?
4. What are industrial relations? Discuss the effectiveness of the mechanism of industrial dispute settlement in the country.
5. Describe the legislative arrangements for worker safety and social security. How are these factors important for labour productivity?
6. Suggest a design for labour reforms aimed at securing the workers interests and increasing productivity in business organisations at the same time. What can be the basic sources of conflict in achieving these objectives together?
7. Identify the factors of jobless growth in the country in the recent years. Give suggestions to make growth employment oriented.

Short Questions

1. How is labour an 'active' factor of production?
2. How is a congenial labour environment important?
3. What are the basic sources of conflict between labour and management?
4. What constitutes labour environment?

5. Why is India's unorganised sector so large as compared to the organised sector?
6. Give three basic reasons for fall in the number of mandays lost in strikes and lockouts in recent years.
7. Give three basic reasons for jobless growth in the country in recent years.
8. What is output elasticity of employment? What does it measure?
9. What is the basic purpose of the Second Commission on Labour?
10. Do you think that the major cause of unemployment in the country is the over-protection of labour through legislation?

Practical Assignments

1. **'Should factories employing workers upto 300 be allowed to hire and fire?'**

Hold a ***panel discussion*** in the presence of the class by three participants each representing company management, government and a trade union. Prepare a written report on the areas of agreement and disagreement and circulate it for comments.

2. Conduct a survey of about 10 manufacturing units and prepare a list of areas in which the respondents consider labour reforms to be urgently required. Also prepare a list of leading problems faced by the units.
3. Hold a group discussion on the Problem of *Jobless Growth* with the objective to find a solution to the problem.
4. Hold a symposium on the *Current Employment Scenario in the country.*
5. Organise a competitive presentation session on *How unemployment Affects Business Organisations.*

CHAPTER 33

GLOBALISATION OF THE ECONOMY: TRENDS AND ISSUES

Chapter Outline :

- Introduction
- What is Globalisation?
  - Levels and Indicators of Globalisation
    - World-level Globalisation
    - Country-level Globalisation
    - Industry-level Globalisation
- Globalisation Trends
  - Progress Towards Globalisation
  - Recent Measures to Promote Globalisation
    - Trade Measures
    - Foreign Investment Measures
    - External Commercial Borrowings
    - NRI Deposits
    - Rupee Convertibility
- Benefits and Costs of Globalisation
  - Gains and Opportunities
    - Competitive and Leaning Effects
    - Technological Gains
    - Larger Markets
    - Outsourcing and Subcontracting Advantages
    - Greater Specialisation
    - Price Stabilisation
    - International Investment Inflow
    - International Economic Cooperation
    - Risks and Threats of Globalisation
- Conclusion

INTRODUCTION

One of the important features of the world economy today is that it is globalising at a fast pace and the different economies of the world are coming closer to one another in terms of economic relations. The process of global integration is being actively debated particularly among the developing countries in terms of its impact on domestic economic policies and the rate of economic growth. Globalisation is now being accepted as an inescapable reality and is being built into the process of economic reforms in a number of developing and emerging market economies in East Asia, South Asia, Eastern Europe, Africa and Latin America. The developed and industrial countries already have a high level of international integration. In other parts of the world, a number of countries are moving away from autarkic structures towards open economic systems through international trade, investment, tourism, information exchange and socio-cultural relations.

In India, though globalisation is not the explicit objective of macroeconomic policy, yet it is an important pillar of the structure of economic reforms. It may be debatable whether globalisation has been accepted by choice or as a force of compulsion, but the fact is that the national and sectoral policies have been designed to develop linkages of the various sectors of the economy with the rest of the world. The process has been slow but the economy is gradually adjusting itself in the global framework and is facing a number of transitional opportunities, challenges and threats. These issues have been taken up in the subsequent sections.

WHAT IS GLOBALISATION?

Globalisation is the process of international integration of products, technologies, human resources, capital, information and cultures. It is characterised by increasing social and economic openness and growing interdependence between the countries of the world. As globalisation progresses, economic, social and political systems of different countries more freely interact with one another and adapt to promote further interaction. Globalisation, therefore, is not a purely economic or business concept but also has social, cultural and political dimensions. Globalisation is greatly aided by the social and economic necessity of different countries to come closer to one another and the willingness of their respective governments for the same. *There are a number of global concerns like bio-diversity, environmental protection, poverty, sustainable development and international security and co-operation which require global action and solution. Such issues help the different countries to come closer to one another.*

LEVELS AND INDICATORS OF GLOBALISATION

Globalisation can be perceived over a wide spectrum of entities right from an individual firm to the world as a whole. These levels are discussed below.

World Level Globalisation

It is the highest level at which globalisation can be perceived. Theoretically speaking, there would be no globalisation of the world if all the countries live in autarky. Globalisation process begins with international economic, social and political relations between the countries. Though these relations have important implications for international business, still the major focus from the standpoint of business environment is on economic or business relations between the countries. Globalisation at the world level has the following alternative indicators:

- The share of world trade in world **GDP**
- The stock of **foreign direct investment** (FDI) in the world as a proportion of world GDP or world investment.
- Total foreign output of **multinational companies** as percentage of world GDP.
- Global transactions in **foreign exchange** as a proportion of world GDP.
- Aggregate turnover in **foreign exchange markets**.
- Total **balance of payments** (BoP) receipts of all the countries of the world as a proportion of world GDP.

Changes in the above parameters reflect the progress of globalisation as seen from different angles. ***A few other indicators like cross-border transactions in financial securities, time spent in international communication and international tourist traffic also reflect movement towards globalisation. In a globalising world, there is an increasing cross-border flow of human resources so that the share of expatriate population in the world population also serves as an indicator of globalisation. Expatriate population spreads home country culture and social values and generates flow of international remittances.***

Country-level Globalisation

Globalisation of a country is indicated by the extent to which it is integrated with the rest of the world. There are various interlinkages through which a large number of cross-border transactions are generated. A systematic record of these transactions with the rest of the world are recorded by all the countries in the form of **balance of payments (Box 33.1)**. The major international transactions include import and export of goods, services, private remittances, interest and dividend payments, foreign loans and investments, commercial borrowings and transactions with the **International Monetary Fund**. The main indicators of a country's globalisation level are the following:

- Share of foreign trade (imports + exports) in **national income** (called **foreign trade orientation**).
- Foreign investment (inward as well as outward) as a proportion of total domestic investment or national income.
- Transactions in foreign exchange as a proportion of the total value of transactions in the economy.
- International investment income flows (inward as well as outward) as a proportion of aggregate **investment income** (dividend plus interest plus royalty etc.) in the country.
- Emigrant and immigrant population as a proportion of total population in the country.
- International tourism traffic as a proportion of total population of the country.
- The share of foreign output of domestic multinationals plus domestic output of foreign multinationals as a proportion of national income of the country.

- Share of inward plus outward foreign remittances in national income.
- Value of BoP credits plus debits as a proportion of national income.

BOX 33.1

What is Balance of Payments?

The balance of payments (BoP) of a country is a systematic summary statement of all the international transactions of its residents (including organisations) with the rest of the world over a particular period of time, usually a year. The transactions can be with a foreign national, organisation or a government. An international transaction involves the exchange of a product or an asset against payment or a gift or other transfers which have an economic value but for which no payment is made. International transactions are classified as credit and debit transactions depending upon whether these involve receipt of payments from foreigners or payments to foreigners. International transactions are divided into **current account** and **capital account** of BOP. Transactions in the **current account** have only ***flow dimension*** and include such items as exports and imports, remittances and dividend and interest flows. **Capital account** records transactions which have ***stock dimension*** as well. Such transactions include foreign loans and investments, international commercial borrowings and foreign government loans. Transactions with the IMF are also included in this category. Balance of payments can be in deficit or surplus according as total foreign receipts fall short of or exceed foreign payments. A BOP deficit is financed either through foreign borrowings or drawn down on the country's foreign exchange reserves.

Depending upon the nature of international linkages and external transactions, different indicators command different levels of significance in different countries. The above indicators are not mutually exclusive, there exists some degree of overlap between them. The indicators based on BOP flows or foreign exchange transactions are much more comprehensive than others. There are also a few ***transitory or intermediate indicators*** which point to the globalisation level of a country. Such indicators are in terms of people-to-people contact (for example, through international telephone calls), exposure to international media (for example, foreign TV channels, magazines etc) and internet use.

Globalisation level of a country can also be assessed in terms of its sensitivity to changes in the economic or social conditions in other regions of the world. In this context, a few correlative measures may be used to show to what extent the economic changes in the country are related to the economic conditions abroad. In particular, correlation coefficients between the following pairs of variables can be used to indicate a country's globalisation level:

- World price index and home price index
- Leading world stock price indices and home stock price index
- Mean level of world rate of interest and mean level of home country interest rate
- World growth rate and home country exports
- World growth rate and domestic growth rate
- Variations in the exchange rate of leading world currencies and exchange rate of home currency.

Globalisation generally tends to reduce the international differences in price levels, rates of interest and other macro-economic variables. The difference between the world level of these variables and the domestic macro variables can therefore be taken as indicators of globalisation

level. These differences are smaller in economies which are more open and globalised. Countries with capitalist economic system which operate on a competitive basis with relatively smaller direct intervention of the government are generally more globalised than the economies which have strong state monopolies, inward-looking economic policies or where government intervention and state control are widespread.

Industry-level Globalisation

Within a country, a few specific industries might be operating at the global level whereas others may be home-oriented. Such industries are those which have high degree of technological advancement and strong competitive advantages on the basis of which they are able to compete in the world market. In developing counties in particular, such industries have significant presence in the form of **multinational companies (MNCs)**. Because of their international linkages, they have better access to foreign markets and can do global **sourcing** for vital inputs like finance and technical expertise. They have wider choices in **outsourcing** and are in a better position to arrange international **vertical integration** of manufacturing processes to reduce cost, reduce tax liability and gain competitive edge. Some of the alternative indicators of the globalisation level of an industry are the following:

- Industry exports plus imports as a proportion of industry output.
- Foreign investment in the industry plus foreign investment by the firms of the industry as a proportion of total investment in the industry.
- Total foreign exchange transactions conducted by the firms in the industry as a proportion of total transactions of the industry.
- Total foreign output as a proportion of total output (domestic plus foreign) of the firms in the industry.
- **Investment income** received from abroad and repatriated as a proportion of total dividend plus interest paid by the firms in the industry to domestic and foreign entities.

Firm Level Globalisation

Within an industrial segment, individual firms can also operate globally. These firms can be foreign collaborations or domestic firms having global operations. These firms often have high level of technological development, strong competitive advantages, international outsourcing connections and access to foreign markets. ***These firms find entry to foreign markets through exporting, foreign direct investment, international licensing and franchising, joint ventures, assembly operations, contract manufacturing, management contracts or through strategic alliances and international market-sharing arrangements.*** These firms are generally mature and enjoy good reputation in domestic and foreign markets. Generally, they are able to attract foreign expertise and **foreign portfolio investment** in their bonds and equities. Most of the indicators for industry-level globalisation can also be applied to indicate globalisation at the firm level. ***Firm-level globalisation is often triggered by survival strategies to retain oligopolistic position, international contacts, unique technological and material resource advantages, economies of scale and product and risk diversification.***

GLOBALISATION TRENDS

As already pointed out, the Indian economy has been gradually opening up under the process of economic reforms initiated in 1991. Over the last one decade or so, various sectors of the economy have been thrown open to foreign competition. Before the decade of 1980s, Indian economy was largely inward-oriented, highly protected and ridden with widespread state controls. During 1980s, the economy witnessed some relaxation and liberalisation of government controls and economic policies as a result of which the linkages of the economy with the outside world increased.

Under economic reforms, the opening up and globalisation for the economy has been slow but clear. In many segments, policies are already in place which are favourable to globalisation but the trend is yet to emerge. In India, main measures taken in the direction of globalisation of the economy are the following.

- Trade liberalisation predominantly through reduction in **import tariffs**, removal of **quantitative restrictions** on imports, wide ranging incentives for exports and simplification and standardisation of trade procedures and documentation. (for details, see **Chapter 34**).
- Liberalisation of norms for the entry of **multinational corporations** and **foreign direct investment** (for details, see **Chapter 35**).
- Liberalisation of foreign exchange management regime.
- Greater freedom to, **foreign institutional investors (FIIs)** to participate in the **money and capital markets** of the country.
- **Convertibility** of the rupee on **current account.** It means that subject to certain standard conditions and restrictions, rupee can be converted into foreign exchange and vice-versa for international transactions relating to foreign trade in goods and services, short-term banking and credit facilities, foreign **debt servicing** and moderate remittances for family maintenance.
- Strengthening of trade infrastructure including ports.
- Widening, deepening and streamlining of the **foreign exchange market.**
- Wide-ranging policies and incentives to attract NRI funds and investments.
- Greater freedom to corporate organisations to raise funds directly from abroad.

PROGRESS TOWARDS GLOBALISATION

progress of globalisation of the economy in recent years can be seen in **Table 33.1.** During the period from 1990-91 to 200-01, the country's foreign trade has risen 2.2 times and **foreign trade orientation** by about 1.5 times. However, in spite of this increase the share of the country's exports in world exports has remained stagnant at 0.6 per cent over the years. The current account transactions in foreign exchange (including trade in goods and services, tourism, **investment income** transfer, **unrequited transfers**) during the period rose by 2.6 times and their size as proportion of **national income** (gross national product at factor cost) increased from 22.0 per cent to 39.3 per cent.

Globalisation through capital transfers has been relatively faster. The aggregate value of international capital flows (inward plus outward) including foreign investments, loans and bank deposits has risen by 2.7 times during the period. The fastest growing component in the capital account has been foreign investment (both direct and portfolio) which rose from $0.1b in 1990-91 to $5.6b in 1995-96 and further to $14.3b in 2000-01. Banking receipts traced a U-shape falling from $10.1b to $6.5b and then rising to $12.8b in the above three years respectively. The international capital flows have increased not only in absolute terms but also relative to total investment in the country. Total international capital flows (inward plus outward) as a proportion of gross domestic **capital formation** in the country rose from 39.6 per cent in 1990-91 to 41.4 per cent in 1995-96 and further jumped to 82.4 per cent in 2000-01.

Table 33.1: Alternative measures of India's globalisation, 1991-2002

	Indicator	1990-91	1995-96	2001-02
	A. Absolute measures ($ billion)			
1.	Foreign trade size[1]	46.4	76.0	104.2
2.	Current account size[2]	61.6	105.9	161.3
3.	Capital account size[3]	33.0	39.3	90.3
4.	Total BOP size[4]	48.2	69.2	147.4
5.	Outstanding external debt	83.8	93.7	99.6
	B. Relative measures (%)			
6.	Foreign trade orientation[5]	14.6	21.4	22.8
7.	Current account size/GNP ratio	22.0	33.5	39.3
8.	Capital transactions/investment ratio[6]	39.6	41.4	82.4
9.	BOP transactions/GNP ratio (external orientation)	9.6	6.5	7.8
10.	External debt service/GNP ratio	2.8	3.4	2.9

Notes: [1] Including exports and imports
[2,3,4] Including both inflows and outflows
[5] Foreign trade as % of national income
[6] Investment represented by gross domestic capital formation
[7] Includes interest repayment and debt amortisation
Source: Prepared from RBI and CSO data.

The picture of globalisation of the economy is more comprehensively presented by the total receipts and payments in foreign exchange as seen in its **balance of payments.** The magnitude of aggregate bop flows (receipts plus payments) rose from $48.2b in 1990-91 to $147.4 b in 2000-01, a jump by about more than three times. These magnitudes when seen in relation to national income provide, what may be called, the **external orientation of the economy.** Aggregate bop flows as percentage of national income (gross national product at factor cost) which was 9.6 per cent in 1990-91 fell to 6.5 per cent in 1995-96 and rose to 7.8 per cent in 2000-01. On this criterion, the economy has receded back on the globalisation scale.

Outstanding external debt which is also sometimes used to indicate the globalisation level is the result of accumulation of foreign loans and borrowings which are obtained either to supplement domestic resources for growth or to finance imports and **debt service** obligations. The borrowings are raised for a large variety of private and official commercial and non-commercial purposes and from an equally wide variety of foreign sources including multilateral institutions, foreign governments, multinational banks, foreign companies and other players in global financial markets. An increasing level of borrowings indicates larger linkages of the economy with the world financial markets. India's outstanding external debt which was $83.8b at March-end 1991 rose to $93.7b by March-end 1996 and further to about $100b by March-end 2001. The debt, as a proportion of national income, moved from 28.7 per cent to 30.8 per cent and back to 22.3 per cent over these years. Similar pattern is witnessed in the ratio of **external debt service payments** to national income which rose from 2.8 per cent to 3.4 per cent and fell to 2.9 per cent over these three years.

Though both absolute and relative measures are used for globalisation, the latter provide a better and more realistic picture. On the relative criteria, the march towards globalisation appears quite modest. A still better picture can be obtained by comparing movements in India's globalisation level to those at the world level or in other countries. In a study conducted by AT Kearny, a foreign policy magazine, in the year 2000, India ranked 49th out of 50 developed and key developing countries in terms of depth of globalisation achieved (**Box 33.2**).

BOX 33.2

India Ranks Second Last in Globalisation

In a survey conducted by **AT Kearny**, a foreign policy magazine, India ranked 49th out of 50 developed and emerging developing countries in terms of globalisation. The ranking was done one the basis of an index developed to measure extent of globalisation in the world. India scored well on transfer payments, both from non-resident Indians abroad and foreign official funds. According to the study, India's overseas population played an important role in sustaining the economy as compared to overseas population of other countries. On the criteria of international travel and tourism and international telephone calls, India ranked last. **In 1998, incoming and outgoing international tourists in the country were about 6 million which constituted just 0.6 per cent of the total population of the country. Minutes per capita (per year) of international telephone calls were only about 2.**India has a very low level of internet penetration. According to the Study, India had only one internet server per 1,00,000 population in 1998 which was less than even many African countries. The number of internet users as percentage of total population was among the lowest in the world. ***The Study pointed out that foreign investors regard public officials and politicians as less corrupt in countries which are more globalised. This is a reflection on the ethical standards and corruption levels of the countries which are at the bottom end of the globalisation index.***It is, therefore, important for the countries that are low on the globalisation scale to restore confidence of foreign investors. Within the countries, there is a need to create a level playing field for domestic and foreign enterprises. In the present year of uncertain recovery, there is a great need to follow best practices in business. Multilateral institutions like the IMF have to strengthen the framework for prevention of crisis that might result in a few economies due to globalisation.

Sources: 'India Second from Last in Globalisation', *The Economic Times,* January 10, 2001 and Kohler, Horst 'Rebooting Globalisation', *The Economic Times,* November 15, 2002.

Recent Measures to Promote Globalisation

The main measures recently undertaken revolve around **trade liberalisation, rupee convertibility,** measures to promote **foreign direct investment** and measure for a larger role of the expatriate population in the economy. These measures are briefly described as follows:

Trade Measures

In order to increase the export-GDP ratio, a number of initiatives have been taken in recent years. These include a reduction in export credit rates, both pre-shipment and post-shipment, higher **duty drawback** rates on a large number of export items, abolition of value limits on a large number of export products covered under the **Duty Entitlement Passbook Scheme (DEPB)** and special financial assistance packages for selected export products having high value addition and high level of international competitiveness.

In January 2002, government adopted a medium-term export strategy which has been developed, taking into account, current international business environment and seeks to achieve its objectives by the year 2007. ***One of the central objectives of the strategy is to increase the country's share in world exports from 0.6 per cent to 1 per cent over the next five years, which, in other words, means a compound annual growth rate of about 12 per cent (in dollar terms) over the Tenth Plan period 2002-07. This involves raising the export level from $ 45b in 2000-01 to about $80b by 2006-07.*** The strategy identifies a set of focus products having comparative and competitive advantages and focus markets which have good potential for these products. The major plans on which the strategy is based include maintaining price competitiveness, strengthening trade-defence mechanism, providing WTO – compatible **subsidies**, attracting FDI in export-oriented industries, making tax concessions to exporters comprehensive and transparent, reducing transaction costs and improving export infrastructure. The strategy, however, will have to work against the formidable export-limiting factors like outdated technology, infrastructural constraints, rigidity of labour laws, sensitivity of agricultural exports, SSI reservations, informational barriers, high transactional costs and high incidence of taxes.

On the import side, the liberalisation has been gradual and sustained. Ever since 1991, when the economic reforms process started, there has been gradual dismantling of **quantitative restrictions (QRs)**. At present, quantitative restrictions have been lifted from more than 95 per cent of the products which were earlier subject to such restrictions on BOP grounds. Restrictions on the remaining less than 5 per cent products have been maintained on the grounds of health, safety and moral conduct. However, no major import surge has taken placed as a result of the removal of such restrictions. Further, the **import duty** rates have been lowered on a large number of product groups. The **average collection rate** defined as the ratio of realised import revenue including basic additional and special custom duties as well as countervailing duty as percentage of the import value of the product for overall imports, has gradually fallen from 47 per cent in 1990-91 to 21 per cent in 2000-01.

Foreign Investment Measures

Some progress towards globalisation has also been made on account of the inflow of foreign investment, both direct and portfolio. The basic motives for **foreign direct investment (FDI)** have been to supplement **foreign exchange** resources, technological upgradation, access to global managerial skills and practices, fuller utilisation of human and material resources and making domestic industry internationally competitive. FDI is also attracted in the expectation that it would provide **forward and backward linkage**, benchmarks for quality processes and products and access to foreign markets. The government has allowed foreign equity holding upto 100 per cent in a large number of industries. It has also provided automatic route for FDI under which foreign investors only need to inform the RBI about their investment within 30 days of bringing their investment and again within 30 days of share issue. There are additional channels of investment for non-resident Indians and through **acquisition of shares** as per provisions of **Section 5 of Foreign Exchange Management Act, 1999**. FDI is invited on liberal terms in **special economic zones**, informational technology sector, oil refining, power generation, telecommunication, hotel and tourism, drugs and pharmaceuticals and various sectors of infrastructure. However, inspite of an open door policy, FDI inflow in India is very weak. Between 1990-91 and 2000-01, the maximum annual inflow was \$3.6b in 1997-98, the minimum being merely \$97 million in 1990- 91. During 1997-2001, the total annual inflow of FDI in developing countries was above \$150b of which India received merely \$2b-3b (*Global Development Finance, 2002*). On a per capita basis, India has been far behind a number of smaller Asian countries at competing for FDI. During 1996-2000, per capita FDI inflow in India was only \$4b which was way behind Singapore, Malaysia, Korea, Taiwan, Thailand, China and a few other East-Asian countries (**IMF Survey**, Nov 4, 2002).

In the UNCTAD's **World Investment Report**, 2002, India's **FDI Performance Index** was 0.2 on the basis of which it was ranked 119th, far below China and lower than even Pakistan and Sri Lanka. India again scored 0.2 at the **FDI Potential Index Value** as compared to 0.16 for Pakistan, 0.19 for Sri Lanka and 0.25 for China. ***UNCTAD measures FDI performance by standardising a country's inflows to the size of its economy and measures FDI potential by using a set of economic and policy factors of importance to foreign investors. It must be commented that globalisation based on foreign investment must consider the diversity of the source pattern. On this score, India performs low as most of the foreign investment in the country comes from the USA, Mauritius, UK and Japan.*** According to a recent study conducted by **Economic Intelligence Unit (EIU)** on World Investment Prospects, India is projected to be the eleventh largest beneficiary of FDI inflows among emerging market economies between the period 2002-06. During 1997-2001, India's position in this respect was sixteenth. EIU has estimated that India will receive an annual average of \$5.3b during the period 2002-06, ahead of other countries such as Thailand, Malaysia, Indonesia and Philippines. India's detailed position with regard to FDI is discussed in **Chapter 35**.

Foreign portfolio investment (FPI) in India has been quite volatile. It was less than \$10m during 1990-92, negative in 1998-99 and peaked at \$3.8b in 1994-95. ***The main routes or sources of FDI are foreign institutional investors (FIIs), Global Depository Receipts, American Depository Receipts and off-shore funds (Box 33.3)*** and FPI flows in all these categories have been widely fluctuating.

BOX 33.3

What are Global Depository Receipts (GDRs) and American Depository Receipts (ADRs)?

Depository receipts are a mechanism by which shares of a firm are traded indirectly. The shares, in this mechanism, are held by a ***depository*** (the share being called ***depository shares***), generally a large multinational bank, which receives dividends etc on shares and issues claims against these shares. The claims are known as **'*depository receipts*'**, each receipt representing a certain number of shares. The receipts are denominated in leading currencies and are tested and traded on major ***stock exchanges*** of the world. The company issuing shares pays dividend in the currency of its country. The ***dividend*** is converted into the currency of denomination of the 'depository shares' by the depository institutions and the dividend is paid to the holders of the depository receipts. The issuing company, in the process, saves the cost and botheration of disclosure, reporting and other mandatory requirements of listing and dealing directly with foreign stock exchanges. American Depository Receipts (ADRs) are issued by a US bank as token of its holding a foreign security on behalf of holders. The terms and conditions of an ADR, its settlement, transfer and negotiability are the same as those for US securities. On the same pattern, ***European Depository Receipts (EDRs)*** and ***Global Depository Receipts (GDRs)*** have emerged which are used to tap multiple foreign markets for equities with the help of single instruments of depository receipts. A number of Indian corporates have used this mechanism in recent years and have brought in proceeds of equity issues in foreign exchange.

External Commercial Borrowings

External Commercial Borrowings (ECBs) are an important and emerging component facilitating globalisation of the corporate organisations as well as the economy as a whole. The government maintains a carefully formulated policy in this regard keeping in view the development requirements of the economy and the implications for external indebtedness. The main guiding principles of the policy towards ECBs are:

- To keep long maturity periods so that the debt burden is spread over a number of years;
- to obtain the borrowings at lowest possible rates with least transaction costs;
- to maintain safe limits of borrowings to keep the debt burden sustainable; and
- to encourage financing of exports and infrastructure in the interest of overall development of the country.

During the period 1998-2002, the major sectors to which such borrowing approvals (in terms of US dollars) have been given are the power sector, financial institutions, petroleum and natural gas and shipping. Gross disbursements which were \$3.2b in 1999-2000, stood at \$3.8b in 2000-01. A larger part of the disbursements in 2000-01 were on account of refinancing of pre-payment of more expensive borrowings. ***The large amount of amortisation caused net inflow to turn negative in 2000-01.*** This was more than compensated by the inflow of about \$5.5b mobilised under **India Millennium Deposits (IMD)**. External Commercial borrowings are raised both by private and public sector organisations. However, year-to-year data on ECBs shows a declining trend which reflects restrictive nature of the government policy in this regard.

In 1998-99, total value of approvals given for ECBs was \$5.5b which declined to \$3.4b in 1999-2000 and further to \$2.8b in 2000-01 (Ministry of Finance data). The restrictions are however being reduced. In a significant development, the government in January 2003 reformed its policy under which companies with overseas offices can retain ADR/GDR proceeds abroad without any limit. Earlier, the limit in this regard was merely \$10,000.

NRI Deposits

NRIs play an important role in the globalisation of the economy. They not only spread Indian culture, values and traditions all over the world but also are an important source of foreign exchange remittances. Outstanding balances under various non-resident schemes in India rose consistently from $15b March 1993 to more than $25b in November 2001. However, there have been marked variations in the net inflow (deposits minus withdrawals) of deposits (Table 33.2).

Table 33.2: **Outstanding balances and net flows under various non-resident deposit Schemes, ($b)**

Year	Outstanding balances[1]	Net inflow
1992-93	15.0	2.1
1994-95	17.2	1.0
1996-97	20.4	3.3
1998-99	20.5	1.0
2000-01	23.1	2.3

Note: [1] As at March-end of the years.
Source: RBI data.

The inflow of NRI deposits depends upon a number of factors like international differences in interest rates, restrictions on repatriation or withdrawal, maintenance expenses or living standards of families supported in India and changes in employment conditions abroad.

Expected movements in the rate of exchange also play an important role in determining the inflow. When exchange rate of rupee is expected to rise (i.e. rupee expected to depreciate in terms of major foreign currencies), the inflow has a tendency to escalate as the same amount of foreign exchange would convert into more rupees if the expectation materialises.

Keeping in view the important role of NRIs in the economy, the government, over the years, has been adopting various measures to forge closer ties with them. On the occasion of the first ***Bhartiya Pravasi Divas*** (NRI Day) observed on January 10, 2002, the government announced the scheme of dual citizenship for persons of Indian origin (PIOs) living in USA, UK, Canada, New Zealand and Singapore. The measure is expected to boost their interest and confidence in the economy and it might give filip to further growth of NRI deposits in the country.

Rupee Convertibility

In a major development towards globalisation, ever since the beginning of the reform process, there has been gradual movement towards **rupee convertibility**. ***Rupee convertibility, broadly speaking, refers to the convertibility of rupee in a foreign currency (generally, US dollar) for certain permitted categories of external transactions.*** Rupee was made partially convertible on trade account with effect from the year 1993-94 and was declared fully convertible on current account subject to certain conditions relating to individual transactions. ***Under Article VIII of the International Monetary Fund, India has the obligations not to apply exchange restrictions to correct balance of payment deficits.***

There has been a good deal of debate on the issue of making rupee convertible on **capital account** as well. The government has been reluctant to do so as it might involve heavy foreign exchange outflow restricting the ability of the RBI to intervene in the foreign exchange market for stabilising rupee exchange rate. There is a widespread opinion that the country is not yet ready to go into capital account convertibility and it would pre-require the existence of a number of parameters of healthy economic performance. However, in a major decision in January 2003, the government has taken a few measures (listed below) in this direction which will further help the economy to integrated with the global economy.

- Discontinuance of the limits on trade-related loans and advances by the **Export Earners' Foreign Currency** (EEFC) account-holders;
- Permission to corporates having branches and offices abroad, to acquire immovable property abroad for business and staff residential purposes;
- Permission to listed Indian companies, **mutual funds** and individuals to invest abroad in companies listed in recognised overseas **stock exchanges** having at least 10 per cent shareholding in a company listed on a recognised stock exchange in India; Such investment, in case of companies, should not exceed 25 per cent of Indian company's net worth. In case of mutual funds, the overall limit for foreign investment is $1b. For individuals there will be separate investment limits determined from time to time;
- General permission to the eligible companies to retain ADR/GDR proceeds abroad.

The above measures mask the beginning of the process of capital account convertibility and might set a trend for subsequent measures in this direction. Much, of course, will depend upon global compulsions, size of **foreign exchange** ***reserves in the country, the trend and projection of the*** **balance of payments** ***position and the overall performance of the economy.***

BENEFITS AND COSTS OF GLOBALISATION

As already pointed out, globalisation is not the explicitly declared policy objective of the government; rather, has been the consequence of economic liberalisation. It is in this sense that globalisation stands accepted as an inevitable phenomenon rather than a necessary evil or as a part of government policy. Nevertheless, globalisation might appear indirectly present on the list of objectives of macroeconomic policy. The various macroeconomic policies explicitly recognise the benefits of global integration and the precautions to be observed. There has, however, been an ongoing controversy regarding the benefits and costs of globalisation of the economy keeping in view the perennial problems like poverty and hunger, malnutrition, morbidity, unemployment, price instability, income inequality and growing marginalisation of social classes. There has also been a debate on whether the economy is ready and mature to face global competition. Apart from this, there have been issues relating to the safe limits and transition to globalisation. Main aspects of such issues are discussed in the following sections.

GAINS AND OPPORTUNITIES

Globalisation unfolds a number of gains and opportunities to the economy. Most of these are *potential* benefits. To what extent these are or can be realised depends upon such factors as the macroeconomic policy, economic institutional system, entrepreneurship and the overall nature of the production system including infrastructure which together determine the absorptive capacity of the economy. These factors are subject to slow change but gradual progress can be made through sustained efforts in this direction.

Competitive and Learning Effects

Globalisation adds new dimensions to domestic competition which spur the domestic firms towards higher efficiency, product innovation, cost cutting and greater professionalisation. Competition is introduced both through imports and **foreign direct investment** carried by **multinational corporations.** Domestic firms and entrepreneurs learn about new products, new technologies and new methods of management and try to adopt these in their own systems. A lot, of course, depends upon learning orientation and abilities as well as entrepreneurship. ***The firms which fail to learn from rivals are generally marginalised in the long run.***

Technological Gains

Globalisation introduces not only new products but also new technologies. Technology encompasses many areas including production, distribution, promotion, information and communication, packaging, transportation, financial operations as well as management. ***Technology***, both **embodied** and **disembodied,** is transferred through foreign direct investment, international **licensing** and **franchising, management contracts, joint ventures, assembly operations** and international consulting. There are also full-fledged open markets for technology from which product-specific technologies can be bought out on outright basis. Firms with goods R&D base are also sometimes able to derive and learn technologies from product examination – a process which is known as **reverse engineering.** Countries living in autarky-like conditions or with limited openness are deprived of these gains.

Larger Markets

Globalisation provides larger markets to domestic producers by way of exports. Domestic firms are able to develop international marketing channels – both direct and indirect – which can be used to understand the nature of foreign demand and to export products accordingly. Foreign markets appear to be a boon in times of domestic recession. Since domestic and foreign demand and competitive situations vary markedly, on many occasions, domestic firms are able to realise high prices from foreign markets – often a multiple of domestic prices. The firms gain better image through global operations which helps them to attract better managerial talents.

Outsourcing and Sub-contracting Advantages

Globalisation provides many sourcing advantages. Firms with worldwide contacts are able to do global **sourcing** for funds and reduce the **cost of capital.** They can outsource technology, distribution and even consumer research. **Subcontracting** arrangements can be negotiated which enable the domestic firms to remain focused on their **core-competence** areas. These advantages enhance operational efficiency and help in compressing costs. Due to these advantages, international **sub-contracting** has been on the rise in recent years.

Greater Specialisation

Globalisation provides motivation to domestic firms to specialise in areas where they have competitive or comparative advantage. Each firm enjoys advantage in certain functional or product areas where it has good competence to compete in the market. Core-competence versus diversified operations continues to be a major debate area in strategic management. Though it is not possible to draw a universal conclusion, the widely accepted fact is that entry of a firm in non-competence areas raises costs and reduces overall competitiveness. To stay successfully in competition, globalisation provides a good inducement to firms to remain close to their competence areas. At the national level, it saves resources and promotes growth and exports.

Price Stabilisation

Globalisation can be expected to reduce international differences in price levels. Theoretically, when a export-surplus country trades with a deficit country, prices tend to recover in the former and come down in the latter country. ***Under free trade and competitive conditions, international price differences should reflect only the additional risk factors, transportation and distribution costs, if mark-ups are not disturbed. For a particular country, international trade as a driver of globalisation provides a route to production surplus and a channel to meet shortages. Price stability is an important factor for a conducive environment.***

International Investment Inflow

Countries with a higher degree of globalisation generally tend to have larger international investment inflow, other things being equal. Foreign investors need freedom to operate or transfer funds globally in order to meet their corporate objectives. Globally integrated countries provide an excellent environment to international investment – both direct and portfolio. Foreign investment further promotes globalisation. For the recipient country, foreign investment supplements domestic resources, brings in foreign exchange, improves **balance of payments** and gives strength to the domestic currency. **Foreign direct investment,** as pointed out above, also provides the benefit of **technology transfer**.

International Economic Cooperation

Globally integrated economies reap in the fruits of international economic cooperation. ***The cooperation comes in the form of trade agreements, investment treaties, avoidance of double taxation, standardisation of commercial procedures, intellectual property protection and the like. International cooperation also enables countries to harmonise their macroeconomic policies for their mutual benefit. This cooperation provides a good environment for the domestic companies to internationalise their operations.*** The ability of a country to derive or maximise gains from globalisation depends on its size, efficiency, material resource strength, technology and, above all, quality of human resources and socio-economic institutions. Good governance in public services and in the corporate sector play a key role in this regard.

Risks and Threats

Globalisation is not a pure bundle of opportunities and benefits. It carries with it certain risks and threats which, if not appropriately dealt with, might create crises in the economy. Globalisation both as an opportunity and as a threat must be managed both at the macroeconomic and microeconomic levels. Some of the major risks and threats are as follows:

- *International economic problems and crises* like inflation, unemployment, **recession** and currency **depreciation** tend to spread, internationally, particularly among globally-integrated countries, through various channels of international influence.
- Globalisation tends to cause industrial and employment restructuring. As countries and companies gradually move into their competitive and comparative advantage areas and as technological upgradation takes place, ***unemployment tends to swell*** among low-skill categories of workers and demand for higher-skill workers tends to rise alongwith compensation. It might be difficult for the low-skill workforce to acquire higher skills in the short run because of their limited learning abilities and inadequacy of training infrastructure. This might result is ***greater income inequality, poverty, social unrest*** and even larger unemployment at the national levels.
- Globalisation raises the degree of dependence or interdependence resulting in lesser control over the domestic economy and loss of economic sovereignty. Developing economies, in particular, as weak partner may face the problems associated with foreign economic dominance.
- ***Availability of readymade foreign technology – both embodied, and disembodied – in the open market scuttles domestic R&D and promotes external technological dependence.*** In a number of cases, foreign technologies are not adaptable to local conditions. Market imperfections, which are rampant in the technology sphere, often substantially raise the acquisition costs for developing countries which generally negotiate from a weak or inferior position.
- Globalisation has been instrumental in the ***drain of basic raw materials through low value added exports***. The value added structure of world trade evidences that the less developed countries are the seller of low value-added and buyers of high-value products in the world markets. The ***exploitative character of trade*** has often been cited as a factor for the perpetuation of their economic underdevelopment. Globalisation of the **factor markets** tends to transfer talented human resources from the less developed to industrial countries which offer better career prospects and facilities for fuller utilisation of talents. From a global perspective, it may be desirable but from the standpoint of losing countries, the **brain drain** is one of their formidable problems.
- Globalisation promotes consumption cultures that may not be in consonance with the lifestyles and values of all the countries. For countries with limited resources, it might cause the problem of ***shift in the industrialisation pattern away from national priorities.***
- Finally, globalisation through foreign direct investment and multinational companies might erode the domestic production base. The domestic resourceful but uncompetitive firms might be acquired by foreign firms thereby reducing competition.

Countries with growing presence of MNCs are confronted with the problem of ***high burden of dividend outflow*** in foreign exchange and ***monopolistic practices.***

CONCLUSION

Globalisation is not an unmixed blessing. ***What is important is how and in what direction the economy is opened up to international influences. Globalisation lands an economy in international competition in various areas and it is important to see that the sectors which are opened up through international trade or foreign investment are able to withstand the rigours of international competition and the overall impact on the economy is not adverse.*** In the present phase of the world economy, when most of the countries of the world are liberalising their economies, it is difficult to remain in isolation. Domestic economic policies must be so designed as to maximise the gains and minimise the costs and risks of globalisation. At the firm level, managers must monitor the trend and pattern of dynamic globalisation and develop suitable response strategies.

Key Terms

Brain drain
Factor market
Globalisation
Outsourcing
Foreign directOinvestment (FDI)
Foreign portfolio investment
Multinational Companies (MNCs)
Import tariff
Foreign exchange
Quantitative restriction's
Foreign exchange market
Foreign institutional investors (FIIs)
Balance of payments
Money market
National income
Capital market
Foreign trade orientation
Debt servicing
Foreign investment
Investment income
Investment income
Capital formation
Current account
Transfer payments
Capital account
Global Depository Receipts (GDRs)
Vertical integration
American Depository Receipts (ADRs)
Forward and backward linkages
Duty drawback
Special Economic Zone (SEZ)
Rupee convertibility
Technology transfer
Reverse engineering
Cost of capital

Supplementary Readings

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Long Questions

1. What is globalisation? What are its various levels? Is globalisation of Indian economy a matter of public policy choice or a compulsion?
2. Examine the progress of Indian economy towards globalisation in the post-reform years. Comment on the slow pace of progress of globalisation and identify the major reasons.
3. How will you compare the globalisation level of two different countries? Discuss the alternative indicators of globalisation pointing out the limitations of each measure.
4. Discuss the major channels of globalisation of Indian economy. How can globalisation be turned into a set of opportunities for growth?

Short Questions

1. Explain globalisation as a 'process'.
2. What are the main drivers of globalisation?
3. Briefly describe the different levels of globalisation.
4. How does balance of payments of a country reflect the level of globalisation of a country?
5. Comment on the trend in foreign trade orientation of Indian economy in the post-reform years.
6. How would you interpret doubling of the BOP capital transactions/investment ratio from 41 per cent to 84 per cent during 1995-2002 (refer to *Table 33.1*)?
7. Give five alternative indicators of globalisation of Indian economy.
8. List three major advantages and three risks associated with globalisation.

Practical Assignments

1. Study the balance of payments of the country over the last five years and prepare a paper on *'The trends and Pattern of Globalisation of India'* for presentation and discussion in the class.
2. Collect newspaper clippings over the last quarter from the leading business dailies related to globalisation and make a presentation of the current scenario.
3. Select two groups of Indian and foreign firms with three companies each in the same industry and compare their globalisation levels. Are foreign firms more globalised than Indian firms? Take the help of indicators of industry and firm level globalisation given in the Chapter.
4. ***'To overcome the problems of the economy, we don't need more globalisation, but better globalisation.'*** Hold a group discussion on this topic with the objective to find out what type of globalisation is suited to the Indian economy.

CHAPTER 34

TRADING ENVIRONMENT AND THE EXIM POLICY

Chapter Outline :

- Introduction
- What Constitutes Foreign Trade Environment?
- Trend and Pattern of India's Foreign Trade
    - Volume Trends in Merchandise Trade
    - Index Numbers of Foreign Trade and Terms of Trade
    - Obstacles to Export Growth
    - Compositional Pattern
    - Export Thrust Areas
    - Direction of Trade
- Policy Environment: EXIM Policy 2002-07
    - Export Promotion Through Thrust Products
    - Push to Agricultural Exports
    - Broadbasing the Market Access Initiative Scheme
    - Special Economic Zones
    - Strategic Package for SSIs
    - Reducing Transaction Costs
    - Strategic Package for Status Holders
    - Continuance of Duty Neutralisation Schemes
- Roadmap for Future Trade Reforms: Kelkar Committ Recommendations
    - Customs Tarrif and Exemptions
    - Customs Procedures and Trade Facilitation
    - Export Promotion Schemes
- Conclusion

INTRODUCTION

Foreign trade, which includes both import and export of goods and services, is an important factor of globalisation and an index of the openness of an economy. As already discussed in **Chapter 7**, in macroeconomic accounting, '**net exports**' or the 'difference between exports (X) and imports (M), is a component of **national income** (Y) defined as:

$$Y = C + I + G + (X - M)$$

Where C = aggregate consumption expenditure; I = investment; and G = government expenditure. The relation between exports, imports and national income is far more complex than that found in standard texts on **macroeconomics**. In standard macroeconomic theory, exports are autonomous with respect to the level of national income (i.e. changes in national income are not expected to affect exports which basically are related to the state of foreign demand for export goods and services) but changes in exports are expected to bring about a multiple increase in the level of national income through **foreign trade multiplier** under standard assumptions or conditions. The mechanism is explained in **Chapter 7**.

Imports, on the other hand, are regarded as a positive function of income. As national income increases, it causes increase in the demand for foreign goods just as in the case of domestic goods. Similarly, the demand for imported raw materials, capital goods, technology and related products also increases resulting in higher imports to the extent that these are permitted under foreign trade policy. Imports are generally considered as leakages from the domestic income stream having negative cumulative effect on the level of national income. The negative effect is partly neutralized by the positive effect of **foreign investment** on income. Development imports also induce indirect investment effects in the domestic sector and may even generate new exports in the subsequence rounds.

In the contemporary world, import and export flows are not independent. As already pointed out, a given increase in exports increases national income which, in turn, increases imports. In a large number of cases exports are based on imported raw-materials, intermediate products and capital equipment. In the like manner, imports may generate exports with **value addition**. Countries that follow **protectionist policies** with high **import tariffs** and restrictions on imports, often face reciprocal action or retaliation from other countries which inhibits the protectionist country's exports. **World Trade Organisation (WTO)**, which today is the most powerful multilateral institution engaged in promoting free trade, has a number of institutional arrangements based on multilateral agreements between countries which seek to reduce restrictions on imports and exports and improve the world trading environment. The impact of the WTO system on India's trading environment in discussed later in the Chapter.

WHAT CONSTITUTES FOREIGN TRADE ENVIRONMENT?

Foreign trade environment refers to the average state of conditions or circumstances which are dynamically changing and affect exporters and importers by influencing their export performance, import behaviour, competitiveness, cost conditions and eventually profitability. Export competitiveness and cost conditions and eventually profitability. ***Export competitiveness and performance of firms basically depend upon resource advantage, organisational effectiveness, product quality, innovation and the extent and quality of international marketing efforts. The performance is greatly affected by the export-import (EXIM) policy of the government. The policy lays down an export-promoting institutional infrastructure, incentives and concessions, procedures and conventions and provisions which affect the access of exporters to foreign markets. These factors, along with other components of macroeconomic policy, like*** **monetary and fiscal policies** ***(discussed in Chapters 11 and 12), determine the transaction costs of exporters which affect the competitiveness of exporters.***

The environment for imports is predominantly set, again, by the EXIM policy. The environment affects the firms' access to **foreign markets** and the cost of imports. As imports have to be financed out of hard-earned foreign exchange earnings of a country (except in case of barter-type **counter-trade arrangements**), governments generally don't give unlimited access to foreign markets and adopt a number of ***tariff*** and ***non-tariff*** measures to control imports. ***The greater the restrictions, the greater are the constraints on the ability of the firms to take advantage of possibly cheaper and superior inputs from abroad.*** Moreover, import control, through higher import tariff, raises import prices proportionately adversely affecting cost competitiveness. Such factors assume greater importance for firms which have higher dependence on imported inputs and may vitally affect their investment decisions. ***Trade restrictions generally depress investment particularly by multinational enterprises. Liberal trade policies encourage competition and investment and that is the reason why more developed countries, in general, have larger international trade volumes as compared to other countries.***

Foreign trade environment of a country is affected by world economic conditions. A ***recession*** abroad, for example, adversely affects the exports of a country. Similar effect will be produced by import restrictions imposed by foreign countries. Multilateral institutions like WTO, which sets the rules of international trade, have a profound impact on the trading environment of member countries. **Regional economic groupings** and trading arrangements in which member countries give trade preference to one another, deprive a number of other countries of trade opportunities. One common form of regional groupings is ***custom unions*** in which member countries demolish, substantially or entirely, the ***import tariff*** between themselves but erect a common external tariff with respect to the rest of the world. ***In this arrangement, it is quite possible that an efficient firm belonging to an outside country which faces a tariff barriers loses its market to a less efficient firm belonging to a member country whose products are exportable free of tariff. Such a phenomenon, called trade diversion, is net loss to the world economy as it distorts the optimality of resource allocation.*** Some of the important groupings are **European Union (EU), North American Free Trade Area (NAFTA), European Free Trade Association (EFTA) Central American Common Market (CACM), Organisation for Economic Cooperation and Development (OECD), Andean Common Market, European Economic Area (EEA), Latin American Free Trade Area (LAFTA), Latin American Integration Association (LAIA), Caribbean Community and Common Market (CARICOM), Southern Cone Common Market (MERCOSUR), Association of South-East Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC), Economic Community of West African States and Organisation of Petroleum Exporting Countries (OPEC).** These groupings have separate objectives and forms of association.

The **exchange rate regime** has an important influence on the state of business environment. ***The regime is a catch-all term referring to the system of exchange rate determination, trends in exchange rates, foreign exchange reserve utilization, foreign exchange management system, working of foreign exchange market and all those factors which affect the above variables. A competitive foreign exchange market is generally considered to be consistent with a favourable environment for international trade.*** Restrictions on foreign exchange flow tend to inhibit growth of international trade and investment. A reasonable measure of regulation is essential, rather good, for orderly growth of the **foreign exchange market** and exchange rate stability, both of which are important for a good trading environment.

Resulting from the above discussion, the factors that constitute and affect trading environment are the following:

- Resource endowments of the exporting country;
- competitiveness of the exporting firms;
- incentives and facilities for exporters;
- the state of import competition;
- availability of foreign exchange reserves;
- import dependence of domestic firms and access to foreign markets both of imports and exports;
- structure of tariff rates;
- transaction costs of international trade;
- trade restrictions;
- international economic conditions;
- regional economic groupings among countries;
- exchange rate regime; and
- monetary and fiscal policies.

TREND AND PATTERN OF INDIA'S FOREIGN TRADE

It is useful to have a look into trends in the pattern of India's foreign trade in recent years. The pattern reflects changes in India's export capabilities and import requirements. It also reflects opportunities in international business. To some extent, these trends portray the dynamism and the current state of business environment in the country. Major developments in the country's foreign trade may be discussed as follows.

VOLUME TRENDS IN MERCHANDISE TRADE

It is interesting to note that India's share in world exports was higher (at 2.2 per cent) just after Independence (in 1948) than what it is now (0.7 per cent). ***It simply means that India's exports***

have risen over the years at a slower pace as compared to the world average rate of growth. This share is in comparison to 4.3 per cent for China, 2.4 per cent for Korea, 1.4 per cent for Malaysia, 1.1 per cent for Thailand and 0.9 per cent for Indonesia.

Table 34.1 gives the major quantitative parameters of the country's foreign trade position. As can be seen from the Table, the country's exports have grown from $32.3 billion to $44.9 billion over 1995-2002. Except for the two spurts in 1995-96 and 2000-01 (due to buoyant demand conditions in the world market), export growth has fluctuated from -3.9 per cent (in 1998-99) to 9.5 per cent in 1999-2000. The export-GDP ratio (%) traces a U-pattern falling from 9.1 per cent in 1995-96, bottoming out at 8.3 per cent in 1998-99 and again rising to 9.8 per cent in 2000-01. Except for the year 1998-99, growth rate in exports in nominal US dollar terms has been positive.

Table 34.1 Volume trends in India's merchandise exports and imports, 1995-2002

Variable	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02
A. **Exports**							
1. Value ($b)	32.3	34.1	35.7	34.3	37.5	44.9	44.9
2. Growth rate (%)	20.3	5.6	4.5	-3.9	9.5	19.6	0.0
3. Exports as % of GDP[1]	9.1	8.9	8.7	8.3	8.4	9.8	9.4
B. **Imports**							
1. Value ($b)	43.7	48.9	51.2	47.5	55.4	59.3	57.6
2. Growth rate (%)	21.6	12.1	4.6	-7.1	16.5	7.0	-2.8
3. Import as % of GDP[1]	12.3	12.7	12.5	11.5	12.4	13.0	12.0
C. **Trade Balance (X-M)**							
1. Value[2] ($ b.)	-11.4	-14.8	-15.5	-13.2	-17.8	-14.4	-12.7
2. Balance as % of GDP[1]	-3.2	-3.8	-3.8	-3.2	-4.0	-3.1	-2.6
D. Ratios							
1. Exports as % of imports	74.0	69.7	69.7	72.1	67.8	75.8	78.0
2. Import cover of foreign exchange reserves (months)[3]	6.0	6.5	6.9	8.2	8.2	8.6	11.3

Notes: [1] Calculated at market prices
[2] Figures may not exactly tally due to rounding
[3] No. of months of imports that can be financed from foreign exchange reserves.
Source: Reserve Bank of India

During 1995-2002, imports remained higher than exports, rising from $43.7 billion in 1995-96 to $57.6 billion in 2001-02. Import growth rate consistently fell over the period 1995-99 and after a jump in 1999-2000, declined thereafter, tracing a step-like pattern. Import-GDP ratio during 1995-2002 has fluctuated within the range 11.5 – 13.0 per cent. As imports have consistently been above exports, the **trade balance** has been negative. The trade deficit during the period has varied between \$11.4 billion and \$15.5 billion. Correspondingly, and equivalently, export-import ratio, yielding a wave-like movement, has varied between 67.8 per cent and 78 per cent. However, due to sustained increased in the foreign exchange reserves the **import cover** (as defined in the Table) has gradually improved from 6 months to more than 11 months.

INDEX NUMBERS OF FOREIGN TRADE AND TERMS OF TRADE

The above trends are in value terms. It is interesting to decompose value terms into its constitutes viz. unit value and physical volume terms. To remove the problem caused by the complexity or multiplicity of prices, currencies, product varieties and measurement units, **Director-General of Commercial Intelligence and Statistics (DGCIS)** compiles trade data in unit value and volume indices. **Table 34.2** gives the trend in these index values in recent years.

Table 34.2 **Recent trends in the unit-value and volume indices of India's exports and imports,** 1995-2002 (1978-79=100)

Year	Unit Value Index		Volume Index		Terms of trade		
	Exports (1)	Imports (2)	Exports (3)	Imports (4)	Gross[1] (5)	Net[2] (6)	Income[3] (7)
1995-96	484	351	384	515	134	138	530
96-97	505	400	412	512	124	126	520
97-98	589	404	386	562	146	146	563
98-99	612	408	399	644	161	150	599
99-00	605	451	461	705	153	134	619
00-01	624	488	571	698	122	128	732
01-02	618	493	593	733	124	125	743

Notes: [1] Defined as (4) as % of (3)
[2] Defined as (1) as % of (2)
3 Defined as [(6) ′ (3)] , 100
Source: DGCI&S data

The Table brings out an interesting fact that unit value realization, on the average, has increased from the index value of 484 to 618, over 1995-2002, representing about 27.7 per cent increase. In case of imports, the unit value increase has been 40.5 per cent. ***By implication, net terms of trade (defined as the ratio of the two indices) has been falling signifying that the relative price or unit value ratios of exports and imports have been adverse for the country.*** Volume index trends for imports and exports have been fluctuating yielding an inverted U-shaped curve for gross terms of trade. Trade performance using the concept of **income terms of trade** has been favourable for the country. The there concepts of terms of trade are separately explained in **Box 34.1.**

BOX 34.1

Alternative concepts of terms of trade

The concept of terms of trade provides us an idea about whether a country trades with other countries on favourable or adverse terms. The three concepts, popular both in theory and practice, are the following:

1. *Net Barter (or, Commodity) Terms of Trade (N)*

   The concept given by f.w. taussig is based on the comparison of export and import prices of the goods traded. It is defines as:

   $N = (P_x/P_m) \times 100$, where,

   P_x = price index of the country's exports; P_m = price index of the country's imports. Thus, compared to the base year (say 2002) if the country's export price index fell by 5% (to 95) and import price index rose by 10% (to 110) in the year 2003, them the country's net barter terms of trade will decline to:

   $N = (95/100) \times 100 = 86.36$

   Practically, it amounts to saying that the country's èxport prices ***relative to*** import prices fell by about 14 per cent signifying improvement in terms of trade.

2. *Gross Barter Terms of Trade (G)*

   It refers to the ratio of the total physical volume or quantity of imports to the total physical quality of exports. ***According to their concepts, a country's terms of trade improve if it obtains greater physical quantity of imports for one physical unit of exports or the same volume of imports for a smaller volume of exports.*** Thus,

   $G = (Q_m/Q_x) \times 100$, where,

   Q_m = Volume index of imports and Q_x = Volume index of exports. Thus, compared to the base year (2002), if Q_m rises from 100 to 120 and Q_x from 100 to 110, in 2003, then improvement in gross barter terms of trade is:

   $G = 120/110) \times 100 = 109.1$

   The major drawback of the measure is that it does not take into account the prices of imports and exports and capital movements caused by trade deficit or similar situations.

3. *Income Terms of Trade (I)*

   The measure given by g.s. dorrance and h. staehle is a refinement of the above concepts and is calculated as:

   $I = (P_x/P_m) \cdot Q_x$

   The measure takes into account the impact of changes in P_x on Q_x. The measure indicate the country's ***capacity to import*** (based upon export earning, $P_x \cdot Q_x$). Thus, if from base year to current year, P_x falls to 95, P_m rises to 120 and Q_x to 120, then

   $I = (95/110) \cdot 120 = 103.63$

   which shows improvement in terms of trade.

OBSTACLES TO EXPORT GROWTH

In view of the country's resource endowments, human resources and liberal economic policies, the export performance is generally rated to be much below its potential. A number of factors, both endemic and temporary, add up to depress the export performance. These factors relate both to the domestic economy and world economic environment. Some of the major factors that constrain export growth are the following.

- Protective tariffs in the US and a number of European countries against India's thrust products like textiles.
- Weakening of the global demand for Indian pioducts in recent years.
- Non-tariff barriers like **quotas, anti-dumping measures** and unilateral changes in rules of origin in other countries.
- Infrastructural constraints which raise domestic costs and reduce the flow of products to export destinations.
- High transaction costs increasing export prices.
- Inflexibility of labour laws and other constraints which limit inward foreign investment in export sectors.
- Slowdown in domestic manufacturing sector reducing export capabilities.
- High burden of taxation making export products less price-competitive.
- Technological and quality constraints on the quality o export products

COMPOSITIONAL PATTERN

The compositional pattern of a country reveals its export advantages and import requirements. **Table 34.3** gives the shares of principal product groups in India's exports and imports. The share of manufactured goods in the country's exports in 2001-02 was about 76 per cent, falling marginally from 78 per cent in 2000-01. The share of agricultural and allied products in 2001-02 stood at 13.4 per cent. There was significant increase in the share of petroleum products from 2.9 per cent to 4.8 per cent over the period. Major agricultural exports of the country include cereals, tobacco, spices, cashew nuts, fruits and vegetables and marine products. These items are labelld as traditional exports of the country and are clubbed together, among others in item (11) of the export product groups in **Table 34.3**.

Table 34.3: Compositional pattern of India's exports and imports by major products, 2001-02

Export product group	% share in total export	Import product group	% share in total import
1. Gem & Jewellery	16.7	1. Petroleum, oil and lubricants	27.2
2. Engg. Goods	15.9	2. Capital goods	9.0
3. Chemicals and related products	13.8	3. Pearls and precious stones	9.0
4. Readymade garments	11.4	4. Gold and silver	8.8
5. Textiles	10.7	5. Electronic goods	7.4
6. Crude and petroleum products	4.8	6. Chemicals	5.4

Contd...

7. Leather and manufactures	4.4	7. Edible oils	2.6
8. Ores and minerals	2.9	8. Coal, coke and briquettes	2.2
9. Marine products	2.8	9. Metalliferrous ores and metal scrap	2.2
10. Cereals	2.2	10. Professional instruments and optical goods	2.0
11. Others	14.4	11. Others	21.8
Total	100.0	Total	100.0

Note: [1]In US dollar terms

Source: DGCI&S data

Some of the important export items in the manufactured products category are:

- Gems and jewellery
- Textiles
- Readymade garments
- Iron and steel
- Cosmetics and toiletries
- Coir and manufactures
- Chemicals and related products
- Leather and manufactures
- Ferro alloys
- Computer software
- Electronic goods
- Handicrafts

In a few product areas, India commands a respectable position in the world export market. **Table 34.4** shows the trends in the share of product items or group which, in any year during 1990-2000, commanded a share of atleast 5 per cent in world exports. ***It can be seen that India enjoys a respectable position in world trade only in traditional product groups. India has fast overtaken other economies, particularly in South-East Asia, in rice exports increasing its share in world exports from only 6.4 per cent in 1990 to more than 20 per cent in 2000. In tea and mate, India continues to occupy a dominant position with about 19 per cent share.*** It has however sharply lost its share to other countries in the export of spices and leather products. In the export of pearls and precious stones, it is gradually enhancing its market position.

Table 34.4 Trend in the share of India's major product items which commanded a share of atleast 5 per cent in world exports of the respective products in any year during 1990-2000.

	Product group	% share in world export of the product group		
		1990	1995	2000
1.	Rice	6.4	18.6	20.1
2.	Tea and mate	22.1	14.4	18.8
3.	Spices	7.7	9.7	2.8
4.	Iron are and concentrates	7.6	6.0	5.0
5.	Manufactures of leather or of composition leather	13.4	6.3	6.9
6.	Woven cotton fabrics	3.7	4.4	5.0
7.	Pearls, precious and semi	9.8	12.0	12.2

Source: United Nations, *International Trade Statistics Year book*, various issues.

EXPORT THRUST AREAS

The **Ministry of Commerce** has identified the following 15 sectors as having high export potential. ***The sectors have been identified on the basis of current export trends, the state of world demand, state of competition in the world markets, domestic cost advantages and overseas import regulations.***

- Packaged tea in value-added forms
- Cereals, particularly wheat
- Processed foods including fruits and juices, meat and products
- Marine products particularly in value-added focus
- Iron ore
- Leather and particularly its manufactures
- Handicrafts and jewellery
- Capital goods and consumer durables
- Electronic goods and computer software
- Basic chemicals
- Fabrics, piece-goods and made-ups
- Readymade garments
- Woolen fabrics and knitwear
- Projects and services
- Granite.

The export potential of these product groups can be realized only through a systematic policy action. These products have to attain international standards of excellence in terms of quality, cost, reliability, delivery and overall competitiveness. This requires an enabling and exporter friendly environment, proactive export promotion, policies and expansion of supply capabilities.

DIRECTION OF TRADE

Trade direction refers to the destination pattern of exports and source pattern of imports. It is basically determined by comparative cost advantages, trade restrictions and international economic relations. Geographical distances which affect transportation costs also impact trade direction. **Table 34.5** shows the directional pattern of India's exports and imports according to major regions in the world economy. India's major destination for exports is the OECD group of countries which are developed and spread over different parts of the world. These countries absorb about one-half of the country's exports. Within this group, European Union countries have absorbed more than 20 per cent of the country's exports each year during the period 1990-2002; UK alone absorbs nearly 5 per cent of the country's exports.

Table 34.5 Directional pattern of India's exports and imports, 1999-2002

(% distribution)

Region	Exports			Imports		
	1990-91	1995-96	2001-02	1990-91	1995-96	2001-02
A. OECD Countries	53.5	55.6	49.3	54.0	52.4	40.1
B. OPEC Countries	5.6	9.7	12.0	16.3	20.9	5.8
C. Eastern Europe	17.9	3.8	2.3	7.8	3.4	1.4
D. Other LDCs	16.8	25.7	28.0	18.4	18.3	19.1
E. Others	6.2	5.1	8.4	3.5	5.0	33.6
Total	100	100	100	100	100	100

Source: DGCI&S Data

The share of India's exports going to OECD countries has recorded an appreciable increase. The share has more than doubled over the period 1990-2002. Similarly, the proportion of India's exports to other less developed countries which are widely spread over the world has appreciably increased from 16.8 per cent to 28.0 per cent. The share of exports going to East European Countries fell dramatically from 17.9 per cent in 1990-91 to 3.8 per cent in 1995-96 and has remained low since then.

The country's imports from OECD countries command an equally important position vis-à-vis exports. However, the share of imports coming from OPEC and East European Countries has sharply declined over the last decade. Other less developed countries account for about one-fifth of India's total imports. ***There is evidence of gradual shift of India's trade from developed to developing countries and in the process the country has attained greater geographical diversification of its overall trade. Some of the major reasons behind the shift are India's declining competitiveness*** *in the markets of developed countries, rising level of effective protection in industrial countries and the country's growing economic relations with the less developed countries.*

POLICY ENVIRONMENT: EXPORT-IMPORT (EXIM) POLICY 2002-07

The country's policy environment for foreign trade is basically set by the five-year EXIM policy 2002-07 announced on March 31, 2002. The policy seeks to rationalize and consolidate the previous policies and has the target to raise India's share in global trade to one per cent. Over the last one decade, a sustained process of trade reforms has been continuing. The major focus of these reforms has been trade liberalisation, openness, transparency and general thrust on outward orientation aimed at building international competitiveness of the economy. ***Over the decade, the government has shown the understanding that import liberalisation plays an important role in export promotion. The government over the years has initiated a series of measures aimed at removing the anti-export bias of erstwhile policies through withdrawal of*** **quantitative restrictions** ***on imports, reduction and rationalization of import tariff structure. Simultaneously, trade procedures have been simplified and rationalized to improve access to export incentives and facilities and*** **exchange rates** ***have been made more realistic through the market mechanism.*** The basic thrust of the new EXIM policy is on the following:

- Trade liberalisation and promotion
- Simplification of procedures
- Reduction in transaction costs
- Areas of comparative advantage and core competence.

The new trade strategy is sought to be operationalised through the following components of the trade policy.

EXPORT PROMOTION THROUGH THRUST PRODUCTS

As a forerunner to the EXIM Policy 2002-07, the government announced its medium-term export strategy in January 2002. As already pointed out, it seeks to enhance India's share in world exports to one per cent by the year 2005. The target is sought to be achieved through 11.9 per cent annual growth in exports over the five years, raising exports to about $80 billion at the end of the period. ***For this purpose, 220 products and 25 foreign markets have been identified to push the exports. Based on the detailed product-wise strategy of various export promotion councils and commodity boards, sector-wise export promotion strategies have also been formulated for identified export potential items. The export potential has been assessed on the basis of the import basket of major importing countries and the competitive advantage in selected products.*** The export strategy also takes into account international growth scenario and the new economic order built by such multilateral institutions like IMF and WTO.

PUSH TO AGRICULTURAL EXPORTS

The new policy gives special emphasis to agricultural exports. ***The government has identified 32 agri-export zones all over the country which seek to promote agricultural and agro-based exports***

particularly in floriculture and horticulture sectors. These zones are identified by the state governments for comprehensive and complete development. The underlying concept has been to integrate various facilities of central and state governments and to provide a comprehensive package of services for effective delivery to farmers, processors and exporters. The zones are expected to significantly increase the remuneration to farmers whose products are picked up by units in these zones for further processing and exporting. The policy also provides for **non-actionable subsidies** (in WTO terminology) such as transport subsidies for the export of floriculture, horticulture, poultry and dairy products which are India's thrust products. The new policy also provides for the removal of export restrictions on a number of agricultural items. The country's performance in agricultural exports greatly depends on the following critical factors:

- Domestic availability of quality products;
- ability to execute timely and safe deliveries;
- state-of-the-art packaging and preservation technologies;
- the level of domestic demand;
- cost of cultivation;
- nutritional content of the produce;
- hygiene standards; and
- price sensitivity of the products;

The efficiency and effectiveness with which agri-export polices are executed would greatly determine the extent to which agri-export potential is realized.

BROADBASING THE MARKET ACCESS INITIATIVE SCHEME

The new policy widens the scope of the **Market Access Initiative Scheme** which was initially launched in September 2001. The policy seeks to provide greater thrust to the country-product approach (i.e. identifying specific product groups with high export potential to specific countries) through greater support for the export marketing efforts of individual export units. The major components of the scheme include the following:

- Extensive survey of the prospective markets though professional export consultants;
- display of selected products in selected centres in focus countries by setting up showrooms;
- schematic displays at leading international departmental stores;
- intensive and sustained publicity and advertising campaigns;
- promotion of branded products; and
- quality upgradation and product development to meet specific requirements of target markets.

The scheme also provides for assistance to state governments for conducting export potential surveys and undertaking specific export assistance measures. The expanded scheme provides for the establishment of business centres in Indian Missions abroad which are intended to provide facilitating services to Indian exporters on business tours abroad. To diversify the export markets, schemes like '*Focus Africa*' and '*Focus CIS*' (Commonwealth of Independent States) are being introduced. Some of the major products covered by the scheme are plastic consumer items, engineering products, IT-enabled services, software services, rubber products, spices, cashew, mango and leather and leather products.

SPECIAL ECONOMIC ZONES (SEZs)

SEZs, originally announced by the government in its Export-Import Policy on March 31, 2000, continue to be a major plank of the EXIM Policy 2002-07. The basic purpose of the SEZ scheme is to provide an internationally competitive environment with highly streamlined procedures for units in these zones. ***An SEZ is basically a duty-free enclave of business firms which are predominantly engaged in export production.*** The business units may be in the public, joint, private or state sectors. The present policy also provides for existing export processing zones into SEZs (**Box 34.2**). Units in the zones are provided special incentives and facilities to enable the exporters to attain competitiveness at the global level. Some of the main benefits to the units in such zones are the following:

- For all trade operations, an SEZ is treated as a duty-free zone for import of various inputs.
- There is no routine examination of import and export cargo by custom authorities.
- No fixed wastage norms exist for the units in the zone.
- Sub-contracting of part of production or production process is permitted for all sectors.
- The units can sell a part of their output in the domestic sector.
- Foreign direct investment on 100 per cent basis is allowed through RBI's automatic route in the manufacturing sector.
- The units can maintain accounts in simplified form and in format of their choice.

BOX 34.2

What are Export Processing Zones (EPZs)?

An EPZ is an enclave of business units engaged in manufacturing, trade or other services, separated from the rest of the economy (called **Domestic Tariff Area**) by fiscal barriers. It provides world class facilities to the units predominantly engaged in exports and a duty-free environment to those business units that achieve international competitiveness. The zone provides developed land for construction of factory sheds, standard-design factory buildings and ready-built sheds, roads, power, water supply and drainage. Custom clearance facilities are available within the zones. Each zone has a **Service Centre** in which banks, post offices and offices of the clearing agents are located. There are four EPZs at Noida (UP), Chennai (Tamil Nadu), Falta (West Bengal) and Visakhapatnam (Andhra Pradesh). The earlier EPZs at Kandla (Gujarat), Santa Cruz (Maharashtra) and Cochin (Kerala) have already been converted into SEZs. In September 2001, there were 703 units in operation in various EPZs and SEZs in the country.

The units are, however, subject to certain regulatory conditions to ensure that they fulfill the basic objectives of SEZs and that the facilities and incentives are not misutilised or diverted. Some of the major restrictions are the following:

- The units face full duty in respect of domestic sales as per import policy in force.
- Within a period of three years, the units have to be net earners of foreign exchange.

- Duty-free import of goods by the units have to be utilized within the approval period of five years.

The performance of the SEZ units is monitored by the **Development Commissioner** and the Customs. Recently a few more measures have been initiated to strengthen the SEZ scheme. To improve the power supply position, units for generation and distribution of power have been allowed entry into the SEZs. The procedures concerning subcontracting by SEZ units have been simplified. The units have also been permitted to **hedge** commodity price risks and sourcing of short-term **external commercial borrowings.** Domestic units supplying materials to SEZ units have been entitled to avail the benefits of **Duty Entitlement Passbook Scheme.**

In addition to the four EPZs converted into SEZs, the Government has given approval to 13 more SEZs at Positra (Maharashtra), Nanguneri (Tamil Nadu), Kulpi, Salt Lake Kolkata (West Bengal), Paradeep and Gopalpur (Orissa), Bhadohi and Greater Noida (UP), Kakinada (AP), Indore (MP) and Hassan (Karnataka).

STRATEGIC PACKAGE FOR SSIs

The policy provides for a special package to SSIs which make an estimated contribution of about Rs 70,000 crore to the country's export basket. The policy lays heavy emphasis on improving productivity and export competitiveness of the small scale, cottage and handicraft industries. The major components of the strategic package include the following:

- Exemption from maintaining the average export obligation under the **Export Promotion Capital Goods Scheme.**
- Lowering of the threshold level of exports for achieving **Export House** status.
- Duty-free access to **Market Access Initiative Scheme funds.**
- Duty-free access to trimming and embellishment for achieving value-added exports.

Further, the policy identifies **Towns of Export Excellence** (such as Tirupur for hosiery, Panipat for woolen blankets and Ludhiana for woolen knitwear) as **regional rural motors of economic development** and seeks to develop infrastructure and support services in these areas.

REDUCING TRANSACTION COSTS

Transaction costs refer to the various costs involved in moving export and import cargo from the point of origin to the point of destination and include such items as transportation, insurance, port charges, handling charges, breakage, bank charges, documentation of costs, government fees, payments to clearing and forwarding agents, inspection fees and similar other expenses. Transaction costs faced by Indian exports are estimated to constitute about 17 per cent of the cargo value and are among the highest in the world. There are also indirect costs in the form of longer transit time, interest on the value of goods in transit and complexities of procedures which sometimes cause breach of commitment, loss of reputation and disputes involving litigation expenses.

Towards reducing transaction costs and improving exporters competitiveness, the government has initiated a series of measures. Most of the measures take effect through simplification and standardization of procedures and documentation concerning foreign trade. Some of the major steps in this regard are the following:

- Adoption of ***8-digit product classification system*** which is expected to reduce trade disputes and litigation expenses;
- reduction of maximum fee limit for electronic filing of applications;
- introduction of the system for same-day licensing;
- introduction of new norms for reduction in percentage of physical examination of export cargo which is expected to reduce transit period;
- simplified brand rate of **Duty Drawback Scheme**; and
- permission for direct negotiation of export documents.

The procedural simplifications cut across various organisations like ***Directorate-General of Foreign Trade, customs, authorities, banks, Directorate-General of Commercial Intelligence and Statistics*** involved in foreign trade at various levels and stages. In the Union Budget for the year 2002-03, peak rate of custom duty was reduced from 35 per cent to 30 per cent and it was further indicated that by the year 2003-05, import duties would be reduced and rationalized into only two slabs, viz., slab of 10 per cent for raw materials, intermediates and components and 20 per cent for final products.

STRATEGIC PACKAGE FOR STATUS HOLDERS

In order to provide further incentives to star achievers in exports like **export-oriented units, export houses** and **trading houses**, the new policy unfolds a number of incentives that are designed to further facilitate their export efforts. Some of the major steps include:

- Issue of licences on self-certification basis.
- Fixation of **input-output norms** on priority.
- Exemption from compulsory negotiation of documents through commercial banks.
- Permission for 100 per cent retention of foreign exchange in **Exchange Earners Foreign Currency Account.**
- Increase in the normal repatriation period from 180 days to 360 days.
- Relaxation of the mandatory condition of export in each of the three licensing years for achieving the formal status in exports.
- Duty-free import of fuel under **Advance Licensing Scheme** provided the licence holder has a captive power plant.

The measures are expected to further enhance the export competitiveness of such units.

CONTINUANCE OF DUTY NEUTRALISATION SCHEMES

In order to maintain a level playing field, the new policy attempts to put imported products at par with domestically produced goods so that the exporters using imported inputs are not at a disadvantaged position. The policy maintains the existing duty-neutralisation schemes like **Duty Entitlement Passbook (DEPB) scheme, Duty Free Replenishment Certificate (DFRC), Advance Licensing Scheme and Drawback for Deemed Export**, in a rather simplified way. These schemes are continuously reviewed and kept in tune with the actual requirements of the exporters. The policies and schemes have been both simplified and liberalized to build a trust-based environment for export growth. Major simplifications include abolition of the DFEC Book and withdrawal of Annual Advance License under **Advance Licence Scheme**.

ROADMAP FOR FUTURE TRADE REFORMS: KELKAR COMMITTEE RECOMMENDATIONS

The Kelkar Committee constituted by the Ministry of Finance has suggested some directions and measures for future trade liberalisation and reforms. These recommendations have been made in view of the globalisation trends, exporters' problems and WTO provisions. The broad set of recommendations fall into three categories explained below.

CUSTOM TARIFF AND EXEMPTIONS

The committee has recommended the following in this group of recommendations.

- There should be zero duty for essential items, 10 per cent duty for raw materials, inputs and intermediate products and 20 per cent for final goods by the year 2004-05. After the introduction of **value added tax** (VAT) by the states these duties may be reduced to 5 per cent for basic raw materials, 8 per cent for intermediate goods, 10 per cent for finished goods and 20 per cent for consumer durables.
- The multiplicity of taxes should be reduced and only three duties viz. basic custom duty, additional duty of customs and anti-dumping, safeguard duties be retained.
- As a matter of policy, all exemptions except in cases of life-saving drugs and goods of security, charitable values and strategic interests, be removed. Relief in other genuine cases may be provided through budgetary provisions rather their EXIM policy. End-use based conditional exemptions should be avoided. As a matter of general rule, there should be no exemption from **countervailing duty**.
- Specific rates of duty should be gradually replaced by ad valorem rates of duty.

CUSTOM PROCEDURES AND TRADE FACILITATION

Recommendations in this area have been guided by the modern best-practices in trade which are based on self-compliance, risk management and analysis and is supported by essential audits. Main recommendations in this category are the following:

- Establishment of a universal green channel;
- extension of **Electronic Data Interchange** (EDI) network to all ports and processes;
- replacement of the pre-clearance system of verification of documents by risk assessment and post-clearance audit;

- introduction of a system of self-assessment of **bill of entry** by one importer, permission to file period bill of entry and permission to release imported goods with minimum documentation for importers with good track record of compliance;
- improvement in custom administration;
- streamlining of the licensing and function of **custom house agents**;
- amendment of the **Trade and Merchandise Act** and the **Copyright Act** to empower the customs officers to enforce **Intellectual Property Rights** (IPRs)

EXPORT PROMOTION SCHEMES

This group of recommendations seek to reduce the multiplicity of export promotion schemes. The major recommendations are the following.

- Focus on **Special Economic Zones (SEZs)** and **Export-oriented Unit** (EOU) schemes for grant of duty exemption on all goods required for export production.
- Expansion of the scope of the **Duty Drawback Scheme** to provide rebate of all duties and on all goods going the export production.
- Merging of the **Duty Exemption Passbook Scheme** with **Duty Drawback Scheme** from April 1, 2005.
- Better Coordination between the **Directorate-General** of **Foreign Trade** and **Customs**.
- Strengthening of an independent body such as **Tariff Commission** to carry out investigations relating to dumping and related duties.

According to the estimate of the committee, the above recommendations are expected to cut exporters transaction costs by about 50 per cent and bring a saving of about Rs 4000-5000 crore per year to the government.

CONCLUSION

In the process of globalisation of Indian economy, foreign trade environment is emerging as a principal component of business environment. The environment is important not only for firms with international business operations; a firm with no international transactions is affected by changes in trading environment as it affects the competitiveness and market position of its rivals who have international business. The ability of a country to earn foreign exchange and stabilize the value of the domestic currency is greatly affected by international trade conditions which affect export performance and import behaviour. Foreign exchange reserves are the potential source of growth stability in the economy as these represent ready liquidity for meeting growth requirements through import of raw materials, intermediates and technology. Maintaining a trading environment conducive to the growth and stability of the economy is a complex task requiring careful formulation and implementation of macroeconomic policies.

Key Terms

Net exports	Quotas	Special economic zone (SEZ)
Trade balance	Import tariff	Duty drawaback
National income	Anti-dumping measures	Export house
Import cover	Counter-trade	Trading house
Foreign trade multiplier	Quantitative restrictions (QRS)	Anti-dumping duty
Net barter terms of trade	Regional economic groupings	Countervailing duty
Foreign investment	Exchange rate	Custom house agent
Gross barter terms of trade	Foreign exchange market	Intellectual property rights (IPRs)
Value addition	Foreign direct investment	
Income terms of trade	Non-actionable subsidies	
Protectionist policy	Hedge	

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Long Questions

1. Explain the nature and current state of India's foreign trade environment. Is the environment friendly to Indian exporters and foreign investors?
2. Comment upon India's export competitiveness. What are the products which have high export potential? How can this potential be realised?
3. Explain major trends in volume, composition and direction of India's foreign trade in recent years. Do these trends portray a favourable trade environment in the country?
4. Is India's export performance satisfactory in relation to the trade reforms introduced in recent years? What steps would you suggest to raise India's share in world exports to one per cent?
5. Comment upon India's EXIM Policy 2002-05. What trade strategy does it reflect? How does it respond to exporters' problems and challenges?
6. Appraise the impact of WTO on India's trade reforms and policies. To what extent is India's EXIM Policy WTO-compatible?

Short Questions

1. What is the relationship between exports and economic growth of a country?
2. Explain the relation between exports and imports of a country.

3. What constitutes foreign trade environment?
4. Give three important factors of export competitiveness of a country.
5. List five factors that affect the performance of EXIM policy of a country.
6. How do tariff barriers affect international trade?
7. Mention three major points in the volume trends in India's merchandise trade in recent years.
8. Identify five products of high export potential in which India has strong comparative advantage.
9. Identify leading obstacles to India's exports.
10. Suggest measures to give boost to India's agricultural exports.