Section 3 in this book had focussed on the detailed discussion of the role of the State in shaping, directing, controlling and promoting business activities in our country. As was stated in Chapter 9, government's intervention in business was necessitated by historical, economic, political and social reasons. During the past five decades, the government has been acting as a regulator and promoter of business activities. If the country has achieved reasonably satisfactory progress on the economic front, credit must go to the dynamic role played by the State, contrary views expressed by the critics notwithstanding.

India has achieved satisfactory level of progress thanks to state intervention.

A new realisation has dawned on economists, policymakers and academicians these days. These people perceive the government as the main bottleneck in development. Getting governments out of the business of development has become an important element in the policy advice given by international institutions, economic experts, and donor agencies. Thatcherism in the UK and Reganism in the USA contributed to this changed mood. Another important contributory factor has been the increasing economic difficulties of many developing countries, and the failure of their governments to take timely corrective action. Partly in response to their own experience and partly in response to international pressure, several developing countries are questioning the role of the government in their economies.[1] Spain, Venezuela, Zambia and the Latin American and African countries come into focus in this context. Our country is no exception.

But the above argument is questioned by everyone now-a-days.

Is this changed mood justified? Is everything over with the State intervention? Has government's role ended? The answer to these questions is 'no'.

WHY THE GOVERNMENT SHOULD CONTINUE ITS INTERVENTIONIST POLICY?

If doubts are expressed about the efficacy of the State to act as a change agent, probably there is justification. Over the years, a sort of false picture about the omnipotence of the State was created. The solution to every problem was sought to be found in the expansion of government activity in that area, irrespective of costs or results. Soon the expansion of the government became an objective in itself, and every priority or failure in the economic field generates a response in the form of new regulatory law or a new public sector corporation. The expansion of the government was also assiduously promoted by coalitions of powerful interests, which benefited directly from the increased economic power of the State. Overtime, the scale of the government became so large that the quality of intervention, as well as the quality of service, provided by the State, deteriorated.[2]

Nevertheless, State's intervention in the business must continue for several reasons.

The State activism in economic activities is necessary to eliminate poverty. It must be admitted that poverty still exists inspite of the growth registered in the economy. One must visit a village or travel in a village bus to understand the magnitude of the poverty. For every one RCC house, there are 10 thatched huts and for every one individual who is fully clad, there are atleast five people who are

State intervention is necessary to eliminate poverty.

half clad. There are victims of malnutrition and reports of even starvation deaths in the media. There is illiteracy, ignorance and helplessness.

World Development Report (WDR), 1991, states that no market economy has ever eradicated poverty so far. It is only State intervention that has helped fund programmes that have alleviated poverty. Today even in the US there is the growing concern about the need for the State to intervene in the provision of healthcare and education. The World Bank is now supportive of the role of the government in the provision of education, health care, development of infrastructure and fostering of the human capital.

WDR is categorical in its assertion about the need for continued State intervention. To quote the Report "many sorts of interventions are essential if economies are to achieve their full potential. (When) markets 'fail', the government must step in. But countless cases of unsuccessful intervention suggest the need for caution. Markets fail, but so do governments. To justify intervention it is not enough to know that the market is failing; it is also necessary to be confident that the government can do better".

When markets fail governments must intervene. But governments also fail.

The "central question of this Report is", says WDR 1991, "why countries like Japan have succeeded so spectacularly while others have failed." The essence of the answer to that question is that Japan facilitated a judicious mix of State interventionism and the operation of a competitive market. Successful interventionists like Japan, *"preserved incentives for technological change by maintaining international and domestic competition and imposing performance requirements in return for any credit subsidies, import protection or restrictions on domestic entry."* In the new found wisdom of the Bank, State intervention, *per se*, is not the villain of the piece but it is the 'quality' and 'quantity' of intervention that matters.

What is important is the quality of intervention but not intervention, per se.

World Development Report 2004 too reitorates the role of state, particularly providing health and education to the citizens.

We are tempted to quote Mr.Deepak N.Nayyar, the former economic adviser in the finance ministry in this context. In an exclusive interview to the *Economic Times* of Feb.25, 1992, Mr.Nayyar strongly defended Central planning and State intervention. To quote him:

"There is neither magic in the market place nor divinity in the invisible hands of the market. There is as much evidence of market failure as there is of failure in State intervention. In India, we are far more familiar with the latter than with the former. But instead of jumping to over-simplified conclusions, it is essential to recognise that markets can only serve those who are part of the market system. In rural India, 200 million people who eke out a bare subsistence, or live in absolute poverty, are not even remotely integrated with the markets. For an economy at our levels of income and development, there is vital role for the government. Planning is essential. So is State intervention, although there is a clear need for change in the nature of this intervention. Sukhamoy Chakravarty

Market is a good servant but a bad master. Market should not be allowed to rule, particularly in developing countries.

used to say that the market is a good servant but a bad master. We would do well to remember his wisdom, lest there be a confusion between means and ends."

Developing countries cannot rely on markets as they are known to fail because of several imperfections.[3] One such imperfection relates to the absence of information and the presence of uncertainty faced by producers and consumers alike. In many developing countries, producers are unsure about the size of local markets, the presence of other producers, and the availability of inputs, both domestic and imported. Consumers may be unsure about the quality and availability of products and their substitutes. Moreover, in contrast to their counterparts in developed markets, producers and consumers usually lack the tools to collect information.

Another imperfection in markets of developing countries is the presence of substantial externalities. Many goods may have a high social value that is not reflected in their market price. Because such goods, such as education and health services, must be provided at a price below their cost or even free, the private sector has no incentive to produce them. The government must, therefore, be responsible for providing these goods in order to ensure a minimum of welfare (See Box 10.1).

Box 10.1

A Public Responsibility

Governments - and the societies they represent - often see improving outcomes in health and education as a public responsibility. They are supported in this by the international endorsement of the Millennium Development Goals which are eight in numbers:

1. Eradicate extreme poverty and hunger
2. Achieve universal primary education
3. Promote gender equality and empower women
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDS, malaria and other diseases
7. Ensure environmental sustainability
8. Develop a global partnership for development

A variety of reasons lie behind this responsibility: classic welfare economics arguments for government intervention, political economy reasons for intervention in key social sectors, and appeals to fundamental human rights. Governments demonstrate their responsibility by financing, providing, or regulating the services that contribute to health and education outcomes. The services come in many shapes: building and staffing schools, subsiding hospitals, regulating water and electrical utility companies, building roads, providing cash transfers to individuals and households.

(Source: *World Development Report*, 2004, P.32)

Another argument for state intervention relates to income distribution. Market mechanisms no doubt ensure better allocation of resources, but they tend to produce unequal distribution of income. Most developing countries have a very skewed pattern of income distribution. Excessive reliance on the market mechanism will not improve that distribution.

It has become a fashion on the part of critics of State intervention to quote success stories of Taiwan, South Korea and other 'Asian Tigers' to prove how only market economy can usher in economic prosperity. Little do these critics realise that in these countries, as in Japan, prosperity has been achieved *via* State intervention and not by distancing the government from economic activities. Look at Box 10.2 for what has happened in South Korea and Taiwan.

It is the management that matters but not whether a unit is in private sector or government sector.

Little also is realised by the critics that it is the responsiveness of the individual company to the competitive forces that matters in attaining efficiency and not whether the unit is in public sector or in the private sector. It is no secret that the most efficient car manufacturing company was still recently in the public sector and the most slothful one continues to be in the private sector. To cry hoarse against the government's role may not be correct.

The private sector has not done better than the public sector.

It is not that the private sector in our country has credited itself with glory so as to demand total withdrawal of the government's presence in the economy. Failures of the private sector need no detailing here but suffice it is to say that all the possible ills of an industry do exist in companies owned by private industrialists too.

Box 10.2

Myths exploded

The replacement of market forces by State control of the economy, referred to as 'command capitalism' is exemplified by South Korea. Between 1961-79, Major General Park Chung Hee's government employed access to credit, protectionism, tax incentives and control over foreign investment for rapid economic development.

In 1961, the Park government nationalised the banking system and by 1970, the State controlled 96.4 per cent of the country's financial assets. By the 1980s, only 9.9 per cent of manufacturing was financed by retained earnings and, instead, relied on credit from government-owned or controlled financial institutions. Guaranteed access to the government-controlled credit enabled Korea's largest business groups, known as the **chaebol**, to undertake projects which were costly, risky or unprofitable in the short term.

In addition to providing secured credit, the government promoted exports through export subsidies, including low tax rates on income earned from exports, accelerated depreciation allowances and duty-free import of selected components. Exporters were allowed to sell in the domestic market at above-market prices.

Exporters were also exempted from indirect taxes on income earned from export sales. Between 1961-72, exporters enjoyed a 50 per cent reduction of corporate and income tax on export earnings. The government also provided infrastructural services such as electricity, water, transportation and communications at low rates. Export firms could also purchase industrial sites at a discount.

Korea's domestic market enjoyed substantial protection from import competition. The share of freely importable commodities in the total import volume fell from 55.6% in 1968 to 38.8% in 1979 before rising back to 61.6%

1968 to 38.8% in 1979 before rising back to 61.6% in 1980.

The Korean foreign investment code imposed stringent controls on foreign capital. Foreign equity participation remained less than 50% in over 75% of all firms involving foreign investments. Majority foreign equity ownership was allowed only in free trade zones, export-oriented sectors and in certain high-tech intensive projects.

The Korean State further interfered in labour markets to maintain wages below the market levels. In 1964, the Park government dissolved unions. The Labour Union Law prevented the formation of unions by authorising the State to render a union decision null and void. Collective bargaining was also banned beyond the local union.

State intervention in the economy also replaced the operation of market forces in Taiwan. The Taiwanese economy is dominated by State-owned and Kuomintang-owned enterprises. The State controls 92.5% of the top 50 financial institutions and owns all commercial banks, the State owned Central Bank of China controls industry's access to credit by setting interest rates.

In the 1950s, State enterprises accounted for 51% of industrial production. By the mid 1980s, 59 large state enterprises dominated the petroleum, steel, railways, electric power, tobacco and spirits, ship-building and telecommunications sectors. Furthermore, seven of the top ten enterprises are state-owned and over 50 enterprises are by the party (KMT).

However, in contrast to India, Taiwan shifted from an import-substitution strategy to export-led growth in the mid-1960s. Therefore, despite domination of the domestic market by the large industrial houses, small and medium businesses thrived on export production.

If these countries are examples of success achieved through aggressive and judiciously selective State intervention and if governments can prove results in other countries, why not in India?

In addition to exerting control over financial institutions and industrial capital, the State of Taiwan influenced exports through a tariff and tax rebate system. Exporters obtained refunds on customs duties and other taxes on imported inputs. Alternatively, domestic producers of such inputs could sell them to the exporter at the lower world market price and receive the amount of tariff duties and other taxes which the exporter would have paid had he imported instead.

WHAT SHOULD BE THE FORM OF STATE INTERVENTION?

The arguments listed above prove that State intervention in business must continue, but not in the form we had during the past four decades. The intervention should be different.

One aspect of the intervention in future relates to the quality of intervention. As is too well known, intervention schemes in 'Asian Tigers' have worked closely with the market forces.

Governments elsewhere used carrots of easy loans and other benefits and sticks of international competition to make firms gain competitive advantage.

The governments in these countries had alertness to use signals emanating from the world markets to judge dynamic efficiency of individual firms. This alertness kept the firms always on their toes. Thus, both in South Korea and in Taiwan, the State has often energetically used the carrot of easy loans and other benefits and the stick of international competition to prod the firms on to the technological frontier. Fortunately, policy makers in New Delhi seem to have realised the need for such qualitative interventions. Hence the economic reforms.

Quality and selectivity of intervention is what is required in the days to come.

The other aspect of the new intervention strategy that deserves careful attention is the selectivity of intervention (in terms of strategic sectors, products and processes in different stages of early industrialisation). Such selectivity in targeting, as opposed to indiscriminate and blanket controls and regulations, saves on scarce administrative skills and makes it easier to pinpoint social costs of policies and adjust them in response to changing technical and market conditions. World Development Report (1996) prescribes four target areas for government intervention (Read Box 10.3 for details)

Box 10.3

Rationale for Government Intervention

* Pure public goods such as defense, law and order and environmental protection cannot be provided by private markets alone. Because everybody shares their benefits automatically, no one is willing to pay for them individually. But governments can provide them and impose their cost on tax payers.
* Goods with positive externalities, or spillover benefits, are worth more to society than to any one consumer. Public health and education, for example, reduce infection rates, add to society's knowledge base and raise productivity. Markets tend to undersupply these goods, and complimentary public funding or provision can therefore improve efficiency. Similarly markets ignore negative externalities, such as industrial pollution; regulation to curb or clean up the activity causing the pollution can improve social welfare.
* Natural monopolies such as gas pipelines, local transport networks and other infrastructure services are most efficiently provided by a single firm. Unconstrained, monopoly producers tend to overprice and undersupply these services. But the public provision or regulation can in principle be efficient.
* Imperfect information, on the part of either consumers or providers, may make markets fail. Private commercial insurance, for example, cannot efficiently insure against risks like unemployment, longevity and deteriorating health in old age, because these risks are influenced by characteristics and behaviours of the insured that the insurer cannot observe, along with the government policy and they affect large parts of the population equally and simultaneously. Governments can regulate private pensions and insurance and complement them with basic public pensions and insurance to improve efficiency and fill gaps in coverage. Governments also inspect food, set standards for airline safety, approve new drugs and regulate banks and securities markets to protect consumers who have insufficient information about the quality of these goods.

(**Source**: *World Development Report*, 1996, p.110)

The third aspect of the new intervention strategy relates to its primary orientation and goals. The East Asian State looked upon its role as that of a pioneer and promoter of industrial transformation in close collaboration and partnership with the private sector. This is very different from a State that regards the private sector at best as a necessary evil and is primarily interested in regulating and supplanting private capital, through capacity licensing and other controls and possible nationalisation. Over the years, the Indian political culture has fluctuated between these two different roles of the State, although in recent years, the emphasis has slowly shifted in reality, if not in rhetoric, towards accepting the State as a primary provider of infrastructure and enabling environment for private as well as public investments to flourish. This is particularly prominent in the role the State plays in some of the new industries. Take the Indian electronics industry. There has been remarkable transformation in nature of State involvement here. The days of preoccupation with mere turf-protection and bureaucratic licensing first under the defence ministry, and then under the department of electronics, are largely over, and the emphasis in the eighties has been more and more on State-sponsored promotional and entrepreneurial projects, providing basic infrastructure in the more liberalised and competitive environment. One of the best examples is provided by Computer Maintenance Corporation(CMC) which graduated from computer servicing to being a major systems engineering firm. Many of its large projects (including the massive railways reservation system) have been aimed at providing informational infrastructure for lomestic investments often at costs below major international competitors and it is now successfully bidding for international contracts. This is the stuff dynamic comparative advantage is made of and it shows that even Indian public sector companies have the potential. Similar entrepreneurial stirrings have been noticed in recent years in the hitherto somnolent Indian telecommunications industry.

In this context, it is useful to quote the World Development Report 1996. Commenting on the need for fundamental change in the government, the Report states: *First*, the role of the government in producing and distributing goods and services must shrink dramatically. Public provision must become the exception rather than the rule. State intervention is justified only where markets fail in such areas as defense, primary education, rural roads, and some special insurance- and then only to the extent that it improves upon the market. *Secondly*, the government must stop restricting and directly controlling private commercial activity and extricate itself from intimate involvement in the financial sector, focusing instead on promoting macro-economic stability and providing a legal and institutional environment that supports private sector development and competition. *Finally*, instead of providing generous guarantees to secure adequate living standards for all, governments need to foster greater personal responsibility for income and welfare. Providing social protection is a key function of the government in all economies but in a market economy it should be mainly targeted at those vulnerable groups who need it most.[4]

State intervention is justified in areas such as defense, education, healthcare and rural roads. These are the areas where markets fail.

Conclusion

In conclusion, it maybe stated that the role of the government in future must be redefined but not ended. The redefinition must be in the direction of improving quality of intervention. This must be India's agenda in future.

We are also reminded of what John Maynard Keynes once said. "The important thing for government", said he, "is not to do things which individuals are doing already, and to do them a little better or a litter worse; but to do those things which at present are not done at all". What is not done till now is the improvement of the social sector: primary education, health, housing, nutrition and the like. Let the Government concentrate on these areas. (Also read Box 10.4.)

Box 10.4

8th Plan on the role of the government

The role of the government should be to facilitate the process of peoples' involvement in development activities by creating the right type of institutional infrastructure, particularly in rural areas. These institutions are very weak particularly in those States where they are needed the most for bringing about an improvement in the socio-demographic indicators. Encouraging voluntary agencies as well as schools, colleges and universities, to get them involved in social tasks and social mobilisation, strengthening of the Panchayat Raj Institutions, reorientation and participation of all the village-level programmes under the charge of the Panchayat Raj institutions, and helping the cooperatives to come up in the organisation and support of local economic activities, for example, are some of the steps which the government must earnestly initiate. A genuine push towards decentralisation and people's participation has become necessary.

QUESTIONS

1. Bring out the points for and against continued State intervention in business.
2. What should be the role of State *vis-a-vis* business in the years to come?

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3. Michacl P. Todaro and Stephen C. Smith, *Economic Development,* 2003, Pearson, p.701.
4. *World Development Report*, 1996, p.110.

CHAPTER 11

Economic Environment

CHAPTER OUTLINE

Nature of Economic Environment

Economic Factors
- *Growth Strategy*
- *Basic Economic System*
- *Economic Planning*
- *Industry*
- *National Income and Per Capita Income*
- *Human Resources*

Claims and Counter Claims

Agenda for the Future

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Describe the nature of economic environment.*
2. *Shortlist factors that constitute the total economic environment.*
3. *Argue for and against the prevailing economic environment.*
4. *List the areas which demand concern and action in the years to come.*

Next to the political environment, it is probably the economic environment which exerts considerable influence on business. This section is devoted to a detailed discussion of the economic environment of business.

NATURE OF ECONOMIC ENVIRONMENT

Economic environment refers to all those economic factors which have a bearing on the functioning of a business unit.

Economic environment comprises variables (economic) that have a bearing on business.

Business depends on the economic environment for all the needed inputs. It also depends on the economic environment to sell the finished goods. Naturally, the dependence of business on the economic environment is total and it is not surprising because, as it is rightly said, business is one unit of the total economy.

The importance of an economic environment is reinforced by the fact that more and more economists (business economists to be precise) are finding place in industrial establishments. Dr.Pendse was the economic adviser to the Tatas for a long time. Richard Freeman is the Chief Economist of ICI, an American company. These two are not isolated instances. There is the Society of Business Economists in England, whose membership now is more than 600. All these members are employed in different industries, if not as economists, but in planning, marketing or finance areas. Thus, trained economists supplying macro-economic forecasts and research are found in major companies in manufacturing, commerce and finance departments.

ECONOMIC FACTORS

It is difficult to be precise about the factors which constitute the economic environment of a country. It is equally difficult to draw the lines of distinction between the political environment and the economic environment and the technological environment. The type of monetary policy, dear money policy or cheap money policy, that the government wants to pursue may be partly political and partly economic. Again, importing a particular technology may be political, economic or both. It was for this reason that we said in the beginning of this book that all these environmental factors of business are closely interdependent.

Coming to the economic environment, we list the following factors which for our purpose, constitute the economic environment of business. We are not confining ourselves to pure economic principles such as the law of demand and supply, marginal utility and the like. We include major macro and micro economic factors which have considerable influence on business. Such factors are:

- Growth strategy,
- Economic systems,
- Economic planning,
- Industry,
- Agriculture,
- Infrastructure,
- Financial and fiscal sectors,
- Removal of regional imbalances,

- Price and distribution controls,
- Economic reforms,
- Human resources, and
- Per capita and national income.

All these have been explained in greater detail in this and subsequent chapters in this section.

Growth Strategy

Growth strategy of India was based on Soviet model.

The economic environment which now prevails in our country is the result of the economic growth strategy relentlessly pursued during the past five decades by the Government of India. It is therefore advisable to recollect the growth strategy. It may be recalled that the growth strategy followed was based on the Soviet Planning model which gave central role to the government in the control and direction of economic activity. Following the Soviet experience, it was believed that the savings rate in the economy and the growth rate, could be increased if India invested heavily in the capital goods and heavy industry sectors at the expense of the consumer goods sector. Since the investments in these sectors were high, largely beyond the capability of the private sector and profitability was low, it followed that such investments would have to be undertaken by the State.

The Second Five Year Plan (1956) was quite clear that *"It cannot be emphasised too strongly that unless steps are taken to augment rapidly the output of the means of production and to build up the fuel and energy resources which are so vital to development, the scale and pace of advancement in the coming years will be inhibited."* As for policies to achieve these objectives, the Plan went on to state that:

"In some cases, fiscal or price incentives may have to be relied on; in others, a licensing system may be essential; in still others, fixation of profit margins, allocation of scarce raw materials or other regulatory devices may be necessary... If the targets of planned investment are to be achieved, means have to be found to secure that the necessary resources do in fact, become available and are not devoted to consumption."

The State emerged both as the mobiliser of savings as well as an important investor and owner of capital. Since the State was to be the primary agent of economic change, it followed that private sector activities had to be strictly regulated and controlled to conform to the objectives of the State policy.

Under this policy, foreign trade had a relatively small role, partly because of the belief that trade was biased against developing countries and primary producers and partly because of the intellectual conviction that export prospects were severely limited. The First Five Year Plan (1951) was practically silent on exports. It only highlighted the limitations to the prospects of increasing export earnings since the *"prices obtainable for exports depend on world factors and may, therefore, be subject to large variations."* The Second Five Year Plan (1956) attempted a projection of balance of trade but concluded that no significant increase in export earnings in the short run could be expected. The intellectual basis for pessimism about exports which was widely shared by the development economists of the time, was broadly the same as that articulated by Nurkse in his *'Export Lcg'* thesis.

The theory postulated that the exports of a primary producing country tend to lag behind the rate of increase in the international trade.

The growth strategy also meant, in the early years of planning, a relative neglect of public investment in agriculture. This negligence of agriculture was supported by the prevailing view that a growing labour force in the developing countries could only be absorbed in industry, and that in the early stages of industrialisation, it was necessary for agriculture to contribute to the building up of modern industry by providing cheap labour. A faster development of industry was the central objective of planning.

The growth followed earlier resulted in the negligence of agriculture.

The above is a thumbnail sketch of the growth strategy followed by the planners in the past four decades. The strategy has been subject to severe criticism particularly during the late 80s when the era of liberalisation was set in motion. The criticisms are: the neglect of exports and trade opportunities, excessive protectionism and import substitution, undue reliance on physical controls, inefficiency of the public sector and total neglect of agriculture. Much of this criticism is however exaggerated.[1] The growth strategy did contribute to the overall growth of the economy as mentioned in the later part of this chapter and in other relevant portions of this section.

Basic Economic Systems

Just as there are two political philosophies, *viz.*, democracy and totalitarianism, there are three distinct economic philosophies, *viz.*, capitalism, socialism and communism. The system of ***capitalism*** stresses the philosophy of individualism believing in private ownership of all agents of production, in private sharing of distribution processes that determine the functional rewards of each participant, and in the individual expression of consumer choice through a free market place. In its political manifestation, capitalism may fall in a range between extreme individualism and no government (anarchism) and the acceptance of some State sanctions as mentioned by Adam Smith and the later philosophers of modern capitalism.

Mention should be made of the Welfare State concept which has developed in recent years. This is a modification of modern capitalism that provides for an increasing degree of State regulation when certain deficiencies appear in the economy. These limitations placed on the free market operations such as workmen's compensation law, provision for social security, laws regulating industrial relations, or direct State financial aid to housing and agriculture, to name but a few, are accepted as a result of the members of a democracy becoming dissatisfied with certain conditions that prevailed or might prevail without these measures. The Welfare State is short of State socialism, in that it does not sanction the public ownership of the activities that are regulated. Some, infact, argue that the acceptance of certain welfare state objectives is necessary to provide flexibility for capitalism, otherwise it might become static and be destroyed because of certain faults. Welfare actions then become modifications within the framework that constitute the basic postulates of capitalism.[2] USA is the best example for capitalism.

The concept of welfare state has become very common now. Welfare state is a modification of capitalism that provides for state intervention when certain deficiencies occur.

Under ***socialism***, the tools of production are to be organised, managed and owned by the government, with the benefits accruing to the public. A strong public sector, agrarian reforms, control over private wealth and investment and national self-reliance are the other planks of socialism.

Under socialism, the tools of production are to be organized, managed and owned by the government.

Socialism does not involve an equal division of existing wealth among the people but advocates the egalitarian principle. It believes in providing employment to all and emphasises suitable rewards to the efforts put in by every worker. Also called *Fabian* socialism, this philosophy is followed in our country and other social democratic countries in the world.

Communism goes further to abolish all private property and property rights to income. The State would own and direct all instruments of production. Sharing in the distributive process would have no relationship to private property since this right would not exist.[3] Alternatively called *Marxism*, communism was followed in Russia, China and East European countries.

Communism goes beyond socialism to abolish private property and property rights to income.

Table 11.1 draws a comparison among the three economic systems.

Table **11.1**

Capitalism, Socialism and Communism Compared

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

(**Source:** Vernon A Musselman and Eugene H Hughes, *Introduction to Modern Business-Issues & Environment*, p.20).

Each economic philosophy has its own strengths and weaknesses. Capitalism, for example, encourages individual initiative, allows the market forces to have free play, promotes a competitive spirit and directs the scarce resources to most profitable uses. The weakness of capitalism stems from the fact that it results in gross inequities of income, recurrence of trade cycles because of the free play of market forces, exploitation of the poor by the rich and the corrupt influence of vested interests over the State. Capitalism results in the wastage of resources. It has a devastating effect on the environment. Finally, people in capitalist societies earn more and consequently indulge in excessive and wasteful expenditure on consumer durables and luxuries.

In common parlance, the terms *socialism* and *communism* are used interchangeably. The East European countries are often called socialist countries though they follow Marxist ideologies.

The great October Revolution of 1917 saw, for the first time, the emergence of a State based on Marxist principles. It was Lenin who set up a communist state in Russia and from here, the ideology spread to Czechoslovakia, Poland, Hungary, Rumania, Yugoslavia and China. Firmly entrenched in these countries, communism appeared to have answers for all the ills associated with capitalism. But cracks developed within the edifice built over a period of more than six decades. The structure started crumbling all of a sudden. We recently witnessed country after country going back on communism and almost embracing capitalism. Several reasons have contributed to the reversal of the Marxist economy. These reasons incidentally testify to the inherent weakness of communism.

The major weakness of Marxism is the denial of individual freedom. One of the essential requirements of human organism is freedom - to work, to earn, to express, to choose and to indulge in the expenditure of one's choice. This freedom is denied to people. The followers of Marxism believed that the ideology would guarantee individual freedom. This expectation was belied as it became clear in the communist countries. No individual freedom existed in these countries, contrary to the theoretical claims made about it.

Major weakness of communism is the denial of individual freedom.

Secondly, communism assumes total commitment of people to work and to contribute to the country's welfare. This has not been forthcoming from people in the communist countries. People worked more or less as they work under capitalism, being driven by the twin forces of the carrot and the stick. Infact, there was more slackness and more pilfering on the part of the workers and probably more corruption on the part of the management than in the capitalist societies.

Thirdly, the communist economies failed to achieve significant economic growth. The rate of growth of these economies has been markedly lower than that of the economies relying on market forces. One of the most striking failures of State or collective ownership has been in agriculture where a super-power like Soviet Union, possessing one-sixth of the land surface on earth, found itself unable to feed its people even after 70 years of revolution.

Fourthly, equality which was the main plank of Marxists, did no succeed in the communist countries. The basic principle that every organised society is subject to stratification very much applied to communist societies also. Years back, therefore, the communist motto of *"for each according to his ability to each according to his need"* was changed in the Soviet Union without fanfare and almost surreptitiously to *"from each according to his work"*. The Stakhanovites made a big dent into the communist theory by being given economic rewards for their work and the differentiation that has been subsequently introduced consists not so much in the money wage but payments in kind and in privilege to those who occupy higher positions in the hierarchy; this, if translated into money, would show a very substantial difference.

The communist ideology of "for each according to his ability, to each according to his need was changed to from each according to his work".

Fifthly, the rulers themselves did not set fine examples for the followers to emulate. Lenin lived, till the end of his life, in one room in Kremlin whereas Brezhnev lived in the equivalent of many palaces and owned a fleet of most expensive of the world's cars. Late Caucescu and his wife in Romania lived in style and led a pompous life. Public anger against the couple was so much that together they died being shot by prosecutors mercilessly. More than 300 bullets were found on the dead bodies of Caucescu and his wife. The number of bullets bear testimony to the public wrath against the leaders who proclaimed equality but did not practise it.

Communist leaders did not set themselves as good examples.

Sixthly, communism has been obsessed with the rights of workers. This obsession has lead to the tendency to strike work, often on unjustifiable grounds. Walk in the streets of Calcutta or Thiruvananthapuram, you will find red flags hoisted at every business or industrial establishment. Public sector units have been taken as private properties to enjoy and squander.

Public sector units have become private properties to enjoy and squander.

Seventhly, the followers of communism seem to have several contradictions. One such contradiction which is too conspicuous is the attitude towards religion. Seventy years of communist rule in the erstwhile USSR did not help eradicate religion. Same is true in West Bengal and Kerala.

Finally, communism collapsed because of its inherent weakness - lack of flexibility and the absence of resilience. Capitalism survives because of its flexibility. It abandons the market where the survival of people is at stake. Look at the way the government intervenes in chosen areas even in the US economy.

Socialism seems to fall between capitalism and communism, partaking the strong points of both the philosophies and avoiding their weaknesses at the same time. It is for this reason that several developing countries of Asia, Latin America and Africa have adopted socialistic philosophy.

But the experience of several countries, particularly the African bloc, belies the expectations pinned on socialism. As the *Economic Times* of July 6, 1986 commented, the "common error of African rulers was to stick with economic policies derived from the half-understood European socialism of 1950s and earlier. Governments, they seem to have thought, could create wealth by decree. People's untidy lives could be improved by government management. So they set up huge bureaucracies (which they could not afford to pay properly, and which, therefore, become corrupt as well as idle) to regulate every aspect of life. They paid for government projects from funds that were meant to pay for crops, and held down

Table **11.3**

Industrial Production Growth Rates(%)

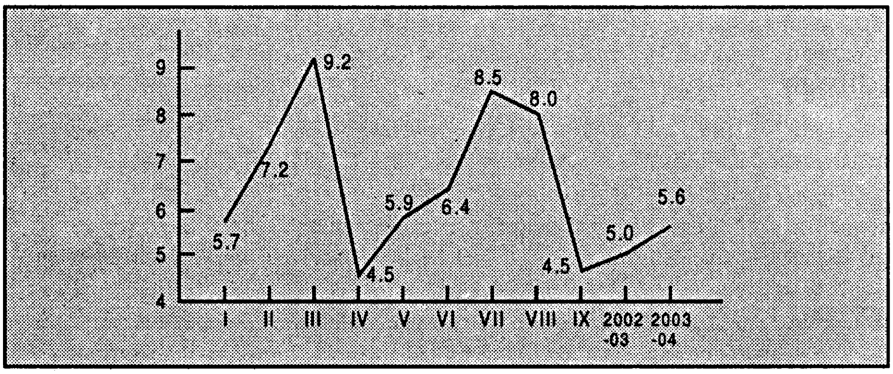
	1990-00	2000-01	2001-02	2002-03	2003-04(P)
Basic goods	5.5	3.7	2.6	4.9	5.4
Capital goods	6.9	1.8	-3.4	10.5	13.1
Intermediate goods	8.8	4.7	1.5	3.9	6.3
Consumer goods	5.7	8.0	6.0	7.1	7.1
Consumer durables	14.1	14.5	11.5	-6.3	11.5
Consumer non-durables	3.2	5.8	4.1	12.0	5.7
P=Provisional					

(Source: RBI, *Handbook of Statistics on The Indian Economy*, 2003-04)

now, five per cent later, rises to eight per cent and falls back to five per cent again (See Fig.11.1). A sustained double digit growth rate over a period of atleast one decade is essential if the country were to be bracketed along with industrialised countries in the world.

Figure **11.1**

Industrial Growth Through Plans (Annual %)



India has potential to become a global player in industrial sector.

Past need not blind us from realising the potential possessed by the country in terms of industrial growth. Stated differently, India is well-poised to become a global player in the industrial sector. Potential is vast and prospects are varied as the following points indicate.

1. As of now, industry contributes nearly 26 per cent of GDP as compared to 53 per cent in China and 41 per cent in Korea (See Table 11.4).

Table **11.4**

Economic Activities' Share in GDP(%)

	China	India	Korea
Agriculture	14.8	22.7	4.4
Industry	52.9	25.7	41.4
Services	32.3	51.6	54.2

(*Source:* "World Bank" as cited in *The Economic Times*, dated November 5, 2004)

There is the talk about India unshackling itself from the eight per cent growth rate in GDP syndrome. But can country achieve this without manufacturing is the question often raised. The answer is negative considering some simple arithmetics.

Industrial sector should overtake services sector, if India were to attain 8 per cent growth in GDP.

Agriculture cannot grow at more than 2 to 3 per cent trend rate. If industry grows at 8 per cent, services need to grow at 12 per cent for India to cross 8 per cent growth rate in GDP. If manufacturing grows at 8 per cent, services will need to grow at 10 per cent. Eventhough services sector is India's strength (See Table 11.4), it has grown in double digits only once in the last 10 years. Obviously, India needs to lift the growth rate of manufacturing to double digits for GDP to grow at 8 per cent plus. In otherwords, industry should overtake services for the GDP to raise above 8 per cent. India cannot afford to ignore industries sector.(5)

2. There is enough scope for making globally competitive manufacturing carried out in India. In diverse sections-pharma, chemicals, textiles, metals, refining, cement, auto and ancillaries-Indian firms are performing competitively and are exporting major chunks of output. Any new plant coming up in any industry can be designed to become globally competitive. Several MNCs are willing to export out of India. Suzuki and Hyundai, for example, view India as a car club. ABB plans to make India a global sourcing base for some of its products which implies closing its European factories.

McKinsey report says that a second a a much bigger wave of manufacturing outsourcing is due to arrive.

3. According to a study conducted by McKinsey and Co., a second and much bigger wave of manufacturing outsourcing is due to arrive. The first wave was $460 billion and consisted of low-tech items like toys and garments. The second wave could reach $1.6 trillion and will comprise high-tech areas like automotives, engineering and chemicals. When the second wave really emerges, two countries-India and China–will be the beneficiaries.[6]

India has large low-cost and skilled workforce. The country has one of the world's largest labour pools.

4. India has large low-cost and skilled workforce. The country has one of the world's largest labour pools (along with China). This large labour pool will limit increases in wage rates for the next 20 years. Besides, India has a high availability of engineers, producing over 400,000 every year, next only to China's 490,000 and nearly 25 times Thailand's 17,000. In addition to engineers, India produces 850,000 graduates every year and over 70,000 diploma-holders. As a result, the country has strong engineering capabilities whether in redesigning processes, products, or equipment, or in ensuring high quality production.[7]

5. India has vast raw materials supply base. The country has abundant raw material, e.g., cotton (India is the third-largest producer of cotton accounting for 3 per cent of world output), ferrous raw materials (India has 5 per cent of world iron-ore deposits and produces 3 per cent of the world's steel), and non-ferrous raw materials (She has 4 per cent banzite deposits and produces 3 per cent of the world's aluminum). In addition, India has built strong supporting industries such as tools and capital goods, which provide equipment and related inputs.

What needs to be done to exploit the potential is the next question. Following are some suggestions:

annum. Reasons are obvious.

The primary reason for low growth levels in the national income is the deficiency in investment. This is followed by high capital-output ratio, low agricultural and industrial growth and population explosion. The last factor is mainly responsible for low per capita income, notwithstanding satisfactory growth in the national income.

Human Resource

Human resources constitute an important constituent of the total economic environment. There are several reasons which bring out the crucial role of people in an economy. In the first place, people provide ready market for goods produced and services rendered by business establishments. With more than 100 crore people, our country offers a vast market. This explains the reason why MNCs are keen in investing their funds in India. Secondly, people together constitute one of the factors of production. It is not enough if a country has land and capital, it needs labour (human resource) to put the other factors to proper use. Our country is endowed with a vast pool of scientists, technicians, administrators, managers, software experts, engineers, professors, doctors, civil servants, strategists, financial wizards and experts in marketing. All these professionals will help run organisations successfully. Thirdly, the degree of economic prosperity, for example, of a nation depends on the quality of its people. Japan's prosperity owes it to its people. The country has been able to reach its present status thanks to the motivated and hard working people. Lack of natural resources has not hindered the country's prosperity. Burma has all the ingredients to become rich-oil (first country in Asia to discover oil), foodgrains, timber, precious rubies, tungsten-but has failed to become one, thanks to its people who are generally not risk takers and majority of them are tribals. Same is the story with Sri Lanka. The country has rich potential to export natural rubber, tea, copra and precious stones. Thanks to the people who seem to believe more in violence and killings than in peace, Sri Lanka could not prosper economically. Fourthly, our economy has entered into a new and exiting phase thanks to the new economic policy measures initiated from the start of the 1990s. In order to sustain the momentum of growth, we need people with competence and motivation. Finally, people need economic growth just as prosperity demands the services of individuals. Whatever is produced should be used by people. It is only then that the economy will have served its purpose (Read Box 11.1).

> Japan is an example of a nation which has prospered because of its people. Burma and Sri Lanka are the countries which are lagging behind because of people.

India is the second largest populated country in the world with the total population being 102.7 cr according to 2001 census. This forms about 16 per cent of the world population. But in area wise, India has got only 2.4 per cent of the land area in the world. Comparisons are interesting. US maintains only 6 per cent of the world's population but has been gifted with 7 per cent of the total land area, Russia has 5 per cent and 12 per cent respectively.

> India has 16 per cent of world's population but occupies only 2.4 per cent of the total land area.

Table 11.7 shows the population trend in India.

Box 11.1

Growth and Workers

Economic growth is good for workers. This has long been true for those living in what are now the world's rich countries, and it has been spectacularly true for the newly industrialising economies of East Asia over the past few decades. Growth has reduced poverty through rising employment, increased labour productivity and higher real wages. Growth also tends to reduce poverty and inequality, including inequality between men and women. For today's low and middle income countries, the fear that growth will primarily benefit capital, create few jobs, and fail to raise wages is unfounded. Vietnam's workers are now some of the poorest in the world. If their country follows the path of other East Asian success, they could enjoy a doubling of their labour incomes in a decade or so.

(**Source**: *World Development Report 1995*, p.3)

Table 11.7

Population Trend

(Crore)

Year	*Population*	*Year*	*Population*
1901	23.80	1951	36.10
1911	25.20	1961	43.92
1921	25.10	1971	54.81
1931	27.90	1991	84.63
1941	31.87	2001	102.70

(**Source**: *Eighth Five Year Plan*, Vol.1, and *Census of India 2001*).

There is another dimension to the problem of overpopulation. It is said that out of 185 nations in the world, we rank not first, second or 10th but 111th in population growth. It is also said that the population is growing more slowly than the world's two-thirds of the nations. Comparisons of this type have purely academic interest. The fact is, we have too many mouths to feed and this has been a drag on our development.

However, it goes to the credit of our country that it was the first in the world to adopt family panning as a State Policy. From the First Plan itself, the need to control population was recognised. During the Second Plan, though both these Plans indicated an official policy to control population, there was no effective implementation. The results of the 1961 Census confirmed the half-hearted efforts at population control and imparted a new urgency to the programme. The Third Plan recognised, for the first time, family planning which till then had relied heavily on the traditional clinical referral approach.

India deserves credit for its pioneering role in promoting family planning in the country.

The Fourth Plan described family planning as a programme deserving the highest priority. It introduced the time and target approach to family planning. The Fifth Plan continued to give this priority status to family planning. In April 1976, the population policy in India received a new impetus, when the government issued a statement in its national population policy. The statement contained several new measures and it reflected the government's realisation that the population explosion had reached a critical stage and was proving to be a major stumbling block in its efforts to raise the living standards of the masses. The programme underwent a change during the emergency, when it incorporated compulsory approach to family planning. In 1977, the nomenclature was changed to family welfare programme from family planning programme. During1977-79, the performance of the programme was extremely poor. The Sixth Plan listed limited population growth as one of its main objectives. The Seventh and Eighth plans too did emphasise the need for limited population growth.

All these efforts have not gone waste. The message of the red triangle has spread far and wide. It is gratifying to note that an illiterate villager now talks about the need for a small family and they accept family planning techniques with appreciation. A visit to a government hospital in a small town is a sight to be believed. The beds in the hospital are ever full with young mothers undergoing treatment after they have undergone tubectomies. There is no need to talk about the problem in cities. People are aware of the need for and advantage of spacing child births and stopping after the first two. Seeds for better tomorrow are sown and the fruits will be reaped in the years to come.

The years to come seem to hold bright future for India. The country has the largest number of young people in the world today. We have nearly 65 million children below 15 years of age, and as many as 400 million youngsters below the age of 23 years. These young people will join the ranks of working people in the next few years, thus creating a huge surge of productive activity, incomes and savings. India's young people can be an asset to the global economy because while India's population will be getting younger in the coming decade, the population of all the developed countries, including China and Russia, will be getting older. The richer countries will face shortage of working age people while India will have surplus of them. Obviously, India can bring in more than Rs.8.8 lakh crores of revenues every year from the richer countries and create 40 million additional jobs by providing a variety of services to the rest of the world.

CLAIMS AND COUNTER CLAIMS

What has been the result of all these developmental efforts? There have been claims and counter claims about the outcome. Official agencies claim that huge investments produced positive results. But these claims are not acceptable to the economists, intellectuals and politicians who do not see eye to eye with the government agencies. What these claims and counter claims are?

> The new government at the centre is serious about economic reforms, compulsions from the left parties notwithstanding. India is one of the fastest growing economies in the world. Domestic market is booming, jobs are multiplying and salaries are rising.

On the achievement side, the claims made relate to industry, agriculture, infrastructure, foreign trade, growth rate of the economy, control of inflation and the standard of living of the people. It is asserted that significant progress has been made in all these and many more during the last five decades of economic planning.

Of late, economy has been doing exceedingly well. The new government at the Centre has, despite the influence of the Communist parties, is serious about pursuing economic reforms. India is one of the countries in the category of fastest-growing economies in the world;

the domestic market is booming; new jobs are being created and salaries are raising; and prospects of outsourcing are brighter.

The following developments, in particular, have made the Indian economy robust.[9]

1. Huge investments have been proposed in the near future. Between 2004-06, India will invest Rs.234,600 crore on infrastructure. Of this, 43 per cent will go to power sector, 20 per cent to roads and the rest to other sectors of the economy, with a consequent multiplier effect.

What is interesting is that bulk of this investments is being made by companies through internal accruals and motivated by the need to meet growing domestic and international demand.

Investments in the past were a contrast to those proposed now. The earlier investments were fueled by unrealistic hopes about the size of the domestic market and a desire to make quick money from a safe market created by high tariff walls. Investments in the past were financed through debt (now lying in the form of NPAs-non-performing assets in banks) or money raised from public issues.

Indian economy has obviously entered into an investment-led growth phase.

2. Competitiveness of the India's economy is high, the country being ranked 34 in IMD's World Competitiveness Report 2004,, up from 50 in 2003. Additionally, in terms of business efficiency, India's rank has moved from 51 to 22, and in terms of economic performance from 22 to 12. The dismantling of industrial licensing system, rationalisation of tax regime, removal of competition-stifling tariffs and the like have boosted India's competitiveness. Profitability of *Business Today 500* companies has increased from 6.02 per cent in 2000-01 to 8.86 per cent in 2003-04.

In terms of business efficiency, India's rank has moved from 51 to 22, and in terms of economic performance from 22 to 12. Profitability of 500 companies has risen from 6.02 per cent in 2000-01 to 8.86 per cent in 2003-04.

3. The outsourcing boom has vastly contributed to India's richness. The country has emerged as hot spot for outsourcing IT, ITEs, pharmaceuticals, engineering design, R&D, clinical research, textiles, and auto components. Table 11.8 shows revenue accruing to India thanks to outsourcing. Outsourcing is going to be much more attractive in the days to come.

Table 11.8 *Outsourcing in Numbers*

		(Figures in $ billion)
	2004	*2009*
IT & ITES	15.80	50.00
Pharma	0.61	3.00
Textiles	14.00	50.00*
Auto Components	0.80	2.60
**By 2010*		

(***Source:*** *Business Today*, September 12, 2004)

4. Increasingly, Indian corporate sector is exploiting global opportunities. Companies are realising that a global presence can help insulate them from the vagaries of the domestic market. Take the example of Tata Motors which recently acquired Daewoo Commercial Vehicle Company of South Korea and is also investing Rs.9200 cr. in Bangladesh. Tata Steel has plans to acquire NetSteel (of Singapore) for Rs.1313 cr. The global foray of Tata Motors and Tata Steel is the culmination of the efforts of Indian firms to establish their presence outside India. In the 1990s, Indian manufacturing companies were considered not competitive enough to compete globally. Today, in areas as diverse as forgings, water pumps, commercial vehicles, and a range of auto components, Indian firms are catering to the global market. This is in addition to businesses such as IT and Pharma where Indian companies have already established themselves as lead players.

Indian companies have increasingly exploiting global opportunities by acquiring foreign firms.

5. Indian companies have become better pay masters. Salaries have risen by anything between 10 to 25 per cent. High-growth and high-attrition industries such as IT, ITES, telecom, banking and financial services have registered highest rise in remunerating employees (See Table 11.9).

Table 11.9

Salary Hikes(%)

	2003	2004
IT	15	17
ITES	23	25
Telecom (Services)	10	12
Insurance	23	25
Banking (Retail)	12	15

(***Source:*** *Business Today*, Sept., 12, 2004)

What is significant is an increase in salaries has resulted in a consequent increase in discreationary spending, thus, adding to the demand for goods and services.

6. Some other developments have also contributed to the growing demand. One billion people supported by high growth rates and a decrease in the number of the poor constitute a huge market. Since the 1990s the number of poor in India has declined from 35 percent of the population to 26 percent. The number of middle class stands between 200 and 250 million. Salaried incomes, as stated earlier, are raising - all these are pushing demand to higher levels.
7. The Central Government is pushing through economic reforms, notwithstanding opposition from Communist parties. The left parties are themselves in favour of liberalising the economy, except on two contentions issues, viz, privatisation and labour laws. Economic reforms have thus become irreversible which augurs will for the country.
8. India's economy is the fastest growing in the world (with 8.2 percent rate in 2003-04). In 2003, the economy of US grew by 3.1 percent, Japan by 2.5 per cent, Brazil by a negative 0.2 per cent, and Asian Tiger Thailand by 7

per cent. IMF predicts that India's economy will grow by 6.8 per cent in 2004-05. Portion of this growth will translate into foreign investment and domestic demand.

> With 8.2 per cent growth rate (2003-04) India's economy is the fastest growing one in the world. In 2003, US economy grew by 3.1 per cent, Japan by 2.5 per cent, and Brazil by a negative 0.2 per cent.

Counter-claims are equally forceful. It is alleged that all is not well with our industrial sector. The sector is facing too many problems as will be described later. Many industrial units are facing the threat of closure. About agriculture, it is alleged that the phenomenal increase in production of foodgrains is only in rice and wheat. Coarse cereals which are consumed by vast majority of villagers have not registered impressive increase in production. Besides, agriculture is highly dependent on monsoon, failure of which disrupts not only agriculture but the entire economy. The talk about achievements does not mean anything to the common man who still reels under poverty, illiteracy and ignorance. Then there is the ever increasing fiscal deficit.

The country has a huge unemployed population of 39 million(1995). China has little over five million. All other developing countries too have the problem of unemployment but not as much as India has.

The achievements of India stand nowhere near to those of China. In the past decade, China has built atleast 12 major international airport (we have been struggling to put up one at Bangalore), 29,000 kilometers of high quality four-line highways (we have not made any headway in laying expressway, a distance of 145 kilometers, between Bangalore and Mysore); renovated city centres, and built shopping districts. Its Guangzhou airport can handle 27 million passengers and one million tonnes of cargo a year. In comparison, all airports in India put together can handle barely three million visitors per year.

> The achievements of India compare nowhere to those of China. In the past decade China has built atleast 12 major international airports and laid 29,000 km of high quality four lane national highways. Has India done any of these in a short span of time?

Thus, the debate can go on. But what should not be lost sight of is the fact that our economy has remarkable resilience. This is borne by the fact that it faced two wars, successive droughts and floods, enormous expenditure on defence and is sustaining more than 93 crore plus people. Whatever the critics may say, the truth remains that, over the years, the lifestyle and levels of living of the people have vastly improved. Population below the poverty line too has declined as is evident from Table 11.10. The late Prime Minister Indira Gandhi, was right when she said that wherever she went, she found smiles on the faces of people and this was the best indicator of economic prosperity that has taken place in our country. See also India Development Report, p.194.

> Criticisms notwithstanding, it is a fact that Indian economy has resilience.

Table **11.10**

Population Below Poverty Line

	%
1983-84	30.1
1987-88	25.5
1993-94	19.0

(**Source**: *Planning Commision,* New Delhi).

Let us also not forget the fact that we have failed in one important dimension of economic development, and it is the building of national character, strong integrity, staunch patriotic fervour and exquisite moral standards, especially among the youth as also in the rest of our countrymen. It is sad that we hardly find young men or women who can proudly say that this is our land and this is our country. It is equally sad that we hardly come across individuals who are inspired by fanatical commitment to their work and to the country. We have managers who do not manage, workers who do not work, teachers who do not teach and students who do not study.

AGENDA FOR FUTURE

Table 11.11 contains series of pressing questions which need satisfactory answers. These questions, incidentally, constitute the agenda for future.

Describing the various components of economic environment and leaving it at that serves no real purpose. What is important is to understand how the economic

Table 11.11

Key Questions

Most of these topics have been discussed in detail at appropriate places in this book.

A. *Macro-economic scene*
1. What will be the likely growth of the economy?
2. What can be done to boost exports?
3. Can we achieve higher growth rate and sustain it?

B. *Inflation and Exchange Rates*
1. Why are interest rates high inspite of low inflation?

C. *Poverty and Public Policy*
1. What is the impact of reforms on poverty?
2. What has happened to anti-poverty measures?

D. *The Energy Scene*
1. Why is there power shortage?
2. Can private power plants help meet the shortage?
3. How can we bridge the gap between demand and supply?

E. *The Environment Scene*
1. What are the pressing environmental problems?
2. How can we deal with air, water and noise pollution?
3. How do we manage our forest cover?
4. What is happening to the Indian biodiversity?

F. *Agriculture and Rural Development*
1. What reforms are needed at the agricultural front?
2. What can be done with agricultural subsidies?
3. What have we done for rural development?

G. *Industry*
1. What can we do to accelerate industrial growth?
2. What can be done to improve efficiency of PSEs?

	3. What can be done to contain growing sickness?
	4. How about corporate governance?
H. *Labour Policy*	
	1. What kind of labour policy reforms are needed?
I. *Securities Markets*	
	1. What have reforms done to improve market efficiency?
	2. What are the roles of primary and secondary markets?
	3. Why has the stock market slumped?
	4. What role do FIIs play?
J. *Banking Sector*	
	1. Have reforms improved the performance of public sector banks?
	2. How should we improve the performance of the banking sector?
K. *Transport*	
	1. What are the problems of railways?
	2. How should we improve railways' share of freight traffic?
	3. What is the problem with roads and road transportation?
	4. Has private entry benefited civil aviation?
	5. How should we improve performance in ports and shipping?
L. *Telecommunication*	
	1. Why are our telecom services so poor?
	2. How should DOT be regulated? What should be our telecom policy?
M. *Planning*	
	1. Why was planning undertaken in the first place?
	2. Is delay on market mechanism justified?
	3. What should be the role of planning?[10]

environment impacts an individual business firm. A chief executive should answer many questions as the following: How will my costs of operations change? Wage rates? Raw materials? Health and benefit costs of my employees? Interest rates on my borrowings? What new competition will I face in the global market? How will the unification of Europe affect my business? Will my competitors cut into my share of domestic market? How can I expand the demand for my products? How much should I spend on R&D? Answers to these and other related questions are available in the economic environment of business.

QUESTIONS

1. What is economic environment? How is it important for business?
2. Describe the economic environment as it prevails today in our country.
3. Do you think that the present economic environment is favourable to business? Discuss.
4. Bring out the unfinished agenda in the industrial sector.

One of the components of an economic environment is the industrial sector. As the economic environment is largely influenced by industrial production, it is useful to discuss all its related aspects. The aspects covered here are industrial policy, industrial licensing, regulation of trade practices harmful to public interest, regulation of foreign exchange, regulation of companies, industrial labour, public sector enterprises, SSI sector, industrial sickness, privatisation and the like. This and the next couple of chapters are devoted for a detailed discussion of all these.

Industrial policy is an important document. It lays a wide canvas and sets the tone for implementation of government's regulatory and promotional roles.

Industrial policy is an important document which lays a wide canvas and sets the tone for implementing promotional and regulatory roles of the government. A discussion of the industrial policy is desirable before describing economic environment. This chapter is devoted for the purpose.

The term 'industrial policy' refers to the government's policy towards industries - their establishment, functioning, growth and management. The policy will indicate the respective areas of the large, medium and small-scale sectors. It will also spell out government's policy towards foreign capital, labour, tariff, and other related aspects. Naturally, the industrial development of a country will be shaped, guided, fostered, regulated and controlled by its industrial policy.

Industrial policy is probably the most important document which indicates the relationship between government and business. The document is helpful to planners and administrators in the government, in as much as it gives clear guidelines for promoting and regulating industries. It is equally helpful to industrialists and others for deciding areas and priorities of their investments.

The industrial policy has no legal sanction and as such its violation cannot be challenged in a court. But it has justification for existence.

The industrial policy has no legal sanction and as such its violation cannot be challenged in a court as is possible in the case of Fundamental Rights guaranteed by the Constitution. However, it has certain broad guidelines for the government's administrative action and deals with only the qualitative aspects thereof. There are no physical targets to be fulfilled, no time-span, no financial commitment as in the case of an industrial plan. There is only a moral commitment on the part of the government to implement the policy in word and spirit.[1]

RATIONALE

Yet, industrial policy has strong justification for its existence. For example, it can:

- Correct the imbalances in the development of industries and help bring about a desirable balance and diversification in them.
- Direct the flow of scarce resources in the most desirable areas of investment in accordance with national priorities.
- Prevent the wasteful use of scarce resources and ensure their conservation and judicious utilisation.
- Empower the government to regulate the establishment and expansion of private industry in accordance with the planned objectives.
- Demarcate areas among the public, private and joint sectors of the economy, as well as large, medium and small-scale industries.

- Prevent, through fiscal and monetary policies, the formation of monopolies and concentration of wealth in a few hands so that the evils associated with monopolies can be effectively curbed.
- Give guidelines for importing foreign capital and the conditions on which such capital should be permitted to operate.

INDUSTRIAL POLICY RESOLUTION OF 1948

Industrial Policy 1948 has four important features: (i) acceptance of the dual sectors:public and private, (ii) division of industries, (iii) small and cottage industries, (iv) role of foreign capital.

The first important industrial policy resolution was issued by the Government of India on April 6, 1948. Following were the main features of the 1948 industrial policy:

1. Acceptance of the importance of both private and public sectors. The industrial policy resolution accepted the importance of both public and private sectors in the industrial economy of India. It assigned a progressively active role to the State.

2. Division of the industrial sector. The Resolution divided industries into four categories. These categories were as under: *(i) Industries where State had a monopoly:* In this category *three* fields of activity were specified - arms and ammunition, atomic energy and rail transport, *(ii) Mixed sector:* In this category, 6 industries were specified - coal, iron and steel, aircraft manufacture, ship building, manufacture of telephone, telegraph and wireless apparatus (excluding radio sets) and mineral oils. However, existing private undertakings in this field were allowed to continue for ten years after which the government would review the situation and acquire any existing undertaking after paying compensation on a "fair and equitable basis". *(iii) The field of government control:* The government did not undertake the responsibility of developing these industries but considered them of such importance that their regulation and direction was necessary. Some of the industries included were - automobiles, heavy chemicals, heavy machinery, machine tools, fertilizers, electrical engineering, sugar, paper, cement, cotton and woollen textiles. *(iv) The field of private enterprise:* All other industries (not included in the above three categories) were left open to the private sector. However, the State could take over any industry in this sector also if its progress was unsatisfactory.

3. Role of small and cottage industries. The 1948 Resolution accepted the importance of small and cottage industries in industrial development. These industries are particularly suited for the utilization of local resources and for creation of employment opportunities.

4. Other important features of the industrial policy. The role of foreign capital in industrial development of the economy was recognized but the need for regulating and controlling it according to the needs of the domestic economy was deemed essential. Therefore, it was stated that in those industries where foreign investment was to be done, Indians should have a major say in the ownership and management. The Resolution called for harmonious relations between the management and labour since this was necessary for industrial development. For this purpose, the Resolution enunciated a policy of just labour conditions wherein workers would be given fair wages. For purposes of maintaining industrial peace, labour participation in mangement was also stressed.

was to be intensified. The virtue of mixed economy was further reaffirmed. The policy also emphasised that industrial development must be governed by the Directive Principles of State Policy enunciated in the Constitution and the more precise direction given to them by the Parliament through its acceptance of the socialist pattern of society. No wonder that the 1956 policy has been hailed as the *'economic constitution'* of India. The 1980 Policy Statement paid the highest tribute when it stated that *"the industrial policy announcement of 1956 in fact reflects the value system of our country and has shown conclusively the merit of constructive flexibility."*

The 1956 Policy was vehemently criticised on the role assigned to the public sector. It was said that a public enterprise in an impersonal industrial venture and an impersonal attitude towards an enterprise is hardly conducive to its growth. Further, it was contended that the State was unduly straining its already overburdened and overstrained financial and administrative resources. Some critics went so far as to suggest that it would bring about State capitalism and that the government will be well-advised to reconsider its policy.

The 1956 Policy no doubt set out some of the principles of Nehru's philosophy but retained sufficient ambivalence to placate the uncommitted elements. As latter developments proved, loopholes and exceptions were more readily availed of by the administrators and industrialists. In industries like coal, oil, etc., which were reserved for public expansion, licences were issued to the private sector. Similarly, three Western oil companies were allowed to establish refineries in the country. Besides, the government signed a deal with STANVAC (later ESSO) for oil exploration with minority participation by the Government of India.

Merits and demerits apart, the 1956 Policy continued to constitute the basic economic policy for a long time. This fact has been confirmed in all the Five Year Plans.

INDUSTRIAL POLICY, 1991

On 24th July 1991, the government headed by Mr.P.V.Narasimha Rao, announced a new industrial policy which sought to drastically alter the industrial scenario in our country. There are several fundamental departures in the new policy. The most important initiatives are with respect to the virtual scrapping of industrial licensing and registration policies, an end to the monopoly law and a more welcoming approach to foreign investments, apart from redefining the role of the public sector. These measures, long overdue, are welcome as they would free the industry from regulations, most of which have outlived their utility.

Objectives

Succinctly, the objectives of the New Industrial Policy are:

(i) Self-reliance to build on the many sided gains already made.
(ii) Encouragement to Indian entrepreneurship, promotion of productivity and employment generation.
(iii) Development of indigenous technology through greater investment in R & D and bringing in new technology to help Indian manufacturing units attain world standards.

(iv) Removing the regulatory system and other weaknesses.
(v) Increasing the competitiveness of industries for the benefit of the common man.
(vi) Incentives for the industrialisation of backward areas.
(vii) Enhanced support to the small-scale sector.
(viii) Ensure running of public sector undertakings (PSUs) on business lines and cut their losses.
(xi) Protect the interests of workers.
(x) Abolish the monopoly of any sector in any field of manufacture except on strategic or security grounds.
(xi) To link Indian economy to the global market so that we acquire the ability to pay for imports, and to make us less dependent on aid.

In pursuit of the above objectives, the Government has decided to take a series of initiatives in respect of the policies relating to the following areas:

A. Industrial Licensing
B. Foreign Investment
C. Foreign Technology Agreements
D. Public Sector Policy
E. MRTP Act

A package for the small and tiny sectors of industry is being announced separately. This policy will be discussed later in this book.

The 1991 Policy comprised five dimensions:
(i) licensing
(ii) foreign investment
(iii) technology agreements
(iv) public sector
(v) MRTP Act.

A. Industrial Licensing Policy

Industrial licensing is governed by the Industries (Development & Regulation) Act, 1951. Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. Industrial licensing policy and procedures have also been liberalised from time to time. A full realisation of the industrial potential of the country calls for a continuation of this process of change.

In order to achieve the objectives of the strategy for the industrial sector for 1990 and beyond, it is necessary to make a number of changes in the system of industrial approvals. Major policy initiatives and procedural reforms are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgement. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policy and procedures must be geared to assisting entrepreneurs in their efforts. This can be done only if the role played by the Government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays.

The winds of change have been with us for some time. The industrial licensing system has been gradually moving away from the concept of capacity licensing. The system of reservations for public sector undertakings has been evolving to the ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. This calls for bold and imaginative decisions designed to remove restraints on capacity creation, while at the same time, ensuring that over-riding national interests are not jeopardised.

In the above context, industrial licensing will henceforth be abolished for all industries, except those specified, irrespective of the levels of investment. These specified industries will continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and overriding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. The exemption from licensing will be particularly helpful to the many dynamic small and medium enterprerneurs who have been unnecessarily hampered by the licensing system. As a whole, the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful place in the world of industrial progress.

B. Foreign Investment

While freeing the Indian industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. In view of the significant development of India's industrial economy in the last 40 years, the general resilience, size and level of sophistication achieved, and the significant changes that have also taken place in the world industrial economy, the relationship between domestic and foreign industry needs to be much more dynamic than it has been in the past in terms of both technology and investment. Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for the promotion of exports. This is particularly necessary in the changing global scenario of industrial and economic cooperation marked by mobility of capital. The government will therefore welcome foreign investment which is in the interest of the country's industrial development.

In order to invite foreign investment in high priority industries, requiring large investments and advanced technology, it has been decided to provide approval for direct foreign investment upto 51% foreign equity in such industries. There shall be no bottlenecks of any kind in this process. This group of industries has generally been known as the 'Appendix I industries' and are areas in which FERA companies have already been allowed to invest on a discretionary basis. This change will go a long way in making the Indian policy on foreign investment transparent. Such a framework will make it attractive for companies abroad to invest in India.

Promotion of exports of Indian products calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities. To the extent that expertise of this nature is not well developed so far in India, Government will encourage foreign trading companies to assist us in our export activities. Attraction of substantial investment and access to high technology, often closely held, and to world markets, involve interaction with some of the world's largest international manufacturing and marketing firms. The

Government will appoint a special board to negotiate with such firms so that we can engage in purposive negotiation with such large firms, and provide the avenues for large investments in the development of industries and technology in the national interest.

C. Foreign Technology Agreements

There is a great need for promoting an industrial environment where the acquisition of technological capability receives priority. In the fast changing world of technology, the relationship between the suppliers and the users of technology must be a continuous one. Such a relationship becomes difficult to achieve when the approval process includes unnecessary governmental interference on a case to case basis involving endemic delays and fostering uncertainty. The Indian entrepreneur has now come of age so that he no longer needs such bureaucratic clearances for his commercial technology relationships with foreign technology suppliers. Indian industry can scarcely be competitive with the rest of the world if it is to operate within such a regulatory environment.

With a view to injecting the desired level of technological dynamism in the Indian industry, the Government will provide automatic approval for technological agreements related to high priority industries within specified parameters. Similar facilities will be available for other industries as well if such agreements do not require the expenditure of free foreign exchange. Indian companies will be free to negotiate the terms to technology transfer with their foreign counterparts according to their own commercial judgement. The predictability and independence of action that this measure is providing to the Indian industry will induce them to develop indigenous competence for the efficient absorption of foreign technology. Greater competitive pressure will also induce our industry to invest much more in research and development than they have been doing in the past. In order to help this process, the hiring of foreign technicians and foreign testing of endogenously developed technologies, will also not require prior clearance as prescribed so far, individually or as a part of industrial or investment approvals.

D. Public Sector Policy

The public sector has been central to our philosophy of development. In the pursuit of our development objectives, public ownership and control in critical sectors of the economy has played an important role in preventing the concentration of economic power, reducing regional disparities and ensuring that planned development serves the common good.

The Industrial Policy Resolution of 1956 gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which has a commanding role in the economy. Today key sectors of the economy are dominated by mature public enterprises that have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.

After the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, overmanning, lack of continuous technological upgradation, and inadequate attention to R & D and human resource development. In addition, public enterprises have shown a very low rate of return on the capital invested. This has inhibited their ability to regenerate themselves in terms of new investments as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. The original concept of the public sector has also undergone considerable dilutions. The most striking example is the take over of sick units from the private sector. This category of public sector units accounts for almost one-third of the total losses of central public enterprises. Another category of public enterprises, which does not fit into the original idea of the public sector being at the commanding heights of the economy, is the plethora of public enterprises which are in the consumer goods and services sectors.

It is time therefore that the Government shall adopt a new approach to public enterprises. There must be a greater commitment to the support of public enterprises which are essential for the operation of the industrial economy. Measures must be taken to make these enterprises more growth oriented and technically dynamic. Units which may be faltering at present but are potentially viable must be restructured and given a new lease of life. The priority areas for the growth of public enterprises in the future will be the following:

Essential infrastructure goods and services.

Exploration and exploitation of oil and mineral resources.

Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate.

Manufacture of products where strategic considerations predominate such as defence equipment.

At the same time, the public sector will not be barred from entering areas not specifically reserved for it.

In view of these considerations, government will review the existing portfolio of public investments with greater realism. This review will be in respect of industries based on low technology, small-scale and non-strategic areas, inefficient and unproductive areas, areas with low or nil social considerations or public purpose, and areas where the private sector has developed sufficient expertise and resources.

The government will strengthen those public enterprises which fall in the reserved areas of operation or are in high priority areas or are generating good or reasonable profits. Such enterprises will be provided a much greater degree of management autonomy through the system of memoranda of understanding. Competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises, part of government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises. There are a large number of chronically sick public enterprises incurring heavy losses, operating in a competitive market and serve little or no public purpose. These need to be attended to. The country must be proud of the public sector that it owns and it must operate in the public interest.

E. Monopolies and Restrictive Trade Practices Act (MRTP ACT)

With the growing complexity of the industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the interference of the government through the MRTP Act in investment decisions of large companies has become deleterious in its effect on India's industrial growth. The pre-entry scrutiny of investment decisions by the so called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopoly houses to obtain prior approval of the Central government for expansion, establishment of new undertakings, mergers, amalgamation and take over and the appointment of certain directors. The thrust of policy will be more on controlling unfair or restrictive business practices. The MRTP Act will be restructured by eliminating the legal requirement for prior governmental approval for expansion of present undertakings and the establishment of new undertakings. The provisions relating to merger, amalgamation, and takeover will also be repealed. Similarly, the provisions regarding restrictions on the acquisition of and the transfer of shares will be appropriately incorporated in the Companies Act.

Simultaneously, provisions of the MRTP Act will be strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation *suo moto* or complaints received from individual consumers or classes of consumers.

In view of the considerations outlined above the government has decided to take a series of measures to protect the Indian industrial economy from the cobwebs of unnecessary bureaucratic controls. These measures will be covered in appropriate places in subsequent chapters.

Merits of the 1991 Policy Statement

- The 1991 Policy Statement is truly historic, whether it is the result of IMF pressure or our own realisation that the time has come to open up the economy.
- The changes, long overdue, need to be welcomed as a bold initiative aimed at making Indian industry more competitive internally as well as internationally, and at freeing the industry from needless and irksome controls, most of which have outlived their utility.
- The delicensing of a host of industries and the abolition of all registration schemes will free Indian entrepreneurs from the need to make endless trips to New Delhi. They can now concentrate on their business and move quickly to seize business opportunities.
- The scrapping of any asset threshold or market share prescription for the definition of an MRTP company and a dominant undertaking allows companies to go ahead with investment programmes without delay.
- The liberalisation of the rules relating to direct foreign investment, permitting 51 per cent equity in a wide range of industries, the easier facilitation of foreign technology agreements and other related measures go a long way in attracting foreign investment and technology.

- Reforms relating to the public sector like privatisation and transferring sick units to BIFR will help improve the performance of the government undertakings.
- Finally, the new Policy Statement is a most welcome package. There is a greater reliance on the market, a bold attempt at deregulation, a desire to integrate with the world economy, and to modernise.

Limitations of 1991 Policy

- Virtual scrapping of licensing means absence of a mechanism to determine priorities and to develop backward areas.
- The policy is silent about tackling the growing industrial sickness. The government has not announced a clear exit policy for sick units. Clearly government seems to have yielded to the pressure of trade union lobby.
- Off-loading of 20 per cent equity in profit making public sector units to mutual funds is a revenue raising exercise than genuine attempt at privatisation.
- Even with the scrapping of all regulations, the expected foreign investment may not come through. Infrastructural deficiencies will deter foreign investment.
- The policy is drafted at the behest of IMF which means virtual surrender of economic sovereignty of the country to a foreign agency.

QUESTIONS

1. What is Industrial Policy? What are its objectives?
2. Why is the Industrial Policy, 1956 hailed as the Economic Constitution of India?
3. Comment on the 1991 Policy.
4. Explain the Industrial Policy 1948.

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2. *Ibid*, p.14.

CHAPTER 13

Industrial Licensing

CHAPTER OUTLINE

Licensing and its Objectives

Legislative Framework for Licensing

– *Industrial (Development and Regulation) Act, 1951*

Criticisms of Licensing

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Define industrial licensing and state its objectives*
2. *Describe the provisions of the Industrial Act classifying the sections into preventive, curative and creative*
3. *Bring out the criticisms of licensing*

Ours is one of the few countries in the world where an entrepreneur is required to obtain an industrial licence from the government before venturing into a new business. This chapter is devoted to a brief description of the objectives, the recent changes announced by the government and other related matters relating to licensing.

Objectives of Licensing

Licence is a written permission issued by the Central Government to an industrial enterprise to locate itself, and produce a stated product.

A *licence* is a written permission issued by the Central Government to an industrial undertaking stating such details as the location, the article to be manufactured, production capacity and other relevant particulars.

It is also subject to a validity period within which the licensed capacity should be implemented.

The main objectives of licensing are:

- to limit industrial capacity within the targets set by the plans;
- to direct investment in industries according to plan priorities;
- to regulate the location of industrial units so as to secure a balanced regional development;
- to prevent both monopoly and concentration of wealth;
- to protect small-scale industries against undue competition from large-scale industries;
- to foster technology and economic improvements in industries by ensuring units of economic size and adopting modern processes; and
- to encourage new entrepreneurs to start industrial units, thus broadening the entrepreneurial base.

The major objective of licensing is to give effect to the industrial policy of the Government. Any change in the industrial policy, therefore, will have its repurcussions on the licensing system.

LEGISLATIVE FRAMEWORK FOR LICENSING

The legislative framework for industrial licensing is provided in the Industrial(Development and Regulation) Act, 1951, MRTP Act, and FEMA.

Industrial(Development And Regulation) Act, 1951

Legislative framework for licensing is through Industries Act, MRTP Act and FEMA.

The Act seeks to secure planned industrial development of the country by regulating, controlling and developing industries that are included in the First Schedule to the Act. Regulation of industries is sought to be achieved by means of registration of existing industrial undertakings, licensing of substantial expansion, production of new articles, change of location of existing undertakings, etc. Control over these industries is sought to be achieved by causing investigation into the working of these industries and taking over of their management and control. Development of these industries, on the other hand, is sought to be secured primarily through the agencies of Central Advisory Council and Development Councils and by offering certain facilities as the government may think fit to be necessary for the development of the Scheduled industries.

The Industries Act has three objectives:
(i) implementation of industrial policy
(ii) regulation and development of industries
(iii) development of new undertakings.

Objectives of the Act

The Act has three important objectives, *viz.*,

- *Implementation of the Industrial Policy*: The Act provides necessary means to the Central Government in order to implement its industrial policy.
- *Regulation and Development of Important Industries*: The Act brings under the control of the Central Government the development and regulation of a number of important industries listed in the First Schedule attached to the Act as the activities of such industries will affect the country as a whole and, therefore, the development of such important industries must be governed by the economic factors of all-India importance.
- *Planning and Future Development of New Undertakings*: A system of licensing is introduced under the Act to regulate planning and future development of new undertakings on sound and balanced lines as may be deemed expedient in the opinion of the Central Government. The Act confers on the Central Government power to make rules for the registration of existing undertakings for regulating the production and development of the industries specified in the Schedule attached to the Act. The Act also provides for the constitution of Central Advisory Council and Development Council.

The following excerpt from *"The Industrial Development of India:Policy and Problems"* adds a new dimension to the objectives of the Act:

"Bringing industry within the purview of this Act has the effect of transferring from the States to the Central Government the responsibility and power of legislation for its regulation, control and development. Since most industries were brought under this Act, something like a constitutional revolution took place in 1952 by virtually making industry a Central subject rather than a State subject as envisaged in the Constitution. This change, however, is of vital and fundamental importance to the building up and the preservation of the economic unity of the country."[1]

Scope of the Act

The Act applies to the whole of India including the State of Jammu & Kashmir. The provisions of the Act apply to industrial undertakings manufacturing any of the articles mentioned in the First Schedule. An industrial undertaking (also called a factory) for the purpose of the Act is the one where the manufacturing process is being carried on:

(a) with the aid of power, provided that fifty or more workers are working or were working on any day of the preceding twelve months; or

(b) without the aid of power, provided that one hundred or more workers are working or were working on any day of the preceding twelve months.

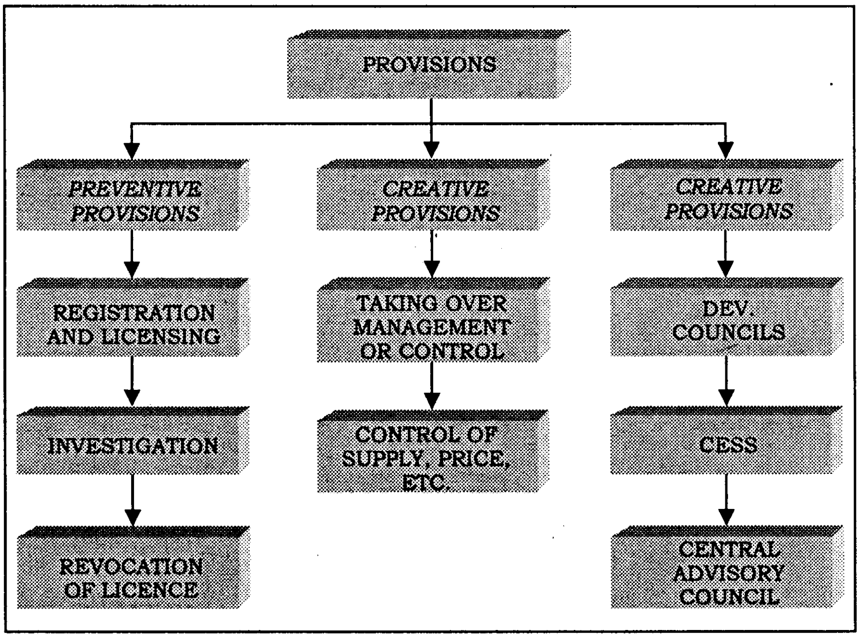
(c) the Act applies only to industrial undertakings. Trading houses and financial institutions are outside the purview of the Act.

Provisions of the Act

The Act has thirty one sections and all of them can be classified into three broad categories, depending upon the purposes they seek to serve.(See Fig.13.1).

Figure 13.1

Provisions of I(D&R) Act



CRITICISMS OF LICENSING

No other regulatory measure of the government was subject to such criticism as licensing.

Licensing was introduced to serve useful purposes which were listed in the beginning of this chapter. However, in its implementation the system ran into disrepute. We state some serious criticisms against licensing with a note that the criticisms have historical value since licensing itself has almost become irrelevant today.

The following defects have been highly conspicuous:

- The issue of licences tends to give an exaggerated picture of industrial capacity which sometimes scares away genuine entrepreneurs who might be chronologically late, at the same time, as it encourages foreclosure of licensed capacity by influential groups and sitting tight on unimplemented licences.
- Licences are normally, in most cases, issued for a capacity 10 to 25 per cent above the target for the end-plan year and that too, mostly around the begining of the plan period. An excessive-though quantitatively unvariable-perssure is thus exerted on the available foreign exchange and possible collaborators and also on domestic suppliers. This leads to bottlenecks and delays, apart from adversely affecting the terms of negotiation with foreign and domestic suppliers and creditors.

- The process of consideration of applications at various levels and at various times contributes to delays and higher costs, without improving the feasibility of the project concerned.
- There is very little follow-up of licensing to see that the approved projects fructify in a satisfactory phased schedule. Even the authorities concerned are not fully aware of the total investment and foreign exchange commitments of licences issued or those under implementation at any particular period of time.[2]

The other criticisms against licensing policy are:

One of the purposes of industrial licensing is to achieve regional dispersal of industries. Even this purpose seems to have not been fully realised. The gains in terms of balanced regional development and wider distribution of entrepreneurs are, at least, moderate. That licensing has served to channelise investment appears extremely doubtful.[3]

- The Dutt Committee came down heavily on the way the private sector was allowed to usurp areas reserved for the public sector as per the Industrial Policy, 1956. Development of aluminium which is classified under Schedule 'A' for example, was completely thrown open to the private sector. Similary, in the machine tools industry, only nine licences were issued to the HMT but the private sector bagged 226 licences. In fertilisers, the public sector got only 12 licences as against 42 licences issued to the private sector. In drugs and pharmaceuticals, the public sector's share was a paltry 12 licences as against 148 licences issued to the private sector. In the case of industries classified under Schedule 'B', synthetic rubber and chemical pulp, for example, all the licences were issued to the private sector. *"It is obvious"*, asserted the report, *"that licensing policy as such can play but a limited role in this respect. Decisions to permit development of certain industries in Schedule 'A' through private enterprise and to encourage the bulk of the development of industries in Schedule 'B' mainly through private enterprise must have been taken by the government at the highest level"* (p.107).
- The Committee criticised the way the term-lending financial institutions perferred the private sector for leading financial assistance. The total assistance provided by the term financing institutions during the period 1955 to 1966 was Rs.498 crores. Out of this, the public sector companies received as assistance of just over 10 per cent but private sector secured a massive 54.2 per cent.
- The provisions of the Industries (Development & Regulation) Act relating to licensing have been, over the years, observed more in its breach than in principle. A letter of intent, for example, is issued for a period of one year. If effective steps are not taken by the grantee to implement the letter of intent within the period of 2 years, it should lapse. Statistics, however, tell a different story. By the end of 1983, 805 letters of intent issued during 1974-79 remained unimplemented. Again between end October 1980 to end October 1986, out of 7,442 letters of intent issued, 2,234 have been converted into licences, 3,884 are yet to be implemented and the remaining 1,324 have lapsed.[4]

Further, "companies licensed to produce a specified quantity have produced 10 to 20 times that amount, the government's reaction invariably being a sightless stare. The big industrial houses and multinational subsidiaries have been the biggest offenders, freely creating unlicensed capacities and producting far in excess of the quantity permitted.

"...Crompton Greaves has a licensed capacity for producing 18,000 sets of metal-cased plugs and sockets. Production in 1979 was-hold your breath-224,207 sets. Hindustan Lever has a licensed capacity of 70,018 tonnes of soap, but has recorded a production of 162,278 tonnes. Similarly, J.L.Morrison's licensed capacity for medicated toothpaste is 31,250 kg. but production has been 67,196 kg. Yet, in over 30 years, there has not been a single case of any company being prosecuted for such acts of commission".[5]

- That industrial licensing is required to control waste of resources is one of those hoary chestnuts that the planners pass around when they have no other argument to fall back upon. Nothing could be more wasteful that the massive bulk of public sector which eats up more resources, monetary as well as physical, than the entire private sector put together. Yet the public sector expansion is a direct result of the licensing system and the commanding heights syndrome. The planners seem to be more worried about some young men getting together and putting up a small plant to make dairy machinery without a licence than the heavy engineering corporation gulping taxpayers' rupee after rupee with a proper licence, without coming anywhere near making both the needs meet.[6]
- "...neither IDRA nor MRTP has enabled it (the government) to put any of its declared social objectives into practice. In fact, going again by the official figures, the two Acts have worked in a perverse manner. Take the case of the textile industry, the oldest and the most rigorously regulated industry in the country. In a country which is said to have nearly 50 per cent of its population below the poverty line, there should be considerable demand for cheap cloth.

"But it is precisely the mills which make the cheap cloth that are in serious trouble - over a hundred of them are sick and have been taken over by a State *Pinjrapole* known as the National Textile Corporation - and those which make expensive cloth like synthetic fabrics are busy minting money. A company like Reliance Textiles which did not own a shed of its own 15 years ago is now the country's biggest textile company. Reliance also had to go through the same licensing churner but has apparently managed to emerge not only unscathed but done very well for itself and its shareholders in the bargain. This is also true of companies like Bombay Dyeing, Gwalior Rayon and Century which have gained enormously over the years, despite the fact that they all belong to large business houses and have had to cross not only the ordinary licensing hurdle but also the MRTP bar.... The fact is that an aggressive industrial society will assert itself no matter what the policy books might say, and the natural laws of supply and demand will make mincemeat of the best laid plans of mice and men, even if some of them are masquerading as planners with 'social objectives".[7]

- The government says that the large industry will not be allowed to expand into areas reserved for small-scale industry. But the truth is that in many

> cases, large industry owns small industry....J.K.Helene Curtis, a small-scale unit, is owned by the Singhania group; Dental Products of India Ltd., another small unit, belongs to Shaw Wallace, as does Vitro-Pharma Products Ltd., Indian National Diesel Co.Ltd., is owned by Mahindra, Ewac Alloys by L&T, Garment Enterprises Ltd., by Finlay and so on.[8]

The impact of licensing on the industrial sector had been a topic of considerable interest. A number of government committees had also been set up since the mid-sixties to examine the working of the licensing system (Government of India, 1964, 1965, 1967, 1969, 1978 and 1979). As a result of these studies and reports, the licensing system had been considerably liberalised since 1973. The reforms had included simplifications in procedure and removal of restriction on capacity expansion. Finally, the scope of licensing has been drastically curtailed and it is now made applicable to only six industries.

Not that the licensing system was an exercise in futility. It played its useful role during the 60s and 70s when our economy faced acute shortage of resources. Whatever resources we possessed had to be rationed across different industries through physical controls. Now that the economy has grown in all directions and has become fairly vibrant, licensing and other controls need to be removed. Our entrepreneurs need freedom to set up units of their choice and exploit the opportunities thrown open to them by the world economy which is becoming increasingly integrated. The delicensing phase initiated by the government, therefore, needs to be appreciated.

The economic reforms introduced from 1990s have made licensing almost irrelevant. As on today, licensing is required only for six specific groups for reasons as safety and overriding environmental issues and manufacture of products of hazardous nature.

The other legislations providing for licensing will be discussed in the next two chapters.

QUESTIONS

1. What is an industrial licence? What are the objectives of licensing?
2. "Licensing has laudable objectives. But in its implementation the system ran into disrepute". Comment.
3. Bring out the objectives and provisions of the Industries (Development and Regulation) Act, 1951.

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CHAPTER 14

From the MRTP Act, 1969 to the Competition Act, 2003

CHAPTER OUTLINE

Objectives of the MRTP Act

Regulation of Trade Practices

- *Monopolistic Trade Practices*
- *Restrictive Trade Practices*
- *Unfair Trade Practices*

Objectives of the Competition Act

Provisions of the Act

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Understand the objectives of the MRTP Act*
2. *Explain how the Act seeks to regulate MTPs, RTPs and UTPs*
3. *Understand the objectives of the Competition Act 2003*
4. *List the prevision of the Act*