(d) *Development Banks*: Since Independence, the RBI has setup a series of development banks like IFCI, IDBI, SFCs etc. through which funds are made available to finance economic activities.

CRR requires that every bank should keep certain minimum cash with RBI.

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

SLR mandates that every bank should deposit, in the form of liquid assets, a certain percentage of its total time and demand deposits.

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

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

It may be mentioned here that the effect of stepping up of CRR and SLR is the same, *viz.*, they reduce the capacity of commercial banks to expand credit to business and industry and thus are anti-inflationary.

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

Selective Credit Controls

Selective credit controls affect particular sectors of the economy and include such measures as:

Selective controls are sector specific.

(i) insisting on minimum margins for lending against specific securities;

(ii) fixing a ceiling on the amounts of credit for certain purposes;

(iii) charging discriminatory rates of interest on certain types of advances;

(iv) moral suasion and

(v) direct action.

While the first three are self-explanatory, the latter two need clarification.

Under moral suasion, RBI appeals to the good sense of banks not to do or do certain things.

Under moral suasion, the RBI addresses periodical letters to banks urging them to exercise control over credit in general, or advances against particular commodities or unsecured advances. Periodic discussions are also held by the Governor of the Reserve Bank with the authorities of commercial banks urging them to restrain from lending liberally.

Direct action may involve refusal by the Reserve Bank to rediscount bills of a particular commercial bank which has failed to comply with the directives of the former. It may, in the extreme case, involve cancellation of licence of an erring bank. Direct action is too severe and is, therefore, rarely followed.

An Evaluation of Monetary Policy

RBI seems to have failed both in controlling or expanding money supply.

Monetary policy has become a target of severe criticism. As was mentioned in the beginning of this chapter, RBI's monetary policy has been characterised as one of controlled expansion. It is said that the RBI has failed both in expansion and control of money and credit in our economy. With regard to the expansion of credit, it is said that the major component of the increase in money supply was the Reserve Bank credit to the Central Government. The inability of the Reserve Bank to deny or regulate credit to the Central Government due to both legal and practical considerations has been interpreted by the Committee (Sukhamoy Chakravarty Committee) as an important factor in the Reserve Bank's helplessness in controlling the rise in money supply. Thus, money supply has expanded inspite of the Reserve Bank and not because of it.

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

It is the government which should be blamed if RBI has been found wanting.

The reasons for the failure to formulate an effective monetary policy should, perhaps, be found elsewhere and not with the RBI. The Sukhamoy Chakravarty Committee has strongly indicted the Central Government for living beyond its means and making the central banking authority impotent in discharging its responsibility in maintaining the value of the currency. The report has clearly shown that the indiscipline of the

Table 26.3 *Balance Sheet of Monetary Policy*

Weaknesses	Strengths
- Higher proportion of non-banking credit - No check on price rise - High currency-deposit ratio rendering the RBI's role less effective - Selective application of credit constraints - Defective statistical and monitoring system. - Growing fiscal needs of the economy	Decision making and implementation is faster than fiscal policy More reliance on selective credit control measures and less on quantitative controls making RBI's pressure on commercial banks less severe Has been responsive to the needs of the economy

fiscal policy has made the monetary policy an exercise in futility. The Central Government has opened the flood-gates of monetary growth and asked the Reserve Bank to plug the small leaks. In simple words, the report conveys that the emperor of monetary policy has no clothes on.

Another argument to prove the Reserve Bank's helplessness is that the powers and weapons of the bank cover only the commercial banks. To the extent inflationary pressure is the result of bank finance, the Reserve Bank's general and selective credit controls will have effect. But if inflationary pressure is really brought about by deficit financing and shortage of goods, the Reserve Bank's control may not have any effect at all. Besides, the apex bank has no power over non-banking financial institutions and indigenous bankers who continue to play a considerable role in financing trade and industry.

Table 26.3 brings out the strengths and weaknesses of the RBI's monetary policy.

Structural Adjustments and Monetary Policy

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

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

1. The stipulation of a minimum lending rate for advances of over Rs 2 lakh has been discontinued and banks would be free to fix their own prime rates.
2. SLR has been reduced to 25 per cent, sharply shrinking the captive market for government securities.
3. State governments too would have to go to market for loans.
4. Automatic monetisation of the budget deficit would cease and has been replaced by a system of *ways and means advances* under which temporary

accommodation provided to the Central Government would have to be liquidated by the end of the financial year.

5. The RBI would endeavour to develop an active market in securities for which it would undertake to develop institutions and instruments as well as an appropriate structure of market-determined rates of interest on securities.
6. A close linkage would be established between monetary policy and exchange rate policy.
7. The RBI is prepared to accept that the bank's choice of asset holdings would be determined not by statutory prescriptions but by risk-reward perceptions.
8. Guidelines have been issued for the promotion of market-makers in major stock exchanges and for the grant of bank advances for the purpose, without any ceiling and without applying the 50 per cent margin applicable to advances against shares.

MONEY MARKET

Meaning of Money Market

Money market is a mechanism through which short-term funds are borrowed or lent.

The *money market* is the market in which short-term funds are borrowed and lent. The Reserve Bank defines a money market as "*centre for dealings, mainly of a short-term character, in monetary assets; it meets the short-term requirements of the borrowers and provides liquidity or cash to lenders. It is the place where short-term surplus investible funds at the disposal of the financial and other institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government*". The money market does not deal in cash or money, but in short-term financial assets like trade bills, promissory notes and treasury bills which are drawn for short periods. These short-term bills are known as *near-money*.

The money market may be distinguished from the capital market. Capital market refers to the market for long-term funds, while the money market refers to the market for short-term funds. "*The maturity boundary that divides the money and capital markets is rather arbitrary, ranging from one to five years, depending on who is doing the classifying*".[2]

Some authors use the term 'money market' to include capital market as well. No such synonymity is maintained in this section. In other words, the two are independently used, money market referring to short-term funds and capital market referring to long-term funds.

Functions of Money Market

Money market adds to the support of funds. It also avoids seasonal fluctuation of funds.

1. By providing various kinds of credit instruments suitable and attractive for different sections, a money market augments the supply of funds.

2. The efficient working of the money market helps minimise the gluts and stringencies in the money market due to the seasonal variations in the flow of and demand for funds.

3. A money market helps avoid seasonal fluctuations in interest rates.
4. A money market, by augmenting the supply of funds and making them readily available to the legitimate borrowers, helps in making funds available at cheaper rates.
5. A well-organised money market, through the quick transfer of funds from one place to another, helps avoid regional gluts and stringencies of funds.
6. It enhances the amount of liquidity available to the economy.
7. A money market, by providing profitable investment opportunities for short-term funds, helps increase the profit of financial institutions and individuals.

Growth of Money Market

For several years, turn-over in our money market was low because of a limited number of players and administered interest rate regime. As is well known, earlier only commercial banks were allowed to operate in the money market. As years went by, several other players were also allowed entry into the money market. The players now include all commercial banks, cooperative banks, development financial institutions, UTI, mutual funds and insurance corporations. Infact, any one having funds to lend is allowed access to the market. To be specific, the following banks and institutions are the big players in the money market:

* All Scheduled Commercial Banks
* Life Insurance Corporation of India
* General Insurance Corporation of India and its subsidiaries
* Industrial Credit and Investment Corporation of India Ltd.
* Unit Trust of India
* Industrial Reconstruction of Bank of India
* Export Credit Guarantee Corporation Ltd.
* Industrial Development Bank of India
* Industrial Finance Corporation of India
* National Bank of Agriculture and Rural Development
* Discount and Finance House of India Ltd.
* National Housing Bank
* Shipping Credit and Investment Company of India Ltd.
* Tourism Finance Corporation of India Ltd.
* Export Import Bank of India
* Small Industries Development Bank of India
* SBI Mutual Fund
* GIC Mutual Fund
* CANBANK Mutual Fund
* LIC Mutual Fund
* BOI Mutual Fund
* Indian Bank Mutual Fund
* PNB Mutual Fund
* Madhya Pradesh Rajya Sahakari Bank Maryadit
* Maharashtra State Cooperative Bank Ltd.
* Tamil Nadu State Apex Cooperative Bank Ltd.
* Urban Cooperative Banks as shown below:
  • Abhyudaya Cooperative Bank Ltd.

- Bassein Catholic Cooperative Bank Ltd.
- Bombay Mercantile Cooperative Bank Ltd.
- Development Cooperative Bank Ltd.
- Sangli Urban Cooperative Bank Ltd.
- Shamrao Vithal Cooperative Bank Ltd.
- Saraswat Cooperative Bank Ltd.
- Janata Sahakari Bank Ltd.
- Rupee Cooperative Bank Ltd.
- New India Cooperative Bank Ltd.
- Goa Urban Cooperative Bank Ltd.
- Ahmedabad Mercantile Cooperative Bank Ltd.
- Cooperative Bank of Ahmedabad Ltd.
- Kalupur Commercial Cooperative Bank Ltd.
- Madhavpura Mercantile Cooperative Bank Ltd.
- Rajkot Nagarik Sahakari Bank Ltd.
- Surat People's Cooperative Bank Ltd.

Note: 1. All the above banks/institutions are also permitted to participate in the call/notice money market. Other cooperative banks not included in the above list are participants in the call/notice/term money market.

2. Institutions in the above list participate as lenders only in the call/notice money market.

It maybe stated that out of all the above institutions, only commercial banks can operate both as lenders and borrowers. Financial institutions and mutual funds are allowed to operate only as lenders.

It may be also stated that the Reserve Bank of India is the regulatory authority controlling all the players and their operators in the money market.

In addition to the permission given to other players to operate in the money market, the Reserve Bank of India withdrew ceiling on interest rates in the money market with effect from May 1989. Furthermore, new instruments were introduced from time to time to cater to the needs of various investors.

Establishment of the Discount and Finance House of India Ltd. (DFHI) in April 1988 was a landmark in the development of the Indian money market.

Another measure contemplated towards the growth of the money market relates to the decision to permit scheduled commercial banks and their subsidiaries to set up Money Market Mutual Fund (MMMF). The measure would provide an additional short-term avenue to investors and bring money market instruments within the reach of individuals and small bodies.

The Indian money market has grown in maturity over a period of time.

Thus, the Indian money market has grown, over the years, in its stature and versatility. The inspiration behind this phenomenal growth has been the recommendations of the Chakraborthy Committee and the Vaghul Working Group.

Operations in the Money Market

Operations in the money market take place in different ways. The major ones are:

(i) Call (overnight) money
(ii) Notice money

(iii) Commercial Bills
(iv) Treasury Bills
(v) Certificates of Deposits
(vi) Commercial papers.

Table 26.4 shows the main features of these investment methods.

Call/Notice Money

All categories of banks and financial institutions are allowed to participate in call/ notice money market. The funds are lent for one day or from Saturday to Monday (call/overnight money) or for a period upto 14 days (notice money) in the call/notice market. In view of the short tenure of such transactions, it is desirable that both the borrowers and lenders have current account with the Reserve Bank of India. This will facilitate quick and timely debit and credit operations. The call market is taken recourse to by banks and institutions to even out their day-to-day deficits and surpluses of money and specially to bridge the shortfall in maintaining the requisite CRR/SLR levels to avoid punitive measures by the RBI. The interest rates in the call money market are highly elastic to the demand-supply position and are known to have moved from a low of 2-3 per cent to over 70 per cent per annum. Even on the same day, variation upto 10 percentage points has been observed. There is, therefore, high interest rate risk to both borrowers and lenders in operating in the call money market. The lenders having steady inflow of funds (e.g., LIC, UTI) look at the call market as a temporary parking place for funds as well as means for deploying funds on a short term basis.

Table 26.4 *Features of Investment Methods*

Money Market instruments	*Minimum amount per transaction (Rs.in crore)*	*Period*	*Secured/ Unsecured*	*Liquidity*	*Participants*
1. *182 Days Treasury Bill*	0.25	1-182 Days	Secured	Easy	Open to all
2. *Commercial Bill*	0.50	1-90	Secured Days	Reasonable	Scheduled commercial banks, select cooperative banks, all-India financial institutions and mutual funds
3. *Certificates of Deposit*	0.25	46-365 Days	Secured	Moderate	Open to all
4. *Commercial papers*	0.25	90-180 Days	Unsecured	Moderate	Open to all
5. *Call Money*	1.00	1 Day	Unsecured	Easy	Commercial and cooperative banks, all-India financial institutions and Mutual Funds
6. *Notice Money*	0.50	2-14 Days	Unsecured	Easy	-do-

Commercial Bills

Discounting commercial bills is one of the ways for banks to extend credit.

One of the ways banks extend credit to their customers is by discounting their commercial bills. Such credit-bill finance is repayable on maturity of the bills. During the usance period, banks have a recourse to the money market to rediscount the eligible bills and get ready money. The eligibility criteria prescribed by the Reserve Bank of India for rediscounting a bill stipulates *inter alia* that the bill should arise out of genuine trade or commercial transactions and the maturity date of the bill should fall within 90 days from the date of rediscounting. The individual bills can be substituted by derivative usance promissory note of equivalent aggregate amount and of maturity by the issuing bank to eliminate movement of papers and facilitate multiple rediscounting. The Government has exempted stamp duty on the discounting of such bills and on derivative usance promissory notes. The bill rediscounting rate is dictated by the market forces. There is less volatility in interest rates in bill rediscounting market than in the call market.

182 Days Treasury Bills

This is a short term government debt security introduced in November 1986. It has certain special features. The Treasury Bill is issued on auction by the Reserve Bank of India. It is issued at a discount and on maturity, the face value is paid to the holder. Every fortnight, Reserve Bank of India invites bids for sale of 182 Days Treasury Bills. The bidder has to specify (i) the price per rupees hundred nominal value and (ii) the face value of the proposed investment. Bids are opened and examined by a committee headed by a Deputy Governor of the RBI. The committee decides on a cut-off price and all bids quoting price equal to or higher than the cut-off level are accepted for full allotment. Others are rejected.

Applications in the prescribed form are to be tendered before 3.00 p.m. on the specified date at the Reserve Bank of India, Mumbai. Results of the auction are displayed at the Reserve Bank of India, Mumbai the next day, indicating the price upto which bids have been accepted. Successful bidders are required to collect the letter of acceptance and deposit the amount with the apex bank within 24 hours from the announcement of the results.

All banks, institutions, corporations and individuals can submit bids at the auction. These treasury bills are eligible assets for the purpose of maintenance of banks' SLR requirement. The discounting rate being based on bidders' quotes at the Reserve Bank of India auctions, gives expected returns to the investors. There is very active secondary market with both outright sale and '*repos*' (buy-back) facilities, providing full liquidity to the instrument. Banks having swing in their demand and time liabilities find this instrument very handy for conversion from cash to treasury bills and *vice versa*. Others like local bodies, corporations etc. which are flush with funds, may also find this instrument attractive.

Certificate of Deposit

The Reserve Bank of India introduced Certificates of Deposit(CD) in 1989. CD is a front-ended negotiable instrument, issued at a discount and the face value is payable at maturity by the issuing bank. In terms of the provisions of the CD Scheme, scheduled

commercial banks are allowed to issue CDs to their customers. The CDs are short-term deposit instruments for a period ranging from three months to one year. Further, the minimum amount of a CD is fixed at Rs.25 lakh in the denomination of Rs.5 lakh. These instruments are subject to the payment of stamp duty like usance promissory notes. A CD is transferable by endorsement and delivery any time after 45 days of issue. The amount of a CD is included in the demand and time liabilities of the issuing bank for the purposes of reserve requirements (CRR and SLR).

Certificate of deposit is a negotiable instrument issued at a discount but face value is payable at maturity by the issuing bank.

Being a negotiable instrument, it is traded in the secondary money market and can be rediscounted after 45 days of holding by the first holder. If a bank acquires, by rediscounting, a CD issued by another bank, it is treated as an inter-bank asset while working out the demand and time liabilities of the rediscounting bank, thereby giving it the benefit in working out its reserves requirements.

Since a CD is eligible for rediscounting in the money market only after 45 days of holding, the maturity period of CDs available on the market can be anywhere between one day to 320 days. A CD is therefore another step in filling the gap between Treasury Bills/Commercial Bills and dated securities.

The discount rates for the issue of CDs are market-determined. The banks can use the CD Scheme to increase their deposit base by offering higher discount rates. Anyone can take CDs issued by banks. Also, there is a fair degree of liquidity to the investments, though it is somewhat restricted due to the non-eligibility of transfer for 45 days after the issue. This is an ideal instrument when surplus cash is to be parked for three months to one year. Banks also find this instrument suitable to reward its big size depositors with a better rate of return than on household deposits.

Commercial Paper

The Reserve Bank of India introduced a scheme of Commercial Paper(CP) in January 1990. CP is a short-term negotiable money market instrument and is issued by companies in the form of a usance promissory note, redeemable at par to the holder on maturity. The period of CP is 15 days to 365 days from the date of issue and is issued at a discount. CP can be transferred by simple endorsement and delivery. Further, the maximum amount for which CP can be issued by a company is limited to 100 per cent of the working capital limit, sanctioned by the company's bank and after the issue of CP, the working capital credit limit is automatically reduced. However, the financing bank can give stand-by facility for meeting the redemption liability on maturity.

Commercial paper is a short-term negotiable instrument issued by companies redeemable at par to the holder on maturity.

Reserve Bank of India has been continuously bringing about relaxations in the scheme and as per the April 1991 credit policy announcement, the conditions for the issue of CP have been relaxed as follows:

(i) The fund-based working capital limit of the issuing company should not be less than Rs.4.00 crore from the banking sector and the company can issue a CP upto 100 per cent of its working capital credit limit.

(ii) The tangible networth of the issuing company should not be less than Rs.4 crore.

(iii) A CP issue should be of a minimum size of Rs.25 lakh (face value) and can be issued in denominations of Rs.5 lakh or multiples thereof.

(iv) The condition of 'prior' clearance from Reserve Bank of India is dispensed with.

(v) The credit rating awarded by CRISIL to the issuing company should be P_2 or higher or A_2 by ICRA, PR_2 of CARE.

(vi) The shares of the company should be listed in one or more stock exchanges.

(vii) The borrowal account should be treated as a *standard asset* by the finanical bank.

(viii) The current ratio should be 1.33:1 minimum, as per the latest audited balance sheet.

The CPs are traded in the secondary money market and are therefore adequately liquid. These are good investment for entities having short term cash surplus.

Role of DFHI

As was stated earlier, the setting up of the Discount and Finance House of India Ltd. in 1988 was a landmark in the development of the Indian money market. During its short span of four years, the role played by the DFHI is noteworthy.

DFHI participates in the inter-bank call/ notice money market and term deposit market, both as lender and borrower.

DFHI has been set up by the Reserve Bank of India jointly with public sector banks and all-India financial institutions to deal in short-term money market instruments. It started operations in April 1988. At present, DFHI participates in the inter-bank call/notice money market and term deposit market, both as lender and borrower. It also purchases and sells 182 Days Treasury Bills, commercial bills, CDs and CPs. DFHI has an authorised capital of Rs.250 crore of which Rs.150 crore has been paid up. Apart from its paid up capital, it has lines of refinance from the RBI and a line of credit from the consortium of public sector banks.

During 1990-91, DFHI opened branches at Delhi, Calcutta, Chennai, Ahmedabad, and Bangalore in order to decentralise its activities and provide money market facilities at the major market centres in the country.

The participation of DFHI in the money market has activised the secondary market specially for 182 Days Treasury Bills and commercial bills. RBI does not purchase 182 Days Treasury Bills before maturity nor does it sell these bills except through the fortnightly auctions. DFHI fulfils the role of provider of liquidity to the Treasury Bills. It quotes every day its bid and offers discount rates for different instruments. While the selling of Treasury Bills by DFHI at the 'offer' rate depends upon the availability of such bills in its assets portfolio, DFHI is willing to purchase Treasury Bills at its *'bid'* rate.

The DFHI also provides *'repos'* facility (buy-back and sell-back) to banks, select financial institutions and public sector undertakings, upto a period of 14 days at pre-determined interest rates.

In regard to commercial bills, the introduction of derivative usance promissory notes (DPN) for rediscounting bills has facilitated multiple rediscounting of this

instrument in the secondary money market. DFHI purchases and sells DPN for a period upto 90 days at its bid and offer rediscount rates.

The call money operations of DFHI has enabled the pooling of borrowers' demand and lenders' supplies to the extent that both borrowers and lenders opt to avail of DFHI services for their operations.

The operations of the DFHI during the first three years of its existence are shown in Table 26.5.

Commercial Banks

Banking is more than 225 years old in the country.

The banking system consitutes the core of the financial sector and plays a critical role in transmitting monitory policy impulses to the economy.

Banking is more than 225 years old in our country. The first bank called the Bank of Hindoostan was established in 1770. Since then, there has never been any let up and as of today, there are 295 banks with 66,514 branches spread across the country.

The banking system in our country comprises three constituents: public sector banks, private sector banks and foreign banks (see Fig.26.1). There are 27 public sector banks accounting for 81 per cent of the total assets of all banks (as on March 31, 1999).

We have private sector banks, whose role has considerably narrowed down after two-step nationalisation. Private sector banking received a shot in arm with the announcement of the New Economic Policy. The number of private banks stand at 32 with 5624 branches (see Fig.26.1).

Table 26.5 ***Discount and Finance House of India Ltd., Operations at a Glance***

(Rs. in crore)

	1988-89	*1989-90*	*1990-91*
Business Turnover			
** Call and Notice Money*	20,362	88,577	2,02,792
** 182 Days Treasury Bills*	11,024	21,953	32,529
** Commercial Bills*	2,866	10,682	12,575
** Term Money*		244	3,532
** Commercial Paper*		26	107
** Certificates of Deposit*		3	8
Operating Results			
** Profit before tax*	11.20	26.76	50.20
** Profit after tax*	5.25	12.14	26.97
** Dividend*			
Amount	4.23	10.81	17.25
Percent	5.00	10.00	11.50
** Return on capital employed*	12.80%	24.78%	33.50%

Foreign banks in the private sector are branches of banks incorporated outside India. There are 36 such banks with 204 branches on end March 1999.

The Indian commercial banks have played a significant role in the economic development of the country. Be it branch expansion, deposit mobilisation, credit expansion, minimising regional imbalances or promotion of new entrepreneurship, the role of commercial banks is considerable. There are shortcomings nevertheless. For example, the banking services have not reached all parts of the country, loan recovery has become a big problem for banks; inefficiency and customer complaints are common in banks and losses have become a way of life. Banks often find it difficult to strike a balance between their commercial compulsions and social obligations.

The Indian commercial banks have played a significant role in the economic development of the country.

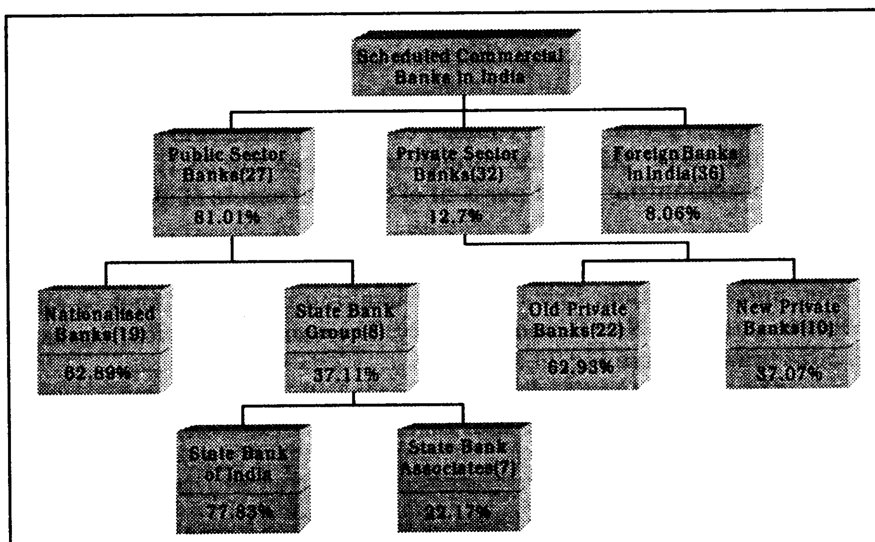

Figure 26.1 *Structure and Assets Composition of Scheduled Commercial Banks*

Notes: 1. Scheduled Commercial Banks are exclusive of Regional Rural Banks (RRBs).
2. Figures in brackets indicate number of banks in each group.
3. Figures in percentages indicate the share of assets of each sub-group in the total assets of their respective group.
4. The percentage shares have been computed using the assets figures as on end-March 1999.

Factors Affecting Competitiveness and Efficiency in Banking

The financial sector plays a major role in the mobilisation and allocation of financial savings. Financial institutions, instruments and markets which constitute the financial sector act as a conduit for the transfer of financial resources from the net savers to net borrowers. The gains to the real sector of the economy, therefore, depend on how efficiently the financial sector performs this basic function of intermediation so that the transaction cost is kept at the minimum. The banks form the most important segment of the financial sector. However, till the seventies, government regulations in most of the countries shielded the banks from the forces of competition. This policy was advocated keeping the '*safety and soundness*' aspect of the banking institutions

in mind. The market imperfection, however, led to operational inefficiency in the banks as under the administered interest regime, they could earn adequate spreads to cover their high operational costs. Consequent to various developments covering *inter alia* the tremendous growth in information technology which dismantled the geographical boundaries and the prolific growth of the non-bank financial companies which made a dent on the banks' assured clientele, the competitive environment in the banking industry has increased.

Changes in the banking policy further facilitated the creation of a competitive environment. Deregulation of the banking industry through the abolition of administered rates for deposits and loans gave the banks the freedom in fixing prices for their products. To compete effectively with non-bank intermediaries, the banks were permitted to undertake newer activities like investment banking, securities trading and insurance business though on a selective basis. The number of players in the market was increased by easing entry barriers. In this set up, margins on traditional banking business declined, prompting the banks to look for more fee-based services and simultaneously, the banks were forced to pay maximum attention to operational efficiency so that their transaction costs remained at the minimum. Increased competitiveness led to inevitable changes in the market. The weak players were either crowded out or they were amalgamated with the strong ones.

In India, till the eighties, the banks were operating in a protective environment characterised by administered interest rates, high levels of pre-emptions in the form of reserve requirements and directed credit. Banking sector reforms were initiated in India in 1992 against the backdrop of challenges faced by the Indian banks from within and outside the banking system in the country as well as forces of globalisation operating worldwide. The accent of the reform process was to improve productivity and efficiency of the financial system. The major policy initiatives taken under the financial sector reform included a planned reduction in the level of statutory pre-emptions and a gradual deregulation of interest rates. As part of the financial sector reforms, effective pre-emption level has been brought down from 54 per cent to less than 35 per cent. The structure of administered interest rates has been almost totally dismantled. Competition among the banks was sought to be fostered by two different policy measures. First, with the amendment of the Nationalisation Act, State owned banks were allowed to access the market to raise funds from the public. Having public as part of the ownership of the bank makes it more conscious of the need to run the institution efficiently and earn profits. Accountability in that sense increases. Secondly, new banks in the private sector were allowed to be set up and the entry of foreign banks was liberalised. The decision to allow the setting up of Local Area Banks was taken with the purpose of creating a more competitive environment in rural and semi-urban areas. Simultaneously with the deregulation measures, capital adequacy measures and prudential norms relating to income recognition, asset quality and provisioning requirements were introduced so as to strengthen the safety and soundness of the banking system.

> Till the eighties, banks were operating in a protected environment.

Induction of information technology and communications networking system is set to change the operating environment of banks drastically. Technology has already enabled some of the banks to introduce innovative products to their customers in the

Information technology and communication networks have changed the operating environment of banking.

form of ATM facility, telebanking, homebanking, *'anytime'* and *'anywhere'* banking. Technology can also be harnessed in automating and networking the branches that will ensure timely flow of information and aid decision making process. A proper Management Information System (MIS) can make a major impact on the pricing of deposits, loans and other services provided by banks. The Committee on Technology Upgradation in the Banking Sector, appointed by the Reserve Bank, in its Report submitted in July 1999, has provided a medium term road map for the absorption of technology by banks and financial institutions. The banks that can adopt and absorb the new technology faster will have a competitive edge over their rivals.

While the enabling policy framework and the operating environment provide a platform for improving the efficiency of the banking sector, its ultimate success depends on how individual banks respond to the competitive environment, identify their core competencies and reposition themselves effectively. These issues have been adequately addressed by the Second Narasimham Committee (1998) and according to the Committee, will form part of the agenda of the second generation of reforms in the banking sector. One of the major factors affecting efficiency is the organisational structure of the banks. With a view to reaping full benefits of liberalisation, the organisational structures of the banks need to be studied carefully. In this context, the chain of command needs to be shortened with adequate authority delegated to the branches. This would also help to enhance efficiency. In addition to the organisational structure, the adoption of proper internal systems and methods can greatly help in the efficient functioning of the banks. Another issue that assumes importance in improving the efficiency of the banks is the human resource development. Recruiting the right people, training/retraining them on a continuous basis keeping in view the changing environment and increasing complexities, and having a remuneration/incentive structure conducive to keeping their morale high, are considered integral part of the process. Another significant factor determining competitiveness is the customer service. The realisation that customer satisfaction is essential for survival and growth has dawned on all the banks. The banks that will emerge as the winners in the impending era will be truly customer-centric banks.

In tune with the liberalisation, organisation structure of the banks needs to be changed from chain of command to the delegated system.

The above description being general in nature, it is useful to take a look at each sector of the commercial banks.

Private sector banks As shown in Fig.26.1, there are 32 banks in the private sector with 5624 branches spread across the country. The private sector banks received a shot in the arm thanks to two major recommendations made by Narasimham Committee. The recommendations are: (1) no more nationalisation of private banks, (2) there is no difference in the treatment between public sector and private sector banks. The acceptance of these two recommendations by the RBI and the resultant reforms in the financial sector helped private sector banks considerably.

Private sector banks no doubt have done well but they have neglected rural sector.

The private sector banks seized the opportunities thrown open to them. They have outperformed their counterparts in the public sector on a number of indicators like loan growth, average yield on earning assets, new provisions and operating expenses. Many of these banks are approaching capital market to raise capital to meet capital adequacy requirements and also to comply with the provisions of the RBI/SEBI.

There are criticisms nevertheless. It is pointed out that the private sector banks have neglected rural sector. Out of their total deposits, only 4 per cent comes from rural areas and together these banks lend about 2 per cent of their money to rural areas. Even in urban areas, private sector banks try to reach out to plum account holders. These banks also practice client discrimination in favour of plum customers by extending customised products, free bank lockers, invitation to events, access to treasury instruments, personalised banking, and telebanking.

Foreign banks As the Fig.26.1 shows there are 36 foreign banks with 204 branches spread across major cities in the country. These are called foreign banks as they are incorporated outside India but have operations in India.

Foreign banks have brought in, along with them, a fresh air into the banking sector in India. Their new technology, professional management practices and innovative products have greatly helped Indian banking improve their functioning.

> Foreign banks have brought in fresh air into the banking sector in India.

The flip-side of foreign banks should not be overlooked. They have created a hype around them claiming that they are the 'best' in the industry. Appearance of their buildings, their infrastructure, the dress their employees wear, the language the employees speak and the parties they attend seem to justify their claim.

What does this hype mean to an ordinary account holder? Who can open an account in a foreign bank in the first place? An ordinary citizen having salaried income is not welcome to open an account. Only elite can do. Account being opened, one needs to keep a minimum balance which varies from Rs.25,000 to Rs.1,00,000.

> Foreign banks have succeeded in creating a hype around them.

The customers are not happy either. The personal touch which you receive when you go to a nationalised bank to draw or deposit money is lost in a foreign bank. For withdrawal, you need to stand in a que near ATM. You are not encouraged to go to the bank for withdrawing cash. You are harassed if you become a loanee. Service charges are too heavy. Still people prefer foreign banks as they carry snob value.

Foreign banks have made huge profits. But these profits have come not from traditional banking but from treasury operations, portfolio management, ATMs and plastic money. The profits earned by foreign banks are seldom used for the development of Indian economy. If foreign banks are shining well, largely blame lies with the RBI. While giving licences to new branches, foreign banks are encouraged to establish branches in metropolises, but Indian banks are advised to disperse and locate new branches in rural areas. And rural branches are not that profitable ones.

> RBI permits foreign banks to open branches in cities, Indian banks are advised to open branches in rural areas.

FISCAL POLICY

Fiscal policy refers to the policy of the government regarding taxation, public expenditure and public debt. There is a general belief, from Keynes in the thirties, that the governments can influence business activities through fiscal measures. Inspired by this belief, governments all over the world have been using fiscal measures to regulate their economic and business activities in order to achieve such objectives as:(1) accelerating the rate of investment; (2) promoting socially desirable investment; (3) achieving rapid economic

> Fiscal policy refers to government's policy towards revenue, debt and expenditure.

development; (4) achieving full employment; (5) promoting foreign trade; (6) reducing inequalities of income and (7) establishing a welfare state.

The Budget

Fiscal policy operates through budget. Budget refers to a set of papers containing financial matters.

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

The budget simply means an estimate of revenue and expenditure. In its true sense, budget is not only *"a plan of revenue and expenditure but the entire condition of material finances as disclosed in the ministerial statement placed before the legislature and orderly administration of the financial affairs for the government"* (F.Shirras). A more comprehensive definition is given by Philip V. Taylor when he says that *"Budget is a master financial plan of the government. It brings estimates of anticipated revenues and proposed expenditures, employing schedule of activities to be undertaken towards the direction of national objectives. It is a device for consolidating various interests, objectives, desires and needs of the people into a programme whereby they provide for their safety, convenience and comforts"*.

The Union Budget

Budget approval is a big exercise because without it (i) no tax can be levied, (ii) no expenditure can be incurred, and (iii) government can spend only on approved items.

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

In deference to the provisions of the Constitution, our government has been preparing annual budgets, placing them before Parliament, getting its approval and spending and raising revenues as stipulated in the yearly budgets.

The work of preparing the Union budget begins in the month of August every year and after finalisation, it is presented to the Parliament on the last day of February. The budget is generally presented by the Finance Minister in the name of the President of India. The budget speech of the Finance Minister is of great importance and is eagerly awaited by the finance and business circles as it contains information about fresh taxes and proposals relating to expenditure. No discussion is allowed on the date of presentation of the budget. Discussion follows on later dates and then the budget demands are put to a vote. When the budget is passed by the Parliament, it goes to the President for his assent. The tax proposals of the budget are embodied in another Bill which is passed as the Finance Act of the year.

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

The receipts and expenditure of the government are audited by the Comptroller and Auditor-General in order to ensure that the executive has spent the appropriated money in accordance with the wishes of the legislature. The office of the Comptroller and Auditor-General came into being in 1913. The Government of India Act, 1935, gave the office constitutional recognition (Article 141).

The budget is divided into two parts, *viz.*, (a) revenue budget and (b) capital budget. The revenue budget deals with revenue receipts, which include receipts from taxes, interest receipts and dividends and profits and revenue expenditure which is mainly on administration. The capital budget is the statement of all capital expenditure and capital receipts which include market loans, external aid, deposits and provident funds. Table 26.6 contains budgetary positions of the Government of India from 1969-70 to 1997-2000. The budgetary position includes both revenue budget and capital budget.

Two parts make up the union budget: (a) revenue, (b) capital. First deals with revenue receipts and expenses and the second covers capital receipts and expenses.

Trends in Revenue

It is useful to analyse the trends in resources and expenditure over the years. For simplicity sake, we take the Union budgets only.

Taking the resources first, it may be stated that the demand for them has been growing since the government is committed to realise the objectives of the fiscal policy stated above. In addition, there have been other demands on public authorities: (i) the demand for resources continues to grow with growth in population which in turn necessitates increased expenditure on education, health, family welfare and the like; (2) ever increasing inflation adds to the demand for resources and (3) increase in defence expenditure since early 1960s.

With such a large demand to be met, the fiscal authorities are forced to raise resources from varied channels - both internal as well as external. Over the years, dependence on external sources has been sought to be given up. The government is increasingly relying on domestic sources. Domestic sources include taxation, market borrowings, deficit financing, surpluses of PSEs, retained earnings of the RBI and balance from current revenue at the pre-plant tax rates. Of these, the first three have been principal sources, although deficit financing has not been favoured as a source of finance.

Taxation has been receiving increasing attention to raise resources. Authorities use taxation to realise certain socio-economic objectives such as: (i) to raise revenue to finance the public sector projects without severely affecting saving and investment of the private sector; (ii) to spread tax burden on different sections of the society so as to minimise inequalities in incomes and wealth; (iii) to discourage conspicuous consumption by sections of the society; (iv) to divert investment from capital-intensive and luxury goods industries to labour-intensive and essential goods industries and (v)to mop up excess profits[3].

In order to achieve the objectives stated above, both central and state governments have taxed the citizens extensively and intensively. The taxes cover *almost all tax bases*-income, wealth, property, comsumption, transfer of income and property, capital gains, intermediary transaction of goods, exports and imports. Table 26.6 shows sources

of tax revenue. As to the *intensification* of taxation, a successful attempt has been made to make both direct and indirect taxation fairly progressive.

Table 26.6

Growth and Composition of Total Union Budgetary Deficits

(Rs. crores)

	IV Plan 1969-70 to 1973-74	V Plan 1974-75 to 1978-79	VI Plan 1980-81 to 1984-85	VII Plan 1985-96 to 1889-90	1990-92	VIII Plan 1992-97	IX Plan 1997-2002	X Plan 2002-2007
1. *Deficit (-) or Surplus (+) under Revenue Account*	+411.20	+2671.70	-9157.70	-46905	-11439	-145875	[illegible]	-217004
2. *Deficit under Capital Account*	-2433.90	6327.90	-1629.10	+9557	+12946	+107680	[illegible]	+217004
3. *Total Budgetary Deficit*	-2046.30	-3656.20	-10786.80	-37348	-16497	-38195	[illegible]	

The following features are observed in our tax system:

(i) The tax base is narrow both for direct as well as indirect taxes.

(ii) There has been a progressive increase in indirect taxation (see Table 26.7).

(iii) Tax structure has been fairly progressive.

(iv) The tax burden on non-agricultural sector is higher as compared to that of the agricultural sector.

(v) Tax burden has been heavy.

However, in the post-liberalisation era, significant changes took place in our tax system. More important of them are:[4]

Post liberalisation witnessed significant developments: (i) tax structure and tax levies are simplified, (ii) better tax administration, and (iii) long term fiscal policy.

(i) Simplification of tax structure and tax laws;

(ii) Better tax administration and the rationalisation of the tax rates;

(iii) Long-term fiscal policy that removed uncertainty of tax changes;

(iv) Increased reliance on fiscal and monetary measures as opposed to physical controls and planning and

(v) Attempts to realise economies in government's current expenditures.

Trends in Expenditure

Expenditure of the government may be revenue expenditure and capital expenditure. Revenue expenditure includes expenditure on social and community services, economic services and grants-in-aid to the state governments. Capital expenditure includes expenditure on general services, social and community services, economic services and loans and advances.

Government expenditure may also be classified as developmental and non-developmental. The first includes expenditure on social and community services,

Table 26.7

Sources of Tax Revenue

	1990-91		1991-92		1992-93		1993-94		1994-95		1995-96		1996-97		1997-98		1998-99	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B
*Direct taxes**	19.1	2.1	22.6	2.5	24.8	2.6	26.8	2.5	28.4	2.7	29.2	2.9	29.4	3.2	29.8	3.6	30.9	2.9
Personal tax	9.3	1.0	10.0	1.1	10.6	1.1	12.0	1.1	12.2	1.2	13.0	1.3	13.8	1.5	14.4	2.0	13.6	1.3
Corporate tax	9.3	1.0	11.7	1.3	11.9	1.3	13.3	1.3	14.7	1.4	14.9	1.5	14.4	1.5	14.2	1.5	15.9	1.5
Indirect taxes	78.9	8.5	75.5	8.3	73.7	7.8	71.6	6.8	71.4	6.8	70.6	7.0	70.6	7.4	70.2	6.5	69.1	6.5
Customs	35.9	3.9	33.0	3.6	31.9	3.4	29.3	2.8	29.4	2.8	28.4	2.8	33.5	3.6	34.3	2.9	30.3	2.9
Excise	42.6	4.6	41.7	4.6	41.3	4.4	41.8	4.0	41.1	3.9	41.2	4.1	35.6	3.6	34.0	3.4	36.2	3.4
Gross tax revenue	100.0	10.8	100.0	10.9	100.0	10.6	100.0	9.5	100.0	9.5	100.0	9.9	100.0	10.6	100.0	10.1	100.0	9.4

* Includes expenditure, interest, gift tax and estate duties
A=as a percentage of gross tax revenue B=as a percentage of GDP.

Government expenditure may be developmental and non-developmental. Developmental expenditure includes spending on social and community services and non-developmental items include payments towards interest, spending on defence and the like.

economic services and grants-in-aid to state governments and union territories for developmental purposes. Non-developmental expenditure includes the amount spent on defence, interest payments etc.

Expenditure of the government has been increasing from year to year. The total expenditure during 1990-91 was Rs.105,298 crore. It went up to Rs.202,024 crore in the year 1996-97. As the percentage of GDP, the expenditure has gone up from 11.1 percent in 1950-51 to 32.5 percent in 1995-96.

Reasons for increase in public expenditure are too obvious. In the last couple of decades, government machinery expanded considerably because of the socialist philosophy sought to be pursued by the government. According to one research[5], the reasons for the growth of public expenditure are- ideology, bureaucratic controls, demographic changes, income elasticity of public goods, increasing cost of government production, foreign aids, etc.

Evaluation of Fiscal Policy

The effectiveness of our fiscal policy can be assessed from three angles: (a) fiscal policy and savings and capital formation, (b) fiscal policy and economic inequalities, and (c) fiscal policy and inflation control. With reference to the first item, it may be safely concluded that fiscal policy has failed to produce enough savings for public investment. Financial crunch has become a standard excuse to avoid or postpone project implementation. With regard to the impact of public revenue and public expenditure on minimising income inequalities, less said the better. Over the years, the chasm between the rich and the poor has widened. For example, in 1992, the top 20 per cent of the population accounted for more than two fifths of the total consumption expenditure, while the bottom 20 per cent had a share of just 8.5 per cent of the total consumption. In the same year, the top 10 per cent of our population spent eight times as much as the bottom 10 per cent. The tax system has, obviously failed to rob Peters and public expenditure has failed to pay Pauls. Finally, fiscal policy has been successful in controlling inflation. The rate of inflation during the last couple of years has been lovering around five percent – a good sign indeed.

Agenda for Future

Fiscal reforms were included as a part of economic reforms initiated since 1991.

The fiscal reforms must be an ongoing process. In the years to come, our approach to fiscal policy must be-

(i) Completion of the tax reform agenda

(ii) Curb wasteful expenditure

(iii) Minimise budgetary allocations to public sector undertakings

(iv) Adopt a new approach to administered prices

(v) Reduce and redirect subsidies

BUDGET HIGHLIGHTS

(in crore of rupees)

	2003-2004 Actuals	*2004-2005 Budget Estimates*	*2004-2005 Revised Estimates*	*2005-2006 Budget Estimates*
1. **Revenue Receipts**	263878	309322	300904	351200
2. Tax Revenue (net to centre)	186982	233906	225804	273466
3. Non-Tax Revenue	76896	75416	75100	77734
4. **Capital Receipts (5+6+7)**	207490	168507	204887	163144
5. Recoveries of Loans	67265	27100	61565	12000
6. Other Receipts	16953	4000	4091	...
7. Borrowings and other liabilities	123272	137407	139231	151144
8. **Total Receipts (1–4)**	471368	477829	505791	514344
9. **Non-Plan Expenditure**	349088	332239	368404	370847
10. **On Revenue Account of which**	283502	293650	296396	330530
11. Interest Payments	124088	129500	125905	133945
12. On Capital Account	65586	38589	72008	40317
13. **Plan Expenditure**	122280	145590	137387	143497
14. On Revenue Account	78638	91843	89673	115982
15. On Capital Account	43642	53747	47714	27515
16. Total Expenditure (9+13)	471368	477829	505791	514344
17. Revenue Expenditure (10+14)	362140	385493	386069	446512
18. Capital Expenditure (12+15)	109228	92336	119722	67832
19. **Revenue Deficit (17-1)**	98262 (3.6)	76171 (2.5)	85165 (2.7)	95312 (2.7)
20. **Fiscal Deficit [16-(1+5+6)]**	123273 (4.5)	137407 (4.4)	139231 (4.5)	151144 (4.3)
21. **Primary Deficit (20-11)**	-816 (0.0)	7907 (0.3)	13326 (0.4)	17199 (0.5)

Direct Taxes

- Income tax brackets and rates revised as follows:

Upto Rs.1 lakh	Nil
Rs.1 lakh to Rs.1.5 lakh	10 per cent
Rs.1.5 lakh to Rs.2.5 lakh	20 per cent
Above Rs.2.5 lakh	30 per cent

- Ten per cent surcharge to be levied on income beyond Rs.10 lakh.
- Threshold exemption level for women raised from Rs.1 lakh to Rs.1.25 lakh and for senior citizens to Rs.1.5 lakh.

- Standard deduction abolished.
- All tax payers allowed a consolidated savings limit of Rs.1 lakh, which will be reduced from the income before tax calculation.
- All other sectoral caps removed. Rebates under Section 88 and 80L eliminated.
- Deductions to continue on housing loan interest, medical insurance premia, specified expenditure on dependent, expenses for medical treatment, interest on loans for higher studies and deduction for a person with disability.
- Experts committee to work out the roadmap for moving towards an exempt exempt tax (EET) system for all savings.
- Exemption on interest earned on accounts of non-resident Indians to continue.
- Benefits enjoyed collectively by the employees, not attributable to individuals, to be taxed in the hands of the employer. New tax at 30 per cent to be called fringe benefit tax (FBT).
- Transport services for staff and canteen services to be out of the FBT net.

Corporate Taxes

- Corporate income tax for domestic companies at 30 per cent plus 10 per cent surcharge.
- No change in the tax regime for foreign companies.
- General machinery and plant to attract depreciation at 15 per cent, but the initial depreciation rate hiked to 20 per cent.
- The requirement of 10 per cent increase in installed capacity for availing the benefit of initial depreciation removed.
- Withholding tax on technical services reduced from 20 per cent to 10 per cent.
- Credit to be allowed for Minimum Alternate Tax (MAT) paid under Section 115 JB of the Income Tax Act.
- Terminal date for exemptions given for specific purposes extended from March 31, 2005 to Mach 31,2007. These include weighed deduction of 150 per cent of expenditure on inhouse research and development in notified sectors like biotech, pharma and electronics; deduction of profits of new undertakings in Jammu and Kashmir and 100 per cent deduction of profits of companies carrying on research approved by the department of scientific and industrial research.
- Extension of tax exemption on agreements to acquire aircraft or aircraft engines on lease upto September 30, 2005.
- Securities transaction tax (STT) raised from 0.015 per cent to 0.02 per cent for all categories of transactions.
- Trading in derivatives in specified stock exchanges not to be treated as speculative transactions for income tax purpose.

Anti-Tax Evasion Measures

- Mobile telephones removed from the one-in-six criterion for filing income tax returns. Instead, payment for electricity charges of over Rs.50,000 per year included in the list.
- Tax of 0.1 per cent on cash withdrawals from banks of over Rs.10,000 in a single day.
- Banks to report all deposits exempt from TDS on interest.
- Large tax payer units (LTUs) to be set up in major cities. Help centres also to be set up for small tax payers.

Indirect Taxes

CUSTOMS

- Peak rate for non-agricultural products down from 20 per cent to 15 per cent. Other slabs put at 10 per cent, five per cent and zero.
- Duty on textiles machinery and refrigerated vans down from 20 per cent to 10 per cent.
- Duty on seven specified machinery used in leather and footwear industry down from 20 per cent to five per cent; and that on ethyl vinyl acetate used in this industry down to 10 per cent.
- Duty on nine specified machinery used in pharma and biotech sectors cut to five per cent.
- Duty on printing presses and battery operated road vehicles cut to 10 per cent.
- Duty on primary and secondary matters lowered to 10 per cent and on industrial raw materials like catalysts, refractory raw materials, basic plastic, molasses and industrial ethyl alcohol down to 10 per cent. Duty on lead and coking coal with high ash cut to five per cent.
- Duty on polyester and nylon chips, textile fibres, yarns and intermediates, fabrics and garments cut to 15 per cent.
- Duty removed on capital goods and inputs for information technology agreement-bound items but a countervailing duty of four per cent levied on those items that attract nil duty.
- No change in duty on agricultural goods, except a hike in duty on cut flowers to 60 per cent and reduction in duty on cloves to 35 per cent.
- Duty on atmospheric drinking water down to five per cent.

EXCISE

- For small-scale industry (SSI), the annual turnover ceiling for claiming exemption from excise duty raised from Rs.3 crore to Rs.4 crore.
- More goods brought under the Cenvat rate of 16 per cent. These include polyester filament yarn, tyres and air conditioners.
- Duty on motor cars and aerated drinks to continue at 24 per cent.

- In the textiles sector, independent texturisers given option to avail of the exemption route or pay eight per cent excise duty with Cenvat credit.
- Surcharge of Re.1 per kg on tea abolished.
- Duty of Re.1 per kg on refined edible oils and Rs.1.25 a kg on vanaspati abolished.
- Duty on iron industry cut to 16 per cent.
- Duty on molasses raised from Rs.500 per tonne to Rs.1000 per tonne and on cement clinkers from Rs.250 per tonne to Rs.350 per tonne.
- Duty rates on cigarettes raised by 10 per cent.
- Ten per cent surcharge imposed on ad valorem duties on other tobacco products including gutkha, chewing tobacco, snuff and pan masala.
- Bidis continue to be exempted from levy.

Taxes on Petroleum Products

- Cess on petrol and diesel raised by 50 paise a litre to fund the National Highways Development Project.
- Customs duty on crude petroleum reduced from 10 per cent to five per cent.
- No excise or Customs duty on LPG for domestic consumption and on subsidised kerosene.
- Customs duty on other petroleum products, including motor spirit and diesel, down from 20 per cent and 15 per cent to 10 per cent.
- Excise duty on petrol and diesel to be fixed as a combination of ad valorem and specific duties.
- Duty drawback rates for exported goods to be reviewed and modified by April 30.

Service Tax

- Tax rate maintained at 10 per cent but new services added to the list and small service providers spared of tax.
- Service providers with gross turnover not exceeding Rs.4 lakh a year exempted from tax.
- New services brought under tax net include pipeline transport of goods, site formation, demolition and related services, membership fees of clubs and associations, packaging and specialised mailing services, survey and map-making, dredging in rivers and harbours, cleaning services for commercial buildings and construction of planned residential complexes with over 12 dwelling units.

QUESTIONS

1. Define Monetary Policy. What are its objectives?
2. What are credit control measures of the RBI? Explain each in brief.
3. Critically examine the working of monetary system in our country.

4. What is fiscal policy? What are its objectives?
5. What is a budget? Why is it so important?
6. Bring out the nature and operations of money market.
7. Comment on the Union Budget 2000-2001.

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CHAPTER

27

Agriculture

CHAPTER OUTLINE

Role of Agriculture

Extent of Farm Output

Problems

Agenda for Action

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Appreciate the role agriculture has played in our country*
2. *Give data substantiating the production of foodgrains*
3. *Enumerate the problems confronted by the farm sector*
4. *Lay down a plan of action for policy makers with respect to agriculture*

The agricultural sector is a major component of our economic environment. Hence, a discussion of the role of agriculture, its problems and the challenges is in order.

ROLE OF AGRICULTURE

For several reasons, agriculture is crucial for our national economy.

1. 24.5(2002-03) per cent of our GDP comes from agriculture alone. It was around 57 per cent in the beginning of 1950s. With gradual industrialisation, the share of agriculture has declined and it is what it should be. As an economy prospers, the share of agriculture in the GDP declines giving place for secondary and tertiary sectors (see Table 27.1).

Agriculture contributes to a major chunk (24.5%) of India's GDP.

Table 27.1

Sectoral shares of GDP (In GDP at factor cost at 1980-81 prices)

	Agriculture	*Industry*	*Services*
1980-81	38	26	36
1990-91	31	30	39
1992-93	30	29	41
1994-95	29	30	41
1996-97	26	31	43
1997-98	24	31	44

2. Agriculture is the backbone for any country's economic development. It is a popular belief that economic development takes place because of rapid industrialisation. But industrial development itself cannot take place without agriculture. Specifically, agriculture contributes to economic development in atleast four ways: (i) product contribution, i.e., making available food and raw materials; (ii) market contribution, i.e., providing the market for goods produced by other sectors; (iii) factor contribution, i.e., making available labour and capital to the non-agricultural sector and (iv) foreign exchange contribution.[1]

Industrial production precedes economic growth. Agriculture precedes industrial growth.

3. Gunnar Myrdal pointed out emphatically that "it is in the agricultural sector that the battle for long-term economic development will be won or lost." Traditionally, the role of agriculture in economic development has been viewed as passive and supportive. Based on the historical experience of Western countries, economic development was seen as requiring a rapid structural transformation of the economy from one predominantly focussed on agriculture activities to a more complex modern industrial and service society. As a result, agriculture's primary role was to provide sufficient low priced food and manpower to the expanding industrial economy, which was thought to be the dynamic "leading sector" in any overall strategy of economic development.

Gunnar Myrdal said that it is in the agricultural sector that the battle for long-term economic development will be won or lost.

But today economists are less sanguine about the desirability of placing such heavy emphasis on rapid industrialisation. They have come to realise that far from

playing a passive, supporting role in the process of economic development, the agricultural sector must play an indispensable part in any overall strategy of economic progress, specially for the 61 low-income developing countries.[2] Such is the role of agriculture in economic development of a country.

In the last couple of decades, people should have got absorbed in industry. This did not happen people still depend on agriculture.

4. Agriculture has been a major source of livelihood for our people. A large percentage of the working population (more than 70% see Table 27.2) is engaged in agriculture. As the economy progresses, the dependence on agriculture for livelihood must decline and more and more people must get absorbed in secondary and tertiary sectors. This has not happened in our country as is evident from Table 27.2. This only shows how dependent people are on agriculture.

Table 27.2

Distribution of Employment by Broad Economic Sectors

Sectors	Total		Male		Female	
	1981	1991	1981	1991	1981	1991
Primary	69.4	67.3	66.2	63.4	81.5	81.0
Secondary	16.6	14.5	17.2	15.3	13.7	7.7
Tertiary	17.7	20.5	19.7	23.3	12.0	10.8

Agri exports amount to Rs.10000 crore per annum.

5. Agriculture plays an important role in our international trade too. The main agricultural commodities which are exported are tea, oil cakes, fruits and vegetables, spices, tobacco, cotton, coffee, cocoa, sugar and sugar products, hides and skins and other varieties of animal hair and vegetable oils. Agri exports now amount to Rs.10,000 crore per annum. The figure is expected to rise to Rs.15,000 crore in the near future.

6. Fluctuations in agricultural output play a key role in the state of the national economy. Rural consumption of industrial goods is nearly three times that of urban consumption. As a matter of fact, the current spurt in the rural consumption of durable goods has led to a redefinition of consumer demographics itself. Obviously, there is a direct relationship between agricultural production and income and the demand for industrial goods. Similarly, performance in agriculture also influences total demand *via* government savings and public investments. For example, a rise in agricultural production results in increased government savings both as a result of the buoyancy of government revenues and reduction in expenditures like drought relief which might otherwise become necessary.[3]

Since agriculture is the main contributor to national income, this sector is also the primary source of savings, and hence capital formation. Rate of capital formation has a major impact on economic growth.

7. Agricultural sector has transformed itself dramatically during the last few decades. Throughout the past century, some of the most vivid images of India were drawn against the backdrop of its farm sector. Most of them were depressing. They depicted famines, relentlessly unchanging bullock-cart economies, undressed and under nourished humans - mostly bonded labour - parched lands fed partly by water - wheels, and a lazy unchanging haze of heat and dust. Such imagery acquired archival value in the second half of the

20th century, particularly the last 30 years, and Indian agriculture underwent a profound transformation.

As pointed out once by J.K. Galbrath, the most significant development that took place in our economy during the past four decades relates to the farm sector. From the position of a net importer of foodgrains, our country has now reached the stage of self-sufficiency. With an annual production of more than 190 million tonnes of foodgrains and overflowing buffer stocks, the problem now is one of storage and not of shortages.

Because of green revolutions we have surplus stocks of foodgrains. The problem now is one of storage and not shortages.

In the year 1960-61, we were depending heavily on PL-480 food and oil imports. We have come a long way since then, having made rapid strides in agriculture, both in the matter of inputs as well as output.

8. Going away from Indian economy, agriculture has its impact on work discipline, power structure and behaviour of peasants (see box 27.1).

Box 27.1

Agriculture and Society

Every society imposes its own distinct work discipline or 'regimen.' Workers are supposed to obey certain rules, often unspoken. Their performance on the job is maintained, polished and a structure of power is in place to enforce the rules.

In First Wave or agricultural societies, most peasants toiled endlessly, yet barely survived. This agrarian work force, organised into family production teams, followed a regimen set by the rhythms of season, sunrise and sunset.

If a peasant was absent or lazy, his own relatives disciplined him. They might ostracise him, or cut his food rations. The family itself was the dominant institution in society, and exceptions aside, it imposed the work regimen. Its dominance over the individual family member was reinforced by social pressures from the villagers.

Local elites might hold the power of life and death over the peasantry. Tradition might restrict social, sexual, and religious behaviour. Peasants often suffered the cruelest hunger and poverty. And yet in their daily work lives, they seemed less minutely restricted than those in the small but growing industrial labour force.

The agrarian work regimen had lasted for millennia, and until only a century or two ago, the vast majority of human beings knew no other and assumed it to be the only logical and eternal way of organising work.

(Source: Alvin Toffler, *Power Shift*, p.207).

EXTENT OF FARM OUTPUT

Indian agriculture has attained both stability and resilience. Output of foodgrains has been increasing from year to year as is evident from Table 27.3. and Fig 27.1.

More than 75 per cent of the total output during 1994-95 is accounted for by two crops, *viz.*, rice (43 per cent) and wheat (32 per cent). The remaining 25 per cent has been contributed by coarse cereals (17 per cent) and pulses (eight per cent).

Table 27.3

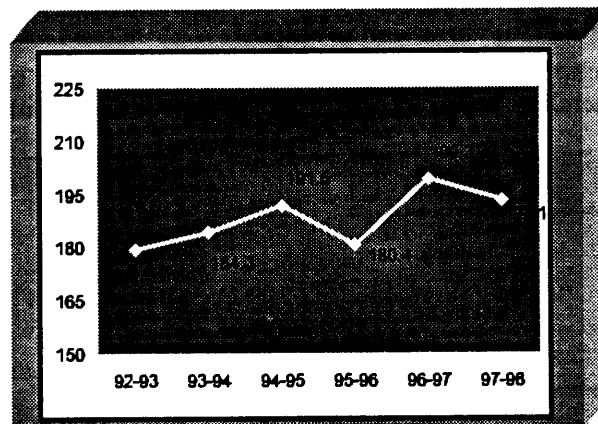
Output of All Foodgrains

	(million tonnes)
1992-93	179.5
1993-94	184.3
1994-95	191.6
1995-96	180.4
1996-97	199.3
1997-98	193.1

(**Source**: *The Hindu Survey of Indian Agriculture*, 1999)

Figure 27.1

Foodgrains Production



The net availability, per capita per day, of foodgrains increased from 395 kg in 1951 to 470 kg in 1994-this was despite the rise in population. This growth has been achieved mainly from domestic production. We hardly depend on imports which, infact, came down from 2.6 m.tonnes per year during the Seventies and to 4.4 lakh tonnes during the Eighties. Droughts or floods need to be well managed without any panic or large scale imports. Something skategic needs to be done to combat the drought situation which is being faced in Gujarat, Orissa and Madhya Pradesh.

PROBLEMS

Farm productivity is very low.

Agricultural sector is beset with serious problems. Some of them are stated here.

(i) Productivity in the primary sector is very low as shown in Tables 27.4, 27.5 and 27.6.

Many factors have contributed to low productivity in agriculture. More important of them are: (a) too many people depend on agriculture, (b) rural environment is not conducive for modernisation of agricultural activities, (c) small size holding, (d) poor techniques of production, and (e) inadequate irrigation facilities.

(ii) Though the total output has increased, the output of crops, other than rice and wheat, has stagnated. While pulses and coarse grains have registered no growth, the shortfall in oilseeds output *vis-a-vis* the demand has necessitated heavy import of edible oils.

Table 27.4 *A View of Indian Agricultural Productivity*

	World Rank	
	Output	*Yield*
Rice	2	54
Wheat	2	38
Groundnut	1	72
Rapeseed	2	33
Tobacco	3	42

(**Source**: Arun Kumar Jain, *Managing Global Competition*, 1994, p.156).

Table 27.5 *Production of Rice, Paddy*

Country	*Area (million hectares)*	*Output (million tones)*	*Yield (Kgs per hectare)*
India	42.30	122.24	2890
China	31.85	192.97	6059
Indonesia	11.20	46.29	4133
Vietnam	7.09	27.65	3899
Pakistan	2.33	6.59	2827
Japan	1.95	12.53	6416
U.S	1.29	8.18	6364

(Figures relate to 1998)

(**Source**: Food and Agriculture Organisation)

Table 27.6 *Land Productivity in Developed and Developing Countries, 2000*

Country	*Average grain yield (kgs per hectare)*	*Population (million)*
U.K.	6,975	60
Japan	5,971	127
U.S.	5,794	278
Indonesia	3,915	207
Bangladesh	2,786	128
Mexico	2,640	97
India	2,293	998
Pakistan	2,255	135
Nigeria	1,208	124
Congo	781	50

(**Source:** MiChael P.Todaro ard Stephen C.Smith, *Economic Development*, p.425)

(iii) The wide regional disparities in the impact of the green revolution and consequently in the output, still persist. While Punjab and Haryana have almost 90 per cent of the area of rice and wheat under HYV, it is less than 40 per cent in some of the Eastern states. A major portion of our agriculture

The impact of green revolution has not evenly spread across the country.

is still operated under rainfall conditions which has also affected the consumption of fertilisers. Inspite of the heavy investment on irrigation and the tall talk about its achievement, 70 per cent of the cropped area still depends on rainfall and grows such important crops as coarse grains, pulses and bulk of cotton.

(iv) Over the years there has been a decline in public investment in agriculture. Resources for higher public investment can only become available if the current large subsidies on agricultural inputs can be scaled down. Cutting down subsidies tends to invite public wrath.

Since the early years of planning, primacy was accorded to capital accumulation by the state which also meant relative neglect of public investment in agriculture. This relative neglect of agriculture was supported by the prevailing view that a growing labour force in developing countries could only be absorbed in industry, and that in the early stages of the industrialisation, it was necessary for agriculture to contribute to the building up of modern industry by providing cheap labour. A faster development of the industrial sector was the central objective of planning.[4]

(v) Large increases in procurement and minimum support prices of foodgrains have undoubtedly strengthened production incentives for these crops. But they have also contributed to general inflation through large increases in the prices of wage goods and diversion of foodstocks from private trade to the Food Corporation of India (FCI), with its attendant high unit costs of storage, handling and distribution. Rising prices for foodgrains particularly have adverse consequences for the poorest segments of rural population, most of whom have very limited access to the Public Distribution System (PDS).

(vi) In the course of half a century of development during 1947-97, the share of agriculture in India's GDP fell from 59 per cent to 31 per cent. Yet, the share of India's population engaged in it has come down relatively marginally during the same period - from 71 per cent to 63 per cent. This implies that industry - led growth philosophies did not yield expected results. The notion that industrial growth will provide remunerative alternative work in the farm sector has been belied. Even at the threshold of the new millennium, the unchanging truism is that the vast majority of Indians are sustained entirely by the agricultural sector. Growth in Indian agriculture would have to develop several times to bring any reasonable well being to them.

(vii) Agriculture suffers from large scale distortions the in pricing of critical inputs such as power, water, fertilisers and credit. These are being provided to farmers at prices that are much below their cost of supplying or their opportunity costs. This leads to huge economic inefficiency in the use of resources on the one hand, and bankruptcy of input supplying agencies on the other, jeopardising further investments in those sectors. In the early 1990s, for instance, for every rupee of planned expenditure in agriculture, there was one and a quarter of a rupee that was being doled out as subsidies through underpricing of inputs. This clearly reveals that input subsidies are eating into the investments in agriculture.

There are large scale distortions in pricing of agricultural inputs.

(viii) Agriculture, right from the beginning, enjoyed high priority, but agriculture exports were discouraged or banned altogether, which had the effect of reducing farmers' income.[5]

The winds of globalisation have been deliberately kept away from touching the farm sector. Government frowns harshly at imports as well as the exports of most farm products. Foodgrains, which are the largest product segment of our agriculture, are the most regulated. Imports of these items are tightly controlled by canalising agencies, the only exception being pulses which can be freely brought into the country by anyone. Exports continue to be within the bounds of an archaic licence - the permit raj. Exports of edible oils (from oilseeds) have been virtually banned. Cotton imports were decanalised only recently, and their exports are strictly licensed. Tea and coffee can be freely exported but their imports are almost illegal.

Globalisation is kept away from agriculture.

(ix) Many agricultural reforms such as special support programmes for small farmers, strengthening of rural credit, revival of agricultural cooperatives, revitalisation of panchayats and other local bodies and the like remain only on paper. They are yet to be implemented.

(x) There are various inherent structural problems inhibiting agriculture. Numerically, agriculture is dominated by small and marginal farmers which account for 78 per cent of holdings but operate only 32 percent of the area. Land ceilings and tenancy laws promote the proliferation of small and marginal farms. Fragmented holdings do not encourage much investment on farms. They cannot reap economies of scale in marketing or in access to modern inputs or in the efficient utilisation of capital inputs.

(xi) There is very high wastage of foodgrains as shown in Table 27.7.

Estimates of waste are based on foodgrain production of 203 million tonnes during 1998-99. The calculation of the number of people who could be fed is based on the assumption of net per capita cereal availability of 451 grams a day.

The figures Table 27.7 contains is staggering: the foodgrains India wasted in 1998-99 could have fed upto 117 million people for a year or the entire country for almost six weeks. Rodents and insects alone polished off the monthly food requirement of 760 million people.

A recent estimate by the Ministry of Food and Civil Supplies puts the total preventable (post-harvest) losses of foodgrains at 10 per cent of the total production-or about 20 million tonnes a year. That's roughly the amount of foodgrain Australia produces annually. India also wastes about 30 per cent of its fruits and vegetables worth Rs.28,810 crore annually-which is more than what the UK consumes in a year.

These revelations are grim because they exhibit an upward trend in foodgrain wastage which was between 6 per cent and 7 per cent of the production till the late 1970s. They also point to a fundamental flaw in the government's policy on foodgrains which remains focussed on enhancing production with scant attention to saving what has been produced.

Table 27.7

Wastemates

Points of Wastage	Waste in million tonne	Millions of people who could be fed for a month
Transportation	0.30	20
Moisture in Storage	1.38	100
Birds' Pickings	1.78	130
Processing Losses	1.87	140
Thrashing Losses	3.41	250
Rodents in Field & Storage	5.08	380
Insects in Storage	5.18	380
Total	18.94	1400

(**Source**: Ministry for Food and Civil Supplies & *India Today* estimates)

(xii) There are problems relating to seeds and other farm inputs. Take seeds first. Often farmers are put to severe losses and hardships because of the poor quality of seeds supplied to them as Box 27.2 tells.

We fall short of targets with regard to the consumption of fertilisers. With regard to the pattern of consumption, there is disparity. In certain regions, a few crops and the rabi season account for the bulk of the fertiliser use at the cost of others.

(xiii) Finally, there has been considerable loss of biodiversity. The spread of high-yielding varieties, developed through modern plant breeding and biotechnology have resulted in the loss of biodiversity in the country. There has been a drastic reduction both in the number of plant species chosen for cultivation and such genetic homogeneity enhances vulnerability to pests and diseases. Divergent gene pools are also the feed stock necessary for the modern genetic industry.[6]

Poor quality seeds supplied to the farmers has hit the farmers badly.

AGENDA FOR ACTION

If agriculture is to record abundance; if poverty is to be abolished quickly and if the chasm between rural-urban divide is to be curtailed, agriculture must grow at the rate of about four percent. This needs action on the following lines[7]:

1. Building Institutions for People's Participation

People's participation at different levels of developmental activity is needed urgently. In particular, their due representation in the decision-making bodies of critical input supplying agencies/sectors such as irrigation, electricity, seeds and extension and in output marketing boards/committees can be a catalyst towards better resource use efficiency and higher profitability in agriculture. At present, all these bodies have a typical *'top-down'* approach for decision making and communication. They are known for inefficiency, delay and corruption.

People participation in the critical inputs-supply process is vital for agricultural growth.

The 73rd amendment to the Constitution is welcome as it has cleared decks for the empowerment of people through Panchayat Raj institutions.

Box 27.2

Monsanto told to Compensate Farmers

The district administration (Warangal in A.P.) has asked the Mahyco-Monsanto company to compensate farmers for the loss of yield due to the use of defective Bt Cotton seed supplied by the company.

The Mahyco-Monsanto sold 25,000 packets of MCH-12/MCH-162 and MCH-184 varieties of cottonseed. Each packet contained 400 gm. of seed, enough for an acre of land. Raasi company sold 26,000 packets of Bt Cotton seed. However, farmers who purchased the seed from Mahyco-Monsanto complained about poor growth and flowering and sarcospora and black arm diseases.

Following the complaints and protests by farmers from Mahabubabad division, the district administration constituted joint teams involving the mandal revenue officer, mandal agricultural officer, panchayat secretary and representatives of farmers and the company in October and collected samples from fields. The samples were then sent to agricultural research centres in Guntur and Jagitial in Karimnagar district.

The Joint Director (Agriculture), M.Laxman Rao, said scientists declared that the loss of crop was on account of soil variations, long dry spells and moisture stress and not on account of seed defect. Following disputes within the joint teams, the district administration again deputed a district-level MoU committee that inspected fields at random and collected samples.

The total yield loss was estimated between 30 per cent and 60 per cent and the average loss was placed at 45 per cent. The committee came to the conclusion that 50 per cent of the loss was due to seed defect and the rest due to natural reasons such as low rainfall, pests and diseases. The officials said on an average, the loss was 1.57 quintal per acre, of which 0.78 quintal of produce should be measured in terms of money and the same should be paid to farmers.

Accordingly, the officials concluded that the farmers lost the crop in an extent of 22,130 acres, the worth of which was Rs.3.3 crores. The committee said the company should pay the compensation.

(Source: *The Hindu*, March 6, 2005)

2. Freeing up Agricultural Markets

Markets need to be freed from middlemen.

Besides empowering farmers, another area needing immediate action relates to cleaning up all the mess that has accumulated in output and input markets over the years. First, a clean sweep is required in the domestic output markets. All controls on free movement, stocking limits, futures trading etc. must be abolished. Levies on rice and sugar should also be abolished.

On the inputs side, many of the inputs (like land, irrigation, electricity, etc) are non-tradable in nature. They, therefore, should be tackled through institutional reforms. The main tradable inputs are seeds, fertilisers, farm machinery and pesticides. Successive governments have failed to introduce any drastic reforms in their areas for political reasons. It needs a strong political will to tackle the issue of subsidies.

On the external markets, it is advisable to take an appropriate approach while the long term objective should be to replace all physical controls on the export and import of agricultural commodities by tarification. In the short run, the export market must be thrown open to agricultural products.

3. Carving an Investment Policy

While building of institutions on the lines of the participatory development model is expected to attain higher efficiency in the use of existing resources, freeing up of agricultural markets would make Indian agriculture more remunerative, thus inviting greater levels of private investments for promoting higher growth rates in agriculture. In order to ensure that this growth remains sustainable, and even accelerates, the government should carve out a comprehensive investment policy, clearly defining the roles of public and private sector investments in agriculture. As is well known, one of the problems is declining/stagnating investment in agriculture since the early 1980s. If this trend is not reversed, the aggregate supply response of agriculture to institutional changes as also freeing up of markets will remain very limited. Therefore, from the long-term point of view, it is very essential that investments in agriculture are raised.

4. Restructuring Rural Credit

There is a need for restructuring rural credit. Agriculture, falling under the priority sector, deserves 18 per cent of the total lending by commercial banks. But the actual lending still remains lower than 15 per cent. If banks and other lending agencies are reluctant to extend specified rural credit, they have justifiable reasons *viz*;

- Concessional rates of interest for the priority sector and
- High default rates in agriculture.

Both are legitimate reasons, and appropriate policy changes would have to be made if agriculture is to be ensured larger credit availability from institutional sources.

The steps needed are-

- Withdraw concessional rates of interest for agriculture gradually within a period of two to three years.
- Resort to group lending approach to check defaults.
- Loans may be lent to women where defaults tend to be less.
- Local NGOs may be involved in the lending process to exercise moral pressure on borrowers.

5. Irrigation

Next to land, water is the scarciest resource among farmers. Through its proper use, even supply of cultivable area can be augmented. The country has an ultimate irrigation potential of about 153.5 million hectares. During 1951-90, India has added 55 million hectares to its irrigation, taking the total irrigated area from 23 to 78 million hectares. This means that there is still ample scope for tapping the remaining irrigation potential. Since crop yields on irrigated lands are much higher (about two and a half times in case of foodgrains) than the yields on unirrigated lands, there is ample scope for increasing agricultural production in the years to come. But this requires proper planning and proritisation of issues relevant for the growth and efficiency of the irrigation sector.

The following may be suggested in this direction:

- Improve maintenance of existing canal network.
- Involve farmers in maintaining the canal systems from distributory level onwards.

- Leave distribution of water and collection of dues thereof to farmers' organisations.
- Introduce volumetric pricing of electricity for ground water irrigation.

6. Dry Land Farming

More than one-third of our cultivated area depends on monsoon and Mr.Monsoon is always the agriculture minister of India. The rainfed areas are characterised by cropping patterns, dominated by coarse cereals, pulses, oilseeds and cotton. The yields of these crops are generally low and fluctuate widely, revealing a high risk factor.

Mr.Monsoon has been agriculture minister of India.

One way of overcoming the above problem is to provide high priority to water harvesting and soil conservation programmes in the rainfed areas. Atleast minimum moisture is needed to raise productivity of dry land crops. To give a boost to such water harvesting schemes, they may be tied with employment generating schemes such as the Jawahar Rojgar Yojana in rural areas. Thereafter, emphasis needs to be placed on the input delivery system and the development of markets such that farmers can be assured of reasonable returns on their investments. A policy of crop insurance can also be thought of to encourage private investments on dry land farms.

It is said that dry land areas are more suitable for horticultural crops, which require less water but more investments. Credit lines need to be strengthened for encouraging horticultural crops. Besides, live stock development holds a better future in these areas than the traditional crop husbandry. Thus, the strategy for dry land areas would comprise high priority to water harvesting, soil conservation schemes and diversification towards horticulture and livestock.

7. Revitalising Research

Research is vital to introduce cost reducing technology and better seeds for cultivation. This fact seems to have not been realised in our country. The status of research in agriculture, as of today, speaks about the general apathy:

- Expenditure on agriculture research is pitiably low accounting for just 0.3 percent to agricultural GDP. In the US, it is 2 per cent to 3 per cent, and 0.7 per cent in the group of developing countries.
- Not only the percentage is too low, from year to year, the investment on research has been declining. We have failed to realise the fact that investment on research has high returns.
- The imported technology in terms of HYV seeds remained restricted to primarily irrigated areas of the north-west for almost two decades, and travelled eastwards only in the late 1980s and early 1990s. Vast areas, particularly unirrigated ones, still do not have any access to better technology.

Research outlay on agriculture is a pitiable low of 0.3 per cent of GDP.

How to reverse the trend? The following needs to be done immediately:

- Invest more on research. Use private agri-based industry to fund research.
- Government research to focus on fundamental (say in breeder and foundation seeds) and private sector to take up the production of certified seeds.
- Streamline laws relating to intellectual property rights to ensure smooth and effective co-operation between the government and the industry.

- Government research must go beyond foodgrains and focus on sunrise areas like horticultural and animal husbandry.
- ICAR to give high priority to dry land crops. Its focus in the past has confined to irrigated regions contributing to regional disparities.
- The coming revolution will be in bio-technology which our country cannot afford to miss. Biotechnology requires huge investments but yields will be greater than under HYV technology. To ensure that we get into this at the right time, ICAR must give high priority to bio-tech research.

8. No More Discrimination

In addition to the action on the seven areas suggested above, there is the need to end discrimination meted out against agriculture till now. Our agriculture has been grossly discriminated against, through a subtle but powerful instrument of trade policy. High protection accorded to the industry, past the stage of infancy, acted as a deterrent to agriculture and prevented it from growing to its full potential. Agriculture has been hit in atleast two ways: (i)Excessive protection resulted in high prices of industrial products relative to agri-products, which hurt the rural poor as consumers of industrial production. (ii) Protectionist policy increased the profitability of industrial production as compared to agricultural activities, thus shifting investments away from agriculture.

Discrimination against agriculture is revealing. Investments, as stated above, went away from agriculture. Government resorted to large scale industrialisation through its public sector enterprises. Private sector industries secured liberal credit through several public and private financial institutions. Infrastructure in terms of roads, electricity, telecom facilities, railways, etc., had a strong bias in favour of industry and urban areas. In comparison agriculture and rural areas were neglected.

This discrimination against agriculture must end.

QUESTIONS

1. Bring out the role of agriculture in the Indian economy.
2. What are the problems faced by the agricultural sector?
3. Discuss the tasks lying ahead in the agricultural front.
4. Why has agriculture been discriminated against? What are the consequences?

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CHAPTER 28

Balanced Regional Development

CHAPTER OUTLINE

Criteria for Backwardness
Causes for Backwardness and Regional Imbalances
The Problem
Measures to Remove Regional Imbalances
- *Resources Transfer*
- *Special Area Development Programmes*
- *Disposal of Industries*
- *Growth Centres*
- *Nucleus Plants and Ancillaries*
- *Banking Policy*

Failure of Regional Planning
Suggestions to Remove Regional Imbalances

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Determine criteria for backwardness*
2. *Point out the reasons for regional imbalances*
3. *Appreciate the extent of regional imbalances*
4. *Suggest remedies to remove regional disparities*
5. *Understand why regional planning has failed and suggest ways of making it successful*

Achieving balanced regional development has been one of the planks of India's economy.

One of the planks of economic development in our country has been the removal of regional imbalances, or positively put, achieving balanced regional development. After four and a half decades of economic planning where we stand in realising this objective, and in the light of the past experiences, what could be done in future are the issues worth examining. We propose to discuss these in this chapter.

Before discussing other aspects of balanced regional development, it is useful to know the meaning of the terms 'region' and 'balanced regional development'. Generally understood, a region means a state within the Union of India like Karnataka, Andhra Pradesh or another state. But for the purpose of planning, a region may be an area within a state, as for example, North Karnataka, Old Mysore and the like. It is an economic entity within a state.

Balanced regional development means the fullest development of the potentialities of an area according to its capacity so that the benefits of overall economic growth are shared by the inhabitants of all the regions. Balanced regional development does not mean self-sufficiency in each state or region. Neither does it mean equal level of industrialisation, nor a uniform economic pattern for each state. Rather, it means widespread diffusion of the industry to backward areas so far as it is economically feasible, the ultimate aim is to raise the living standards of the people in backward regions to those of the advanced. It may be through the development of agriculture, industry, trade or commerce.[1]

It was Stalin who conceived the idea of regional development.

The idea of regional planning originated with Stalin. Stalin wanted to develop each region in the former Soviet Russia in such a way that in the event of an invasion, the occupation of any region by the capitalist powers might not cripple the economic power of the country. The first Western country to recognise the problem of regional disparities was Great Britain. The British Government took its first tentative action in the field of industrial location in the 1930s when unemployment in the older specialised industrial regions of Northern England, Wales and Scotland rose to alarming levels. Two policy objectives were recognised: the alleviation of the short-run unemployment problem and the long-run need to strengthen the economic structure of the declining regions. It was assumed that both objectives could be achieved by the same policy - that of taking work to the workers, a proposition which is still largely adhered to despite strong arguments and much evidence to the contrary.[2]

In our country, efforts at removal of regional imbalances were first initiated during the Second Plan. The Second Plan admitted that in any comprehensive plan of development, it is axiomatic that special needs of the less developed areas should receive due attention. The pattern of investment must be so devised as to lead to balanced regional development. Originated during the Second Plan, the concept of regional development has been underlined by the planners in all subsequent plans.

CRITERIA FOR BACKWARDNESS

The Sixth Plan mentioned 17 criteria for determining the prevalence of backwardness. These were density of rural population, percentage of urban population to total population, percentage of Scheduled Castes and Scheduled Tribes, percentage of area irrigated, agricultural output per hectare, farm investment per cultivator household,

rural unemployment rate, consumption standards of weaker sections in rural areas, percentage of debt owed by all households to landlords and moneylenders, surfaced road mileage, percentage of villages electrified, per capita industrial output, number of persons engerged in secondary and tertiary activities per lakh of population and the like. Going by the criteria, the Sixth Plan identified the following backward areas:

(a) *High Population Density Areas in the Gangetic Plains*: These areas have a high potential for agricultural production but the potential is not fully exploited with the result agricultural yield rate tends to be low. There is heavy pressure on land due to the high density of population. The debt bondage to lands and moneylenders is quite high.

(b) *Areas With Exceptionally Low Agricultural Productivity*: Mostly found in Central and Western India, these areas fall in the drought-prone belt. Many of these areas have a high density of population with limited opportunities for non-agricultural employment.

(c) *The North-East*: The problem of this region arises partly from its remoteness from the national market and partly from the socio-cultural base.

(d) *Tribal Areas*: These are generally found in two compact blocks, one in the North-Eastern part of the country and the other in Central and Eastern India. In the former case, the problems are largely locational and social. As regards the latter, small pockets of modern industry co-exist with backward rural areas with a high rate of unemployment.

(e) *Ecological Problem Areas*: These include desert and hill areas which have a limited scope for economic development.

CAUSES FOR BACKWARDNESS AND REGIONAL IMBALANCES

The causes for economic backwardness and regional imbalances may be historical, geographical, economic or political.

Britishers developed some regions at the cost others, thus leading to imbalances.

Historically, the existence of backward regions started from the British rule in India. The British helped the development of only those regions which possessed facilities for prosperous manufacturing and trading activities. Maharashtra and West Bengal were two states preferred by the British industrialists. Further, under the land system of the British, the rural areas were continuously pauperised and the farmers remained the most oppressed class, the zamindars and the moneylenders were, of course, the only prosperous persons on the rural scene. The absence of effective land reforms allowed the structure in most of rural India to remain inimical to economic growth. Again, the uneven investments in irrigation during the British period helped some areas to become prosperous under British rule.

Richness of factor endowments of a region is also a cause for regional imbalances.

Geographical or physical factors are still major causes having their bearing on wide disparities prevailing in the development of regions. The development of a particular region or country depends on a favourable climate for settlement of the people; availability of natural resources for their conversion into wealth; possibilities for carrying on agricultural operations; facilities for starting and developing industries and the convenience with which trade and commerce can be handled. Physical environment prescribes

boundaries, and places hurdles in the path to progress of all these economic activities, notwithstanding the tremendous technological breakthrough achieved by man during the past 150 years.

Economic factors refer to locational advantages in terms of transport, labour market, technology, raw materials and other related factors enjoyed by certain regions. As is well known, not all the regions possess all the locational advantages in equal proportions. The areas which are right in materials possess a vast market, and enjoy a high degree of infrastructural facilities that attract new investments, particularly in the private sector.

It is not just economic factors alone, even political factors contribute to regional imbalances.

Political factors play an important role in the location of business undertakings, particularly in the public sector; resource transfer or in special area development programmes. Political considerations are becoming more powerful these days. Local leaders are whipping up regional feelings among the public at the time of elections to state assemblies. Tall promises are made to the electrorate to catch votes and after gaining power, undue patronage is meted out to the areas or regions not realising the fact that such unequal favours are highly divisive in nature.

Colin Clark, in his famous book *The Conditions of Economic Progress*, has stated that the levels of income are higher in those regions where a larger proportion of the working population is engaged in the manufacturing and tertiary sectors. Since these activities are not evenly spread, there are bound to be disparities in incomes.

The introduction of new technology in agriculture has added to the disparities among regions. There have been differences in the use of new technology and of improved variety of seeds.

Financial institutions and banks have played no less role. They preferred borrowers from developed regions.

Sanctions and disbursements by financial institutions and commercial banks have shown a distinct tendency towards the concentration of investments in the relatively more developed states. Subsidised lending by banks for financing priority credit and refinancing facilities given by financial institutions have helped the richer states to gain greater access to investible funds at subsidised rates.

There exists a glaring regional imbalance and disparity among different states in the provision of educational and training facilities, particularly technical education. According to a report by the All India Council for Technical Education (AICTE), four states of Karnataka, Andhra Pradesh, Tamil Nadu and Maharastra account for as many as 1056 technical institutions out of a total of 1818 in the country.

Fiscal policy, by favouring high income areas for public investment and spending, has also contributed to regional imbalances.

The operations of the system of public finance in the country have also added to regional imbalances. In the low income states, for example, the level of public investment, infrastructural growth and standard of administrative services are lower compared to those in the high income states, thus perpetuating disparities. Similarly, the prevailing system of sales taxation has facilitated the richer states to export a significant portion of their tax burden to the residents of poor states.

THE PROBLEM

In order to assess the extent of backwardness, the Centre for Monitoring Indian Economy (CMIE) has developed an aggregate index to show economic development using district-wise data on various aspects of development.

All India average has been taken at 100. The index numbers prepared for different states indicate a range from 1075 for the Union Territory of Delhi down to 10 for Manipur. Eight states are above the all India average, while 13 states and five union territories are below the average. The better developed parts of the country are Goa, Gujarat, Haryana, Karnataka, Kerala, Maharastra, Punjab, Tamil Nadu and West Bengal. Chandigarh and Pondicherry (both union territories) also fall under this category. Union territories and states which are below average and backward are Andhra Pradesh, Assam, Bihar, Dadar and Nagar Haveli, Himachal Pradesh, Lakshwadeep, Madhya Pradesh, Meghalaya, Mizoram, Nagaland, Manipur, Orissa, Rajasthan, Sikkim, Tripura and Uttar Pradesh. The data for there new states, viz., Jharkhard, Chattisgarh and Uttranchal are not available.

Another index-known as the index of disparity, is measured as a ratio of the per capita income of the most affluent state to that of the one at the bottom. This index which stood at 2.88 during the Sixth Plan, moved up marginally to 2.97 during the Seventh Plan before widening to 3.29 in the early nineties.

In 1992, the top 20 per cent of the population accounted for more than two-thirds of the total consumption expenditure, while the bottom 20 per cent had a share of just 8.5 per cent of the total consumption. In the same year, the top 10 per cent of India's population spent eight times as much as the bottom 10 per cent (Also see Fig.28.1).

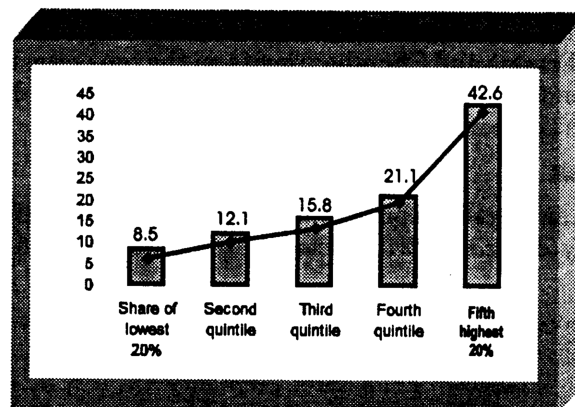


Figure 28.1

Inequality in India (Share of each quintile in consumption, 1992)

Across the globe too, disparities are glaring. Disparities in Brazil are the widest in the world. During 1990s, the top 20 per cent of the Brazilian population had more than two-thirds of the national income while the bottom 20 per cent had a meagre 2.1 per cent share.

A summary measure of inequality is the Gini Index-closer the index is to 100, greater the inequality and a value of 0 indicates perfect equality. On this count as well, Brazil has the dubious distinction of a very high Gini Index. South Africa-just recovering from decades of apartheid, naturally has wide disparities.Surprisingly,

inequality in China is worse than in India-perhaps because of unequal opportunities thrown up after the 1978 reforms.

Disparities in Russia too are wide. But in most former socialist economies, the gap between the rich and poor is less than elsewhere. Poland has the lowest inequality record. Generally, the Scandinavian countries (example, Sweden) enjoy a much less unequal distribution of income.In Japan too, disparities are less than in most other parts of the world.

Then there is the competitiveness index for rating the states. The ratings are[3]: Karnataka 56.19, Punjab 82.80, Gujarat 60.63, Kerala 67.71, Rajastan 39.80, Maharastra 48.77, Uttar Pradesh 25.27 and Bihar 22.36.

Table 28.1 gives more details about wide disparities prevailing among different parts of the country.

While Maharastra and West Bengal are flourishing, BOMARU states are languishing.

Economic boom witnessed during the post-reform period has only widened the disparities. For example, during 1980s, the slowest growing state had a growth rate of 0.9 per cent while the fastest growing one had a growth rate of 4.7 per cent. During the 1990s the respective growth rates were 0.7 per cent and 8.6 per cent. More glaring is the fact that two prosperous states-Maharastra and West Bengal-account for about one-fourth of NDP. But the BOMARU States (Bihar, Orissa, Madhya Pradesh, Assam, Rajasthan and Uttar Pradesh) are languishing.

India Today, the leading magazine in India, has ranked all the states and union territories on eight performance factors. The variables identified and employed are: agriculture, industrial environment, consumer market, health, education, law and order, infrastructure and budget and prosperity. Table 28.1 contains the ranking. Among the big States, Punjab tops the list, Goa occupies the top slot among the small states and Chandigarh sits on the top of the heap among union territories. The lowest ranking goes to Bihar, Meghalaya and Dadra and Nagar Haveli among the three categories respectively.

Intra-state Disparities

Imbalances exist not only among states but within a state, disparities are found among districts. The CMIE study (covering 172 districts in seven states in July 1996) reveals the following:

- The more developed the state, the more inequitous is the pattern of development in the state.
- Districts classified as backward by the state appear to have much higher per capita DDP than the so-called non-backward districts; and
- Relatively developed or under-developed districts tend to be spatially concentrated ignoring the intervening state boundaries.

It is not that any figures are necessary to demonstrate the imbalances prevailing among different regions. The problem is there for anybody to see. Ours is a vast country supporting a huge population. We have villages where inhabitants have not

Big States	Rank	Small States	Rank	Union Territories	Rank
Punjab	1	Goa	1	Chandigarh	1
Kerala	2	Delhi	2	Andaman & Nicobar	2
Himachal Pradesh	3	Pondichery	3	Daman & Diu	3
Tamil Nadu	4	Mizoram	4	Lakshadweep	4
Haryana	5	Sikkim	5	Dadra & Naga Haveli	5
Maharastra	6	Arunachal Pradesh	6		
Gujarat	7	Manipur	7		
Karnataka	8	Nagaland	8		
Uttaranchal	9	Tripura	9		
Jammu & Kashmir	10	Meghalaya	10		
Andhra Pradesh	11				
Rajasthan	12				
West Bengal	13				
Madhya Pradesh	14				
Chattisgarh	15				
Assam	16				
Uttar Pradesh	17				
Orissa	18				
Jharkhand	19				
Bihar	20				

Table 28.1 *India's Best and Worst States*

(**Source:** *India Today*, August 15, 2005)

seen a train yet; not gone to a movie; take hours to take a seriously ill patient to an allopathic doctor; and feel highly blessed when rivers overflow submerging villages, for devastating floods bring in their wake scores of relief measures which guarantee ration, blankets and utensils that would last at least one full year. There are tribals who offer you, with gratitude, a basketful of fruits just plucked from the trees very cheap. There are villages which are not electrified, have no good roads, no schools and no sanitation. There are villages where nearly 50 per cent of the inhabitants are infected with tuberculosis, the disease being mainly caused by the thick smoke which comes out of ovens, while cooking food and there being no openings in the thatched roofs for the smoke to go out. The streets of villages are narrow, often zigzag and are literally dirtied by beedi butts and enormous spits. Half-clad children in an unkempt condition play in the streets with gay abandon amidst themselves and admilst dirty dogs. All eyes will be focussed on you if you happen to pass through the streets as if you had come down from the city. If you go with a vehicle (even a two wheeler), the children surround you, touch the vehicle, feel it, sound the horn, touch the buttons and wonder how it would run and how you could ride.

We have villagers who have not boarded a train, not seen a movie in a theatre, take hours to visit an alopathic doctor and wait for floods, for in the wake of such events, relief materials pour in.

MEASURES TO REMOVE REGIONAL IMBALANCES

The problem of regional imbalances is not peculiar to our country. The problem is universal. The successful planning of a regional economic development programme

is one of the most difficult tasks facing the modern world. It is a problem shared by advanced industrial nations and those in the earlier stages of development, and it exists in both capitalist and socialist economic systems.[3]

The following measures have been taken to remove regional imbalances in our country. They are:

(a) Recognition of backwardness as a factor to be taken into account in the transfer of financial resources from the Centre to states;
(b) Special area development programmes directed at the development of backward areas;
(c) Dispersal of industries;
(d) Growth centres;
(e) Nucleus plants; and
(f) Banking policy.

Resources Transfer

Financial resources are transferred from the Centre to states. The main criterion for transfer is backwardness of states. Often, Central funds are transferred to fill state's revenue gaps, if any.

Funds are transferred based on the recommendations of Finance Commissions from time to time. Funds transferred from Fifth to Tenth Commissions are given in Table 28.2.

Table 28.2

Transfers to States

Commission	*Amount (Rs Crore)*	*% of Central Revenue*
Fifth	5,421	27.90
Sixth	11,048	25.90
Seventh	22,880	26.09
Eighth	29,452	24.10
Ninth	1,06,062	22.74
Tenth	2,26,643	24.50

As seen from the Table 28.2, transfers were increasing in absolute terms, but declining percentage-wise.

Resource transfers, instead of minimising regional imbalances seem to have contributed to disparities as is evident from Table 28.3.

As is clear from this table, the percentage increase in per capita transfer is the highest in the most advanced state, *viz.*, Gujarat. Rajasthan, which is highly backward, registered the least increase in per capita transfer of central funds.

(Tables 28.2 and 28.3 are based on the *Economic Times* dated Jan.4, 1996).

Special Area Development Programmes

Special schemes have been evolved by the Central Government for the development of deserts, hill areas, tribal areas and drought prone areas.

Table 28.3

Per Capita Transfers

States	Ninth Commission (1981 Census)	Tenth Commission (1991 Census)	% increase
		High Income States (Rs)	
Maharastra	961	1741	80%
Gujarat	996	2159	116%
Punjab	935	1785	90%
		Low Income States (Rs)	
Uttar Pradesh	1544	2606	68%
Rajasthan	1769	2402	36%
Orissa	2028	3081	50%

Dispersal of Industries

The most effective way of achieving balanced regional development is to ensure dispersal of industries to backward areas. Backward areas, it is believed, will shed their backwardness once they are brought on the industrial map of the country.

There is reluctance on the part of private entrepreneurs to go to backward areas because of the absence or inadequacy of infrastructural facilities. The government should take the initiative and locate its industrial undertakings in backward areas. The government did take the initiative and established a number of undertakings in backward areas.*

Besides establishing its own undertakings in backward areas, the government has been encouraging private investors to go to backward areas for locating their industrial enterprises. Encouragement has been shown in the form of fiscal and monetary incentives given to entrepreneurs who select backward areas for locating plants. The government has identified 303 districts (see Table 28.4) as backward areas for awarding fiscal and monetary incentives.

Table 28.1

Statewise Division of Backward Districts

1. *Andhra Pradesh (14 Districts)*	16. *Himachal Pradesh (Entire State)*
2. *Bihar (18 Districts)*	17. *Jammu & Kashmir (Entire State)*
3. *Gujarat (11 Districts)*	18. *Manipur (Entire State)*
4. *Haryana (4 Districts)*	19. *Meghalaya (Entire State)*
5. *Kerala (7 Districts)*	20. *Nagaland (Entire State)*
6. *Karnataka (11 Districts)*	21. *Sikkim (Entire State)*
7. *Madhya Pradesh (36 Districts)*	22. *Tripura (Entire State)*
8. *Maharashtra (14 Districts)*	23. *Arunachal Pradesh (Entire State)*
9. *Orissa (8 Districts)*	24. *Goa (Entire State)*
10. *Punjab (5 Districts)*	25. *Mizoram (Entire State)*
11. *Rajasthan (16 Districts)*	26. *A & N Islands (Entire Union Territory)*
12. *Tamil Nadu (9 Districts)*	27. *Dadra & Nagar Haveli (Entire Union Territory)*
13. *Uttar Pradesh (41 Districts)*	28. *Daman & Diu (Entire Union Territory)*
14. *West Bengal (13 Districts)*	29. *Pondichery (Entire Union Territory)*
15. *Assam (Entire State)*	30. *Lakshadweep(Entire Union Territory*

* For more details, read chapter on 'Public Enterprises' in this book.

Licensing of industries has been used as a weapon to ensure the dispersal of industries to backward areas. The share of backward areas in the total letters of intent issued has been steadily increasing. It was 33.2 per cent in 1978, 43.9 per cent in 1980 and shot up to 61.5 per cent in 1983.

But of late, there has been a decline in the number of licences issued to the backward areas. In 1986, a total of 618 licences were issued. Out of this, 278 were for the backward areas. In terms of percentage, this works out to be about 45 per cent. By 1988, the number of licences issued had come down to 360 and the share of backward areas to 42.5 per cent, or only 153 licences. By 1990, the number of licences stood at 387. The share of backward areas was about 43 per cent (See Table 28.5).

Table 28.5

Share of Backward Areas in Total Licences Issued

Year	*Total licences*	*Share of backward areas*	*% of backward areas*
1986	618	278	45.0
1987	472	192	40.7
1988	360	153	42.5
1989	418	175	41.9
1990	387	167	43.2

Further, financial institutions have been** directed by the government to give loans at concessional rates of interest to entrepreneurs who locate their enterprises in backward areas.

Growth Centres

Growth centres, equipped with funds and infrastructural facilities, would promote industries in backward areas.

One of the reasons for poor industrial activities in backward regions is the lack of good and adequate infrastructural facilities. For promoting industrial development in backward areas, it was announced, in 1988, that the focus would henceforth be on the development of growth centres that would attract industries. The growth centres would be endowed with infrastructural facilities at par with the best available in the country, particularly in respect of power, water, telecommunications and banking. It was decided to develop 70 such centres during the Eighth Plan. These would be allotted to different states. Each growth centre would be provided with funds ranging from Rs.25 crore to Rs.30 crore. So far, locations of 64 growth centres have been identified and notified.

Six years after the announcement, the scheme of growth centres seems to be destined to die a natural death for the want of funds. Although, land has been acquired in many cases, construction work is yet to begin, thanks to the paucity of funds.

Meanwhile, a new scheme of integrated infrastructural development, including technological back-up services, to facilitate location of industries in rural and backward areas and to promote stronger linkages between agriculture and industry is being finalised in consultation with concerned authorities.

** The role played by the financial institutions in the development of backward areas is explained in the chapter on "Development Banking" in this book.

Nucleus Plants and Ancillaries

A nucleus plant is one which is located in a backward area and which is expected to promote ancillary units around it. For this obligation, the nucleus plant will be entitled to central and state level incentives. The nucleus plant will be so called only after the Ministry of Industry certifies it to that effect. It is hoped that the concept of a nucleus plant will contribute to the development of backward areas.

Nucleus plants and ancillaries would also help remove imbalances.

Banking Policy

Expansion of banking facilities to rural areas is yet another way of development of backward regions. Geographical spread of the branches is emphasised by the Reserve Bank of India while permitting the opening of new branches. The extension of the monetary infrastructure to backward regions is expected to provide an impetus for the growth of these regions.

The setting up of Regional Rural Banks (RRBs) marked another step towards increasing the flow of monetary resources to the backward regions. Particular attention has been given to expand the RRBs in backward states-Orissa, Uttar Pradesh and Rajasthan.

FAILURE OF REGIONAL PLANNING

Inspite of the measures undertaken by the government, the problem of regional imbalances, as was pointed out earlier, still persists. One peculiarity of the problem is that there are pockets of poverty in well-developed states and highly developed patches in the underdeveloped states. The reasons for this are not difficult to see. The most important reasons are as follows:

There are pockets of poverty in developed states and areas of affluence in underdeveloped regions.

(i) One basic reason for the widening of disparities is that the richer states refuse to shoulder their part of the responsibility of transferring through the Central Government some of the resources to the poorer states. The advanced states like Punjab and Haryana have a per capita development expenditure of about two and a half times the level of the less developed states like Bihar. Naturally, the rate of economic development is faster in these states which leads to the accentuation of the existing regional imbalances.

States refuse to transfer resources among them. Sharing of river water, for example, has been a contentious issue between Karnataka and Tamilnadu.

(ii) At the same time, the poorer states rely too much on the flow of resources from the richer states through the Central Government and they do not believe in self-effort and self-help to promote their own development. These less developed states have developed an attitude of a lethargic reliance on whatever resources that can be got out of the Central Government by pathetic pleading or bland political pressures. Besides, the poor states attempt to waste their limited resources and accordingly, their development effort is chronically inadequate.

(iii) Most of the area development measures are specially meant to help the drought-prone areas or hilly areas or those inhabited by Scheduled Tribes.

But these measures do not come under the above categories. Besides, the barriers to development in backward regions are such that an integrated approach is necessary. The First Plan ignored such an approach. The Sixth Plan strategy of integrated rural development attempts to remove this weakness.

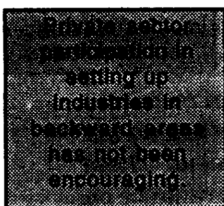
(iv) The method of locating large central projects in the backward states has not paid off in any significant way in improving their economics.

(v) The benefits of Central Government subsidy for industrial investment in specified backward state areas are concentrated in a few districts/areas. Besides, the amounts given as subsidy are not related to employment but to capital investment. Moreover, the government has not so far made any discrimination in favour of those industries which could have a favourable effect on employment or on resources development of forward linkages. Because of the limited infrastructure facilities such as transport, power, communication etc. and inadequate monetary and fiscal incentives by the state governments, there has been no development of any ancillary, secondary and tertiary industries around these major Central industrial complexes.

There is however very little evidence to show that this investment has led to any noticeable progress in the regional development of the backward areas where these projects were located. In this connection, the Sixth Plan states: "Our experience with large industrial projects in backward areas shows that their spread effects are low and the surrounding areas continue to remain poor and undeveloped. Infact, such development by creating a dualistic economic structure may pose more problems than it solves. However, location of industries in some backward regions is very essential, particularly in those areas which are densely populated and which have natural resources for industrial development."

(vi) Only a few entrepreneurs have approached the public sector financial institutions for concessional finance even though sufficient publicity has been given to the facilities. Besides, as in the case of investment subsidy, the benefits have accrued to a small proportion of the districts covered.

(vii) The state governments alone can tackle the problem of intra-state imbalances and local planning is the main plank of any strategy for balanced spatial development within a state. The process of planning will have to be decentralised and priorities as well as sectoral proposals should be put forward as the district and regional levels to be later integrated into state plans. Punjab, Haryana and Tamil Nadu have encouraged private sector entrepreneurs to set up industrial ventures by offering them many incentives. But other states were lukewarm in attracting industrial units. In most cases, private entrepreneurs treated states like Orissa in a stepmotherly fashion and did not locate big projects in these states.



(viii) Not all states have earmarked separate outlays for the development of backward and special problem areas. It is absolutely necessary for the states to recognise the fact that without special efforts including the allocation of separate funds, disparities between different areas will not be eliminated.