INTRODUCTION TO

BUSINESS ENVIRONMENT

AUTHORS

DR. SAUMYABRATA NATH

DR. RITA BISWAS

MS. SHAMALI KIRPANE

DR. M. RAJAKRISHNAN

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By:

Dr. Saumyabrata Nath
Assistant Professor, Management (International Business),
Vivekananda Global University, Jaipur, Rajasthan 303012

Dr. Rita Biswas
Dr. Rita Biswas, Senior Facilitator, Regenesys Business School,
South Africa

Mrs. Shamali Kirpane
Academician and Entrepreneur

Dr. M. Rajakrishnan
Assistant Professor, Department of Commerce with Computer
Applications., PSG College of Arts & Science, Coimbatore,
Tamil Nadu

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PREFACE

This Book on Introduction to Business Environment is intended to introduce the students to the present state of our knowledge of Business Environment in India. Its purpose is not only to describe the basic knowledge on business environment, but also to indicate the theories, issues and challenges faces in real life situation in internal and external environment in businesses. Detailed discussion on different environmental factors is covered which effects the business decisions; critical remarks have been introduced occasionally where it seemed necessary, in order to determine facts, or to justify the views taken on matters of fundamental importance.

The historical development of Business Theories does not seem to come within the scope of this book and would only interfere with unity of design and explanation of the work. It would therefore be superfluous to quote scientific management works which have only a basic interest. In the references which will be found in the work the chief object has been to introduce the students to those writings in which they will find a fuller discussion of those parts of the subject which have been only touched on briefly. In some cases the writings of others have been quoted because they represents views different from others, and because it is desirable to place the student in a position to form a judgment for themselves. Others again of the references are simply for the purpose of citing the authorities on which reliance is placed for statements that have not come within the range of the author's own observation.

The reader of this book will at least learn the names and standing of those researchers who have in recent times contributed most essentially in the Business Environment and specifically the various macro and micro environmental factors affecting business decision making.

The table of contents will give sufficient indication of the plan of the work, the index should be consulted for references to the other parts of the book where an explanation of the different terms will be found when their meaning does not appear in any particular passage.

ACKNOWLEDGEMENT

Writing a book is harder than I thought and more rewarding than I could have ever imagined. None of this would have been possible without the blessings and support of the Almighty.

I would like to express thanks to my all my friends and my mates for their support throughout my research work. I would like to thank my Co-Authors **Dr. Rita Biswas, Mrs. Shamali Kirpane and Dr. M. Rajakrishnan** for their valuable inputs.

Lastly but most Importantly, I would like to express my deepest gratitude to all my Mentors, Relatives and Family members. My special thanks and gratitude to **Mr. Samaresh Nath Barbhuiya** (Father), **Ms. Minati Nath** (Mother), **Mr. Tapash Mozumder** (Father in law), **Ms. Maya Nath** (Mother in law), **Ms. Priyanka Mozumder** (Wife), **Mr. Subhabrata Nath** (Brother) and **Mr. Saathvik Nath** (Son) for their constant understanding, patience and encouragement in all the undertaking I purse.

Dr. Saumyabrata Nath

Dr. Rita Biswas

Mrs. Shamali Kirpane

Dr. M. Rajakrishnan

ABOUT THE AUTHORS

Dr. Saumyabrata Nath is an Academician, Researcher & Soft Skill Trainer with around 13+ years experience in Academics and 2+ years in Industry. He has worked as Asst. Professor for MBA/MMS Dept. in different universities, colleges & institutions under VGU-Jaipur, Mumbai University, Bangalore University and Visvesvaraya Technological University - Belgaum. He is qualified with Ph.D(HR) from Utkal University, D. Litt. from Theophany University – Haiti, MBA(HR & Marketing) from Bangalore University, MBA(OM),MA(English), MA(Education) M.Sc(Maths), PGDM(Tourism), B.Ed (Maths & Economics) from University of Mumbai and B.Sc with Honors (Mathematics) from Assam Central University. He is also C-TET qualified under Central Govt. of India. He is also the recipient of Two Honorary Doctorates in Social Sciences and in Education by International Agencies affiliated to Govt. of USA and United Nations Organization.

Currently he is working as Asst. Professor & Research Scholar in Management Department (International Business) under Vivekananda Global University (NAAC A+ graded), Jaipur - Rajasthan. He is pursuing his second Ph.D in Marketing Management. Dr. S. Nath is an approved faculty for Management Studies (PG Courses) under University of Mumbai, Maharashtra. He has also worked as a Soft-Skill trainer under Infosys Campus Connect Program initiated by Infosys Ltd. Bangalore.

He has also presented 61 Research Papers in various International / National Journals and published in Scopus Indexed /UGC CARE / UGC Referred / Google Indexed, Peer Reviewed and conference proceeding books. He has published many patents under Govt. of India as well as written 3 books.

Dr. Nath is a certified Career Coach from Mindler & Career development Alliance, USA. He is also a certified Six Sigma Green Belt Professional.

He is also the member of many International & National academic forums, Conducted 50+ guest sessions, seminars, FDPs, SDPs and Workshops as a Key Resource Speaker in India & Foreign Countries and has won many National & International Awards for his contributions towards upliftment of student community.

Dr. Rita Biswas has completed her PhD in Management, MBA in HR & 5 years LLB Course. She had done her PhD from North Maharashtra University, Jalgaon in Management discipline (Topic: Entrepreneurship). She has more than 19 years of experience, which includes 6 years of Industry experience and more than 13 years of Teaching experience in different Universities & Institutions. Presently she is working with Regenesys Business School (under Regenesys Institute of Management Pvt Ltd) as a Senior Facilitator. In past, she hadworked with Universal Business School under Cardiff Metropolitan University, UK. She had also worked with various Management (MBA & BBA) Institutions under Mumbai University. She taught different levels of Students from PhD, MBA, BBA & B.Tech. She had a Corporate experience as Senior HR. She had total 16 different types of International & National Publications. She has written two books on Human Resource Management. She is a passionate Teacher who likes to conduct Lectures and try to make it interesting and meaningful for her Students. She has received various Awards for her Teaching & Research Activities.

Mrs. Shamali Kirpane is an Academician and Entrepreneur with over 19 yrs of experience in Academics and Industry. She has been associated with management department college affiliated with Mumbai University. She has a double MBA in Finance from ITM business School and Punjab Technical University. Apart from being Academician and Researcher she is also a Financial Consultant, Business Consultant, Portfolio Manager and Entrepreneur and possess a deep knowledge of Share Market, Corporate valuation, Derivatives, Financial Modeling and Project management.

Dr. M. Rajakrishnan is working as Assistant Professor in the Department of Commerce with Computer Applications., PSG College of Arts & Science, Coimbatore, Tamil Nadu. He is an academic counselor for M.Com. programme at the Indira Gandhi National Open University. He has teaching experience of 7 years and 7 months. He earned his Ph.D. in Commerce (Finance) from Thiruvalluvar University, Vellore, M.Phil. in Commerce (Marketing), MBA in Human Resource Management, Postgraduate Diploma in International Business, and M.Com. in Computer Applications from Bharathiar University, Coimbatore. He got qualified in TN-SET and UGC-NET in commerce. Dr. N.G.P. Arts and Science College (Autonomous), Coimbatore, Tamil Nadu, recognised him as

"Best Mentor" and "Best Teacher". He is also a certified computerised accountant using Tally. Student project sponsored by Tamil Nadu State Council for Science and Technology was completed under his guidance in the year 2018–19. He has written one book chapter and published 18 journal articles. He has presented at a number of national and international conferences. He actively participated and organized workshops, conferences, seminars and programmes for faculty development. He served as resource person for programmes emphasising skill development in office and accounting package.

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Module - 1

Overview of Business Environment

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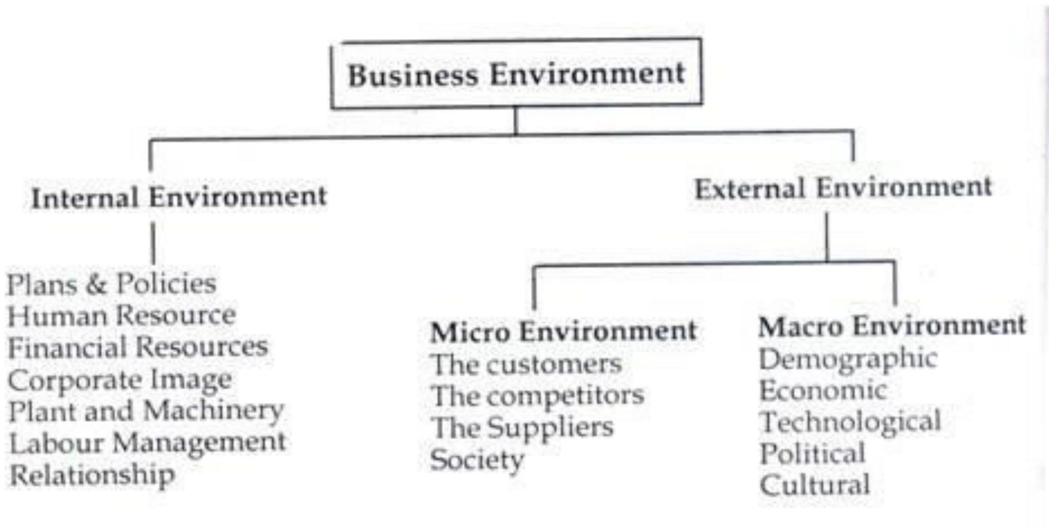
Business establishes, grows or operates and dies in environment. It exchanges resources within environment. It collects inputs i.e. Man money, materials, machines etc. And provides output i.e. Goods and services in the environment. Environment means surrounding. Business environment defines as a force that effects on organizational performance. It includes internal an eternal factors. It provides opportunities and threats.



Source: business management ideas

1. **Internal Environment**

It is defined as all the forces or conditions that are available within an environment that effects on organization and business. Inland Environment lies within the origin are known as internal environment. Internal factors are generally regarded as controllable factors It is also known as controllable factors because business can control them. It includes

I. Employees

Business hires employees. It is the major internal factor. It works inside the business. It can be controlled by the business. Employees differ in skill, knowledge, morality, and attitude and so on. When managers and employees have difference in goals an beliefs then conflict may arise. The task of management is to divide the work and assign the work to the suitable employee and handle the conflict.

II. Shareholders:

Management deals with many shareholders. Shareholders have the right of ownership, power of management and voting right. The actual management of organization is carried out by elected representative of shareholders jointly known as boar of directors. Boards of directors have the responsibility of overseeing the management of organization. It plays the major role in formation of objectives, policies, strategies of the organization as well as their implementation.

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III. Organization structure:

It is located inside the organization. The arrangement of various facilities, pattern of relationships among the various department, responsibility, authority and communication is the organization structure. It also included specialization and span of control.

IV. Organization culture:

The sets of values that help the members to understand what organization stand for how it does work, what it considers, cultural values of business forces of business and so on. It helps in direction of activities.

V. Plans & Policies:

The plans and policies of the firm should be properly framed taking into consideration the objectives and resources of the firm. Proper plans and policies help the firm to accomplish its objectives.

The higher authority must analyse the internal environment to foresee the changes and frame appropriate policies well in time.

For example: the personnel policy in respect of promotion should be based on merit rather than seniority.

VI. Plant and Machinery:

Plant and machinery is the internal part of the business firm. If the machines are obsolete or outdated, they should be replaced by a new one, or that adversely affects the business firm.

VII. Labour and Management Relationship:

There should be smooth labour and management relationship. The management should understand the problems of their workers and gain confidence in them. The labours should be motivated by providing with monetary and non-monetary incentives (benefits).

Better Labour- Management relationship helps in increasing the morale of the employees and motivates them to put efforts in the business. Such strong relationship enhances organisations development.

VIII. Promoters vision:

The promoter should have far sight vision to forecast opportunities and threats in the business so that the opportunities are properly grabbed and threats are diffused off in time.

2. **External Environment (PEST)**

All the forces and condition that cannot be controlled by the business is called external environment. . It is also known as uncontrollable factors because business can't control them. It is located outside the business. It affects on organizational performance.

It includes:

I. Political or Legal Environment

It is defined as rules and regulations determined by the government. Business must fulfill demand of government. There should be non violation of rules and regulation of government. Business should avoid unfair trade and should provide essential information to the government

II. Economic Environment.

It indicates the condition of economy in which business organization operates. It has continuous and great impact on business. It includes national income, production, inflation, savings, investment, price, government activities. Business person must have constant watch on this factor.

III. Social Environment.

Business must have good environment where a business can be established neatly. Business also helps in employment opportunities generation. There should be socio cultural understanding and application of anti-pollution measures.

IV. Technological Environment:

It defines about the methods available for converting resources into product or services. It transforms inputs into output. Inputs means material, capital, man, machine. It affects on business. It helps to change the level of job, skill, and product and so on. There can be innovation, development of scientific techniques which encouraged mass production and distribution.

Business Environment Types (External Micro and External Macro)

External Micro Environment:

Micro external forces have an important effect on business operations of a firm.

However, all micro forces may not have the same effect on all firms in the industry. For example, suppliers, an important element of micro level environment, are often willing to provide the materials at relatively lower prices to big business firms.

They do not have the same attitude towards relatively small business firms. Similarly, a competitive firm will start a price war if its rival firm in the industry is relatively small. If the rival firm is a big one which is a capable of retaliating any adverse action from its rival, a competitive firm will hesitate to start a price war. We explain below important factors or forces of micro-level external environment.

I. Suppliers of Inputs:

An important factor in the external environment of a firm is the suppliers of its inputs such as raw materials and components. A smooth and efficient working of a business firm requires that it should have ensured supply of inputs such as raw materials. If supply of raw materials is uncertain, then a firm will have to keep a large stock of raw materials to continue its transformation process uninterrupted. This will unnecessarily raise its cost of production and reduce its profit margin.

To ensure regular supply of inputs such as raw materials some firms adopt a strategy of backward integration and set up captive production plants for producing raw materials themselves.

Further, energy input is an important input in the manufacturing business. Many large firms such as Reliance industries have their own power generating plants so as to ensure regular supply of electricity for their manufacturing business. However, small firms cannot adopt this strategy of vertical integration and have to depend on outside sources for supply of needed inputs.

Further, it is not a good strategy to depend on a single supplier of inputs. If there is disruption in production of the supplier firm due to labour strike or lock-out, it will adversely affect the produc-tion work of a firm. Therefore, to reduce risk and uncertainty business firms prefer to keep multiple suppliers of inputs.

II Customers:

The people who buy and use a firm's product and services are an important part of external micro-environment. Since sales of a product or service is critical for a firm's survival and growth, it is necessary to keep the customers satisfied. To take care of customer's sensitivity is essential for the success of a business firm.

A firm has different categories of customers. For example, a car manufacturing firm such as Maruti Udyog has individuals, companies, institutions, government as its customers. Maruti Udyog, therefore, has catered to the needs of all these types of customers by producing different varieties and models of cars.

Besides, a business firm has to compete with rival firms to attract customers and thereby increase the demand and market for its product. In the present day of intense competition a firm has to spend a lot on advertisements to promote the sales of its product by creating new customers and retaining the old ones. For this purpose, a business firm has also to launch new products or models.

With increasing globalisation and liberalization the customers' satisfaction is of paramount impor-tance because the consumers have the option of buying imported products. Therefore, to survive and succeed a firm has to make continuous efforts to improve the quality of its products.

III. Marketing Intermediaries:

In a firm's external environment marketing intermediaries play an essential role of selling and distributing its products to the final buyers. Marketing intermediaries include agents and merchants such as distribution firms, wholesalers, retailers.

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Marketing inter-mediaries are responsible for stocking and transporting goods from their production site to their destination, that is, ultimate buyers. There are marketing service agencies such as marketing research firms, consulting firms, advertising agencies which assist a business firms in targeting, promoting and selling its products to the right markets.

Thus, marketing is an important link between a business firm and its ultimate buyers. A disloca-tion of this link will adversely affect the fortune of a company. A few years ago chemists and druggists in India declared a collective boycott of a leading pharma company because it was providing a low retail margin. They succeeded in raising this margin. This shows that a business firm must take care of its intermediaries if it has to succeed in this age of intense competition.

IV. Competitors:

Business firms compete with each other not only for sale of their products but also in other areas. Absolute monopolies in case of which competition is totally absent are found only in the sphere of what are called public utilities such as power distribution, telephone service, gas distribution in a city etc. More generally, market forms of monopolistic competition and differen-tiated oligopolies exist in the real world.

In these market forms different firms in an industry com-pete with each other for sale of their products. This competition may be on the basis of pricing of their products. But more frequently there is non-price competition under which firms engage in competition through competitive advertising, sponsor-ing some events such as cricket matches for sale of different varieties and models of their products, each claiming the superior nature of its products.

The readers will be witnessing how intense is the competition between Coca Cola and Pepsi Cola. Sometimes there has been price war between them to capture new markets or enlarge their market share. Likewise, there is severe competition between the manufacturers of Aerial and Surf washing powders, between manufacturers of various brands of colour TV. This type of competition is generally referred to as brand competition as it relates to producing and selling different brands of a product.

External Micro Environment:

But not only is there a competition among the producers producing different varieties or brands of a product but also among firms producing quite diverse products as all products ultimately compete for attracting spending by the consumers of their disposable incomes.

For example, competition for a firm producing TVs does not come only from other brands of TV manufacturers but also from manufacturers of air conditioners, refrigerators, cars, washing machines etc. All these goods compete for attracting disposable incomes of the final consumers. Competition among these diverse products

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is generally referred to as desire competition as all these goods fulfill the various desires of the consumers who have limited disposable incomes.

As a consequence of liberalisation and globalisation of the Indian economy since the adoption of economic reforms there has been a significant increase in competitive environment of business firms. Now, Indian firms have to compete not only with each other but also with the foreign firms whose products can be imported.

For example, in the USA American firms faced a lot of competition from the Japanese firms producing electronic goods and automobiles. Similarly, the Indian firms are facing a lot of competition from Chinese products. It is important to note that for successful competi-tion the Indian firms have to improve not only the quality of the products but also to enhance their productivity so that cost per, unit can be reduced.

Publics:

Finally, publics are an important force in external micro environment. Public, accord-ing to Philip Kotler "is any group that has an actual or potential interest in or impact on a company's ability to achieve its objective". Environmentalists, media groups, women associations, consumer protection groups, local groups, citizens associations are some important examples of publics which have an important bearing on environment of the firms.

For example, a consumer protection firm in Delhi headed by Sunita Narain came out with an amazing fact that cold drinks such as Coca Cola, Pepsi Cola, Limca, Fanta had a higher contents of pesticides which posed threat to human health and life. This produced a good deal of adverse effect on the sale of these products in 2003-04. The Indian laws are being amended to ensure that these drinks must not contain pesticides beyond European safety standards.

Similarly, environmentalists like Arundhi Roy have been campaigning against industries which pollute the environment and cause health hazards. Women in some villages of Haryana protested against liquor shops being situated in their localities.

Many citizen groups are actively campaigning against cigarette manufactures for their advertising campaigns luring the people to indulge in smok-ing. Thus, the existence of various types of publics influences the working of business firms and compels them to be socially responsible.

External Macro Environment:

Apart from micro-environment, business firms face large external environmental forces. The external macro environment determines the opportunities for a firm to exploit for promoting its business and also presents threats to it in the sense that it can put restrictions on the expansion of business activities. The macro-environment has thus both positive and negative aspects.

An important fact about external macro-environmental forces is that they are uncontrollable by the management of a firm. Because of the uncontrollable nature of macro forces a firm has to adjust or adapt itself to these external forces.

External macro-environmental factors are classified into:

(1) Economic,

(2) Social,

(3) Techno-logical,

(4) Political and legal, and

(5) Demographic.

We explain below all these factors determining external macro-environment:

1. Economic Environment:

Economic environment includes the type of economic system that exists in the economy, the nature and structure of the economy, the phase of the business cycle (for example, the conditions of boom or recession), the fiscal, monetary and financial policies of the Government, foreign trade and foreign investment policies of the government. These economic policies of the government present both the opportunities as well as the threats (i.e. restrictions) for the business firms.

The type of the economic system, that is, socialist, capitalist or mixed provides institu-tional framework within which business firm have to work. For example, before 1991, the Indian economic system was of the type of a mixed economy with pronounced orientation towards the pub-lic sector. Prior to 1991 private sector's role in India's mixed economy was greatly restricted. Many industries were reserved exclusively for investment and production by the public sector.

Private sector operations were limited mainly to the consumer goods industries. Even in these goods the private sector production and operation was controlled by industrial licensing system, Monopolistic and Restrictive Trade Practices (MRTP) Commission. The private sector was also subjected to various export and import-restrictions. High tariffs were imposed to protect domestic industries and to pursue import substitution strategy of industrial growth.

Now, there have been significant changes in the economic policies since 1991 which have changed the macroeconomic environment for private sector firms. Far-reaching structural economic reforms were carried out by Dr. Manmohan singh during the period 1991-96 when he was the Finance Min-ister. Industrial licensing has been abolished and private sector can now invest and produce many industrial products without getting license from the government.

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Many industries, except only a few industries of strategic importance, which were earlier reserved for the public sector have been thrown open for the private sector. Import duties have been greatly reduced due to which domestic industries face competition from the imported products. Incentives have been given to boost exports. Rupee has been made convertible into foreign currencies on current account. It is thus evident that new economic reforms carried out since 1991 has significantly changed the business environment.

2. Social and Cultural Environment:

Members of a society wield important influence over business firms. People these days do not accept the activities of business firms without question. Activities of business firms may harm the physical environment and impose heavy social costs. Besides, business practices may violate cultural ethos of a society. For example, advertisement by business firms may be nasty and hurt the ethical sentiments of the people.

External Macro Environment

Businesses should consider the social implications of their decisions. This means that companies must seriously consider the impact of its actions on the society. When a business firm in their decision making take care of social interests, it is said to be socially responsible.

Social responsibility is the felt obligation or self-enforced duty of business firms to serve or protect social interests. By doing so they promote social well-being. Good corporate governance should be judged not only by the productivity and profits earned by a business firm but also by its social-welfare promoting activities.

It is worth noting that in modern management science a new concept of social responsiveness has been developed. By social responsiveness we mean “the ability of a corporate firm to relate its operations and policies to social environment in way that are mutually beneficial to the company and society at large”.

It may be noted that social responsibility or social responsiveness is related to ethics. The discipline of ethics deals with what is good and bad, or right and wrong or with moral duty and obligation. Further, even if managers enjoy full freedom to adopt actions and policies in accordance with the conceived notion of social responsibility, they may not do so if standards applied to evaluate their performance are quite different.

Every manager would like its performance to be positively appraised. Therefore, if the performance of managers of business firms are judged by the amount of profits .they make for the owners of the firms, it is then not proper to expect socially responsible actions from them.

3. Political and Legal Environment:

Businesses are closely related to the government. The political philosophy of the government wields a great influence over business policies. For example, after

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independence under the leadership of Jawahar Lal Nehru India adopted ‘democratic socialism as its goal.

In the economic sphere it implied that public sector was to play a vital role in India’s economic development. Besides, it required that working of the private sector were to be controlled by a suitable industrial policy of the government. In this political framework provide business firms worked under various types of regulatory policies which sought to influence the directions in which private business enterprises had to function.

Thus, Industrial Regulation Act 1951, Industrial Policy Resolution 1956, Foreign Exchange Regulation Act (FERA), Monopolistic and Restrictive Practices (MRTP) Act were passed to control the business activities of the private sector. Besides, role of foreign direct investment was restricted to only few spheres.

However, since 1991 several structural economic reforms have been undertaken following a change in political philosophy in favour of a free market economy. The collapse of socialism in Soviet Russia, China and East European Countries has brought about a change in political thinking about the roles of public and private sectors in India’s industrial development.

To encourage the growth of the private sector in India, licensing has now been abolished, role of public sector greatly reduced and foreign capital, both direct and portfolio, is being encouraged to raise the rate of capital formation in the Indian economy. FERA has been replaced by FEM A (Foreign Exchange Management Act) It is evident from above that with the change in the nature of political philosophy business envi-ronment for private firms has greatly changed.

4. Technological Environment:

The nature of technology used for production of goods and services is an important factor responsible for the success of a business firm. Technology consists of the type of machines and processes available for use by a firm and the way of doing things. The improvement in technol-ogy raises total factor productivity of a firm and reduces unit cost of output.

The use of a superior technology by a firm gives it a competitive advantage over its rival firms. The use of a particular technology by a firm for its transformation process determines its competitive strength. In this age of globalisation the firms have to compete in the international markets for sales of their prod-ucts. The firms which use outdated technologies cannot compete globally. Therefore, technological development plays a vital role in enhancing the competitive strength of business firms.

It has been generally observed that the competition between firms in the domestic economy and in international markets ensures that the firms will try to improve the technology they use because failure to do so would pose a threat to their survival. In the

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protected markets, technological improve-ments are slow and firms are able to survive for a long period without making technological changes.

This is quite evident from the experience of automobile industry in India. Manufacturers of Ambas-sadors and Fiat Cars not only made no significant changes in their models, but also did not make any improvement in technology for decades because of absence of competition. The users had no choice and Ambassador and Fiat cars survived for decades in the protected environment.

It is when Maruti Udyog Ltd. was started in India using superior technology and introducing more attractive models that there has been a significant improvement in car manufacturing. With liberalisation of the Indian economy new car manufacturing firms have entered the industry and are producing different verities and models of cars with improved technology.

Besides, the cotton textile industry is another important example of an industry which due to protection provided to it by imposing high tariffs on imports of cotton textiles became sick. Follow-ing trade liberalisation many cotton textile firms have closed down because they could not withstand competition. Technological environment affects the success of firms and the need for technological advancement cannot be ignored.

5. Demographic Environment:

Demographic environment includes the size and growth of population, life expectancy of the people, rural-urban distribution of population, the technological skills and educational levels of labour force. All these demographic features have an important bearing on the functioning of business firms. Since new workers are recruited from outside the firm, demographic factors are considered as parts of external environment.

The skills and ability of a firm's workers determine to a large extent how well the organisation can achieve its mission. The labour force in a country is always changing. This will cause changes in the work force of a firm. The business firms have to adjust to the requirements of their employees. They have also to adapt themselves to their child care services, labour welfare programmes etc.

The demographic environment affects both the supply and demand sides of business organisations. Firms obtain their working force from the outside labour force. The technical and education skills of the workers of a firm are determined mostly by human resources available in the economy which are a part of demographic environment.

On the other hand, the size of population and its rural-urban distribution determine the demand for the products of industrial firms. For example, when there is good monsoon in India causing increase in incomes of rural population dependent on agriculture, demand for industrial products greatly increases.

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In the wake of economic reforms initiated in the early nineties when foreign investors were al-lowed to make investment in India, they were prompted to invest in India by pointing out that the size of Indian market was quite large. They were told that 200 million Indian people could afford to buy the industrial products and this constituted quite a large market which could be profitably exploited.

Besides, the growth rate of population and age composition of population determine the demand pattern of goods. When the population of a country is growing at a high rate, its child population will be relatively large. This means demand for products such as baby food which cater to the needs of children will be relatively high.

On the other hand, if population of a country is stable and life expec-tancy of the people is high, this will cause greater proportion of elderly aged people in the population of a country. This means different demand pattern of goods. Thus business firms have to consider all these demographic factors in their planning for production of goods and services and formulation of marketing strategies for sale of their products.

Demographic environment is also important for business firms as it determines the choice of technology by them. Other things being equal, if labour is abundant and relatively cheaper than capital, business firms will prefer relatively labour-intensive techniques for production of goods.

However, for various reasons such as rigid labour laws and low productivity of labour, various tax concessions on investment in capital equipment and machinery, business firms in India are generally seem to be using capital-intensive technologies imported from abroad. This has resulted in the increase in unemployment of labour, especially among the young workers.

Therefore, social and government pressure is increasing on the business firms to create more employment opportunities for labour so as to render help in solving the problem of unemployment. It is quite interesting to note here that to take advantages of relatively cheap labour in India and China that foreign MNCs are setting up manufacturing plants in these countries. It is evident from above that demographic factors play a crucial role in determining the produc-tive activity of business firms.

6. Natural Environment:

Natural environment is the ultimate source of many inputs such as raw materials, energy which business firms use in their productive activity. In fact, availability of natural resources in a region or country is a basic factor in determining business activity in it. Natural environment which includes geographical and ecological factors such as minerals and oil reserves, water and forest resources, weather and climatic conditions, port facilities are all highly significant for various business activities.

For example, the availability of minerals such as iron, coal etc. in a region influence the location of certain industries in that region. Thus, the industries with high material

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contents tend to be located near the raw material sources. For example, steel producing industrial units are set up near coal mines to save cost of transporting coal to distant locations.

Besides, certain weather and climatic conditions also affect the location of certain business units. For example, in India the firms producing cotton textiles are mostly located in Bombay, Madras, and West Bengal where weather and climatic conditions are conducive to the production of cotton textiles.

Natural environment also affects the demand for goods. For example, in regions where there is high temperature in summer there is a good deal of demand for dessert coolers, air conditioners, business firms set up industrial units producing these products. Similarly, weather and climatic con-ditions influence the demand pattern for clothing, building materials for housing etc. Furthermore, weather and climatic conditions require changes in design of products, the type of packaging and storage facilities.

It may however be noted that resource availability is not a sufficient condition for the growth of production and business activities. For instance, India through rich in natural resources re-mained poor and underdeveloped because available resources had not been put to use due to lack of adequate capabilities of Indian business class. Thus, it is not the availability of natural resources alone but also the technology and ability to being them into use that determines the growth of business and the economy.

Ecological Effects of Business:

Until recently businesses had generally overlooked the serious ecological effects of its ac-tivities. Driven purely by the motive of maximizing profits, they cause irreparable damage to the exhaustible natural resources, especially minerals and forests. By their careless attitude they caused pollution of environment, especially air and water which posed health hazards for the people.

By creating external detrimental diseconomies they imposed heavy costs on the society. Thanks to the efforts by environmentalists and international organisations such as World Bank, the people and the governments have now became conscious of the adverse effects of depletion of exhaustible natural resources and pollution of environment by business activity.

Accordingly, laws have been passed for conservation of natural resources and prevention of environment pollution. These laws have imposed additional responsibilities and costs for business firms. But it is socially desirable that these costs are borne by business firms if we want sustainable economic growth and also healthy environ-ment for human beings.

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The Difference between Internal & External Business Environments

UNDERSTANDING THE DIFFERENCE between internal and external business environments is very important. These environments have a major effect on the operations and performance of the company.

To fully understand the difference between internal and external business environments and how they apply to your company, you need to establish what each environment represents. As the name suggests, "internal" business environment refers to internal factors and resources that affect the running of the business. This primarily includes the workforce. The employees play a vital role in affecting the company's performance. If you have well trained, motivated employees, you are more likely to get good output from them. However, if you have unmotivated employees who don't work hard or dig in their heels when a new plan is proposed, this will definitely affect your company's production levels.

Another factor is the company assets available, such as plants and machinery, motor vehicles, and any other equipment used in production. If you have adequate assets in good condition, your production will be better than if you don't. Another component of the internal business environment is your available finances. This includes your capital, if you're just starting out. In an established business, this includes all the money available to facilitate the day-to-day running of the business.

The "external" business environments include factors: political, technological, economical, legal, demographic and socio-cultural. These factors may not have an immediate direct effect on your business, but they will play a role in shaping your business with time. For instance, if your country faces economic hardships, your business may not do so well. Your market's spending habits will change accordingly, your raw materials costs will also change, and you may end up reducing your production and letting go of some of your employees. Retrenchment is one of the biggest negative impacts of economic problems.

Technology can have negative or positive impacts on a business. Technological developments can help make your work easier and increase your productivity; it can also allow for the expansion of your business. However, it can lead to the reduction of your workforce due machines which, therefore, means loss of jobs for some people. For instance, a job that was previously done by ten people may now be done by one person who will be operating the machines.

External environments may also affect your ability to acquire loans from banks or other financial institutions. For instance, when the economy goes down, financial institutions don't lend money easily. This is because they are also affected by the economy; they may, therefore, have inadequate funds. Most institutions also consider these times very risky for lending out money.

Many people and businesses may not be in a position to pay back the loans that they get. Economic crisis will also affect the internal operations of a business. For instance, the business will not have a lot of financial resources due to the loss of a ready market. Some businesses also end up retrenching some of their clients due to the reduction of work and inability of the company to maintain the employees' payment packages.

Sometimes external and internal environments are intertwined. For instance, political and economic issues will affect the availability of a workforce and other resources. They will also affect the availability of finances to the business. During political unrests, most businesses are not able to operate normally and some end up shutting down all together.

Other external environments that can affect the internal environment include legal restrictions. Sometimes, laws are passed that affect some businesses. For instance, some of the laws like the increase of taxes on some goods and services affect the business. When tanning taxes were increased in America, a lot of Americans stopped going to tanning salons. The business operations were reduced and the clients decreased in numbers.

Other factors that can be described as part of the external environment include natural disasters or calamities, such as tornados, hurricanes and tsunamis. These calamities affect the operations of the business. They affect the workforce, the market, and all other resources and, in most cases, they lead to the closure of the business due to property destruction.

The central difference between internal and external business environments is that, one can be controlled while the other one can't. However, you have some control over your internal business environment. You can control your management and resources to ensure that you realize good production levels at your company. External environments, on the other hand, aren't easy to control or manage. In fact, some of these factors can lead to the closure of your business.

The main reason why the external environments are hard to control is because, at times, they can be unpredictable. For instance, it may be hard to plan ahead for the occurrence of a natural disaster. Furthermore, you may not be in a position to do anything about them when they occur, unlike internal environments that you may be able to control and manage effectively. If you maintain a corporate risk assessment, you can put up measures to deal with any problems that may occur as a result of issues with the internal environment. However, it's hard to prepare for external environments since some of the issues that occur aren't predictable.

Advantages of Environmental Analysis

Formulation of business policies and strategies should be based on a careful business environmental analysis. The following as the merits of a proper environmental analysis.

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1. Helps in Achieving Objectives

When a company neglects to adjust its strategy to the business environment, or does not react to the demands of the environment by changing its strategy, the company cannot achieve success in attaining its objectives. However, environmental analysis enables the business enterprises to study the environment and formulate the strategies accordingly, which will result in successful attainment of objectives.

2. Identification of Threats

Business Environment analysis and diagnosis give businessmen time to anticipate opportunities and to plan to take optional response to these opportunities. It also helps strategies to develop an early warning system to prevent threats or to develop strategies, which can turn a threat to the firm's advantage.

3. Happenings in the Market Place

Every firm should be in constant touch with the market place and should be aware of what is happening in the marketplace. If the company fails to adjust or react to the demands of the environment, by changing their strategies, it can't achieve corporate objectives.

4. Threats Inherent in any Opportunity

Business Environmental diagnosis helps the businessmen in two ways. 1. He can ascertain the possible threats to the business. This will enable him to take proper preventive measures. 2. He can identify the opportunities and avenues in which the businessman can operate successfully and achieve the object.

5. Forecasting the Future

Changes in the environment are often frequent and all of a sudden. Moreover, such changes cannot be predicted precisely well in advance. Again the entrepreneur can anticipate only a few of such changes and not all. If the anticipations and expectations are precise and accurate, the decisions are likely to be better. Hence business environment analysis helps to forecast the future prospects of the business concern.

6. Threats and Opportunities

Some factors of the environment present threats to the company's present strategy and the accomplishment of the objectives. While some factors, on the other hand, present greater opportunities for a great accomplishment of the objectives. A thorough analysis of the environmental factors shall enable the analyst to recognize the inherent risk involved and also enable him to take advantage of the opportunities.

In every threat there is an opportunity and in every opportunity there is a threat. By properly analyzing the environment and anticipating the changes likely to occur in the environment, the business manager can estimate the future and adjust his plans accordingly. Of course, not all the future events can be anticipated but some can and are, the extent to which the expectations are accurate, managerial decisions are likely to

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be better. Moreover, the process of environmental analysis reduces the time pressures on a few which are not anticipated.

Limitations or Disadvantages of Environment Analysis

Environmental analysis suffers from certain limitations also. These limitations are as follows:

1. Lack of Forewarning of Unforeseen Events

Environmental analysis does not predict the future. It does not eliminate uncertainty for the organization also. Business enterprises sometimes face events, which are unexpected during analysis. Environmental analysis, however, should aim at minimizing the frequency and extent of surprises that may attack a business organization.

2. No Assurance as to Organization Effectiveness

Environmental analysis does not ensure organizational effectiveness. It acts only as inputs in strategy development and testing. Sometimes, managers place uncritical faith in the data without thinking about the data's verifiability or accuracy. If this is the case, it may lead to misleading outcome.

3. Not fully Reliable

Normally, people place too much reliance on the information collected through environmental scanning. But in practice, it is not so. When there is overloading of information, one is likely to get confused.

4. Absence of Strategic Approach

Success of any organization lies in adventure and strategic risk-taking. Environmental analysis often makes an individual too cautious in his approach and he is likely to be left behind the events. So this analysis should be strategically done.

5. Unexpected and Unanticipated Events

We cannot tell unexpected and unanticipated events in business environment analysis. Sometime, business has to face unexpected happenings. So, there will no benefit of business environment in these cases.

6. No Sufficient Guarantee

Business environment analyst does not give any guarantee whether all events will happen as per estimation in business environment.

7. Uncritical Faith

Sometime data may be incorrect. So, decisions on basis of these analysis may be risky for business.

8. Too Much Information

Sometime too much information relating to business environment analysis will create the doubt in businessmen.

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Legal and Regulatory Factors Affecting Business

The legal and regulatory environment plays a very crucial role in determining the success of any businesses. The government imposes taxes among other regulatory measures to promote economic growth and to cushion consumers from exploitation. Therefore, before establishing or when running a business, it is imperative to understand the role of regional tax measures and regulatory measures to determine how they affect your business.

Understanding legal and regulatory measures also help you to adapt to your business environment and to account for all your regional economic analysis.

Tax

Tax is one of the legal and regulatory factors that affect business. Tax codes may vary from one country to the other and from one region in a country to the other. They can support a business while other tax restricts certain business operations. The government can also increase or reduce taxes to promote or control economic growth. Increase in tax can affect a business negatively because it reduces consumer spending and vice versa.

It is also essential to note that tax come in form of income tax, individual income tax, corporate income tax, gross receipts tax and fiscal balance tax among others. Therefore, as a business person, it is wise to understand the kind of tax imposed in your location, population and the criterion used to run your business smoothly and profitably.

Trade Policies

Trade policies also affect business. They include tax policies, monetary policies, fiscal policy, government policy, regulatory policy and property rights policies. These policies can allow for business growth or prevent growth of business. For example trade policies can prevent free trade in a specific area. Establishing a business under strict trade policies can mean trading in losses.

Politics

Politics can affect a business a great deal. This is form of government where political environment determines whether a business will be stable or not. A stable political environment builds investor confidence and boosts the growth of a business.

It is also essential to note that parliament can exert pressure on the government to allow for establishment of certain businesses and closure of others. As a business person, it is therefore, imperative to keep in mind the role of government in creating a stable political environment.

A good government does not allow for politics to affect business. Instead it creates rules and regulations that cushions businesses from political interferences.

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What's more, there are governments that encourage diplomatic events that promote growth of business for the benefit of its people. Such a government creates a good business environment thus, allowing for increased productivity and profitability.

Economic Policy

Economic policy of the government also affects business. It is a legal and regulatory factor that helps to promote economic growth in a country. With favorable economic policy, a business can grow enormously without any problem. However, a bad economic policy that restricts businesses and free trade cripples much business.

Other legal and regulatory factory includes high costs of business operations to prevent establishment of certain business. Therefore, before running a business, it is important to consider legal and regulatory factors in your country or location. This will enable you to operate a successful business.

Ecological Environment: Critical Issue in International Business:

Modern industry and internationalization has provided people with a material prosperity unequaled in the history. It has also created unparalleled environmental threats to present generation and to future generations. The very technology that has enabled people to manipulate and control nature has also polluted the environment and rapidly depleted the natural resources.

As the twenty-first century begins, several well-established environmental trends are shaping the future of civilization. This includes: population growth, rising temperature, falling water tables, shrinking cropland per person, collapsing fisheries, shrinking forests, and the loss of plant and animal species.

Between 1950 and 2000, world population increased from 2.5 billion to 6.1 billion, a gain of 3.6 billion. A second trend that is affecting the entire world is the rise in temperature that results from increasing atmospheric concentrations of carbon dioxide (CO_2).

The modest temperature rise in recent decades is melting ice caps and glaciers. Ice cover is shrinking in the Arctic, the Antarctic, Alaska, Greenland, the Alps, the Andes, and the Quinghai-Tibetan Plateau.

One of the least visible trends that are shaping the future is falling water tables. Since it takes roughly 1,000 tonnes of water to produce 1 ton of grain, this is the equivalent of 160 million tonnes of grain, or half the U.S. grain harvest. In consumption terms, the food supply of 480 million of the world's 6 billion people is being produced with the unsustainable use of water.

Also making it more difficult to feed the projected growth in population adequately over the next few decades is the worldwide shrinkage in cropland per person.

Humanity also depends heavily on the oceans for food. From 1950 until 1997, the oceanic fish catch expanded from 19 million tonnes to more then 90 million tonnes.

These three parallel trends – falling water tables, shrinking cropland area per person, and the levelling-off of the oceanic fish catch – all suggest that it will be far more difficult to keep-up with the growth in world demand for food over the next half century.

So intractable and difficult are the problems raised by these environmental threats that many observers believe that they cannot be solved.

Mankind will not work on it until he has suffered greatly and much that he now relies upon has been destroyed. The problems are so varied and so vast and the means for their solutions so far beyond the resources of the scientific and technological know-how on which people have relied that there simply is not time to avoid the impending catastrophe.

In present scenario environmental issues raise large and complicated ethical and technological aspects for the international business society which are as following:

1) The extent of the environmental damage produced by present and projected industrial technology.
2) Extent of largeness that threats pose to the people's welfare.
3) Values people must give-up to halt or slow such damage.
4) Whose rights are violated by pollution and who should be given the responsibility of paying for the costs of polluting the environment.
5) The time interval of natural resources availability.
6) Obligations those firms have to future generations to preserve the environment and conserve the resources.

Ecological Issues:

Environment issues, a key area of corporate social responsibility is the impact that a firm has on the environment and this may attract significant media coverage.

There is a tendency to assume that this impact is mostly negative. However, **business may have positive impacts** on the local environment and national environment. For example, firms fund improvements in the local infrastructure and provide community facilities. They may improve the environment by taking derelict sites and redeveloping these to provide local amenities.

However, much of the focus on this aspect of the external environment will always be on pollution and other negative effects of production. These are called 'negative externalities'. and include:

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- **Congestion** caused on the use of local services - roads etc.
- **Noise** - noise is also a form of pollution and many forms of business activity are noisy
- **Air and water pollution** - a side effect of many production processes is pollution of some form, though there are often options to minimise these side effects.
- **Use of non-renewable resources** - many processes use fossil fuels or other non-renewable resources. These are by their very nature un-replaceable and so will have a serious impact on future economic activity.

There are many ways that businesses can reduce the negative effects of their operations and work with stakeholders to promote more environmentally friendlier practices:

To minimise damage to the environment, businesses consider:

- Reducing emissions
- Producing or using lead free fuels and other 'greener' sources of energy, e.g. renewable resources or energies. It is not uncommon for business developments to include sources of wind and solar energy on site.
- Incorporating cleaner production methods in new buildings, plants etc.

To reduce levels of waste they:

- Improve industry re-cycling programmes
- Encourage energy management schemes
- Offer free long-life shopping bags or other bio-sensitive packaging of products

To try to raise environmental awareness, they:

- Ask staff for ideas
- Promote customer awareness and participation
- Publish literature such as sustainability reports

To help protect the environment, they:

- Donate money for environmental projects that directly affect their stakeholders
- Fund or sponsor education programmes
- Provide recycling facilities

To assist the community, they support:

- Tree planting
- Urban re-generation schemes

Sustainable Development:

Sustainable development is the organizing principle for meeting human development goals while at the same time sustaining the ability of natural systems to provide the natural resources and ecosystem services upon which the economy and society depends. The desirable end result is a state of society where living conditions and resource use continue to meet human needs without undermining the integrity and stability of the natural systems.

While the modern concept of sustainable development is derived mostly from the 1987 Brundtland Report, it is also rooted in earlier ideas about sustainable forest management and twentieth century environmental concerns. As the concept developed, it has shifted to focus more on economic development, social development and environmental protection for future generations. It has been suggested that "the term 'sustainability' should be viewed as humanity's target goal of human-ecosystem equilibrium (homeostasis), while 'sustainable development' refers to the holistic approach and temporal processes that lead us to the end point of sustainability.”

The concept of sustainable development has been — and still is — subject to criticism. What, exactly, is to be sustained in sustainable development? It has been argued that there is no such thing as a sustainable use of a non-renewable resource, since any positive rate of exploitation will eventually lead to the exhaustion of Earth's finite stock; this perspective renders the Industrial Revolution as a whole unsustainable. It has also been argued that the meaning of the concept has opportunistically been stretched from 'conservation management' to 'economic development', and that the Brundtland Report promoted nothing but a business as usual strategy for world development, with an ambiguous and insubstantial concept attached as a public relations slogan.

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Module - 2

National Income

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National Income: Definition, Concepts and Methods of Measuring National Income

INTRODUCTION:

National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, national income means the total value of goods and services produced annually in a country.

In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

1. Definitions of National Income:

The definitions of national income can be grouped into two classes: One, the traditional definitions advanced by Marshall, Pigou and Fisher; and two, modern definitions.

The Marshallian Definition:

According to Marshall: "The labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial including services of all kinds. This is the true net annual income or revenue of the country or national dividend." In this definition, the word 'net' refers to deductions from the gross national income in respect of depreciation and wearing out of machines. And to this, must be added income from abroad.

It's Defects:

Though the definition advanced by Marshall is simple and comprehensive, yet it suffers from a number of limitations. First, in the present day world, so varied and numerous are the goods and services produced that it is very difficult to have a correct estimation of them.

Consequently, the national income cannot be calculated correctly. Second, there always exists the fear of the mistake of double counting, and hence the national income cannot be correctly estimated. Double counting means that a particular commodity or service like raw material or labour, etc. might get included in the national income twice or more than twice.

For example, a peasant sells wheat worth Rs.2000 to a flour mill which sells wheat flour to the wholesaler and the wholesaler sells it to the retailer who, in turn, sells it to the customers. If each time, this wheat or its flour is taken into consideration, it will work out to Rs.8000, whereas, in actuality, there is only an increase of Rs.2000 in the national income.

Third, it is again not possible to have a correct estimation of national income because many of the commodities produced are not marketed and the producer either keeps the produce for self-consumption or exchanges it for other commodities. It generally happens in an agriculture- oriented country like India. Thus the volume of national income is underestimated.

The Pigouvian Definition:

A.C. Pigou has in his definition of national income included that income which can be measured in terms of money. In the words of Pigou, "National income is that part of objective income of the community, including of course income derived from abroad which can be measured in money."

This definition is better than the Marshallian definition. It has proved to be more practical also. While calculating the national income now-a- days, estimates are prepared in accordance with the two criteria laid down in this definition.

First, avoiding double counting, the goods and services which can be measured in money are included in national income. Second, income received on account of investment in foreign countries is included in national income.

It's Defects:

The Pigouvian definition is precise, simple and practical but it is not free from criticism. First, in the light of the definition put forth by Pigou, we have to unnecessarily differentiate between commodities which can and which cannot be exchanged for money.

But, in actuality, there is no difference in the fundamental forms of such commodities, no matter they can be exchanged for money. Second, according to this definition when only such commodities as can be exchanged for money are included in estimation of national income, the national income cannot be correctly measured.

According to Pigou, a woman's services as a nurse would be included in national income but excluded when she worked in the home to look after her children because she did not receive any salary for it. Similarly, Pigou is of the view that if a man marries his lady secretary, the national income diminishes as he has no longer to pay for her services.

Thus the Pigovian definition gives rise to a number of paradoxes. Third, the Pigovian definition is applicable only to the developed countries where goods and services are exchanged for money in the market.

According to this definition, in the backward and underdeveloped countries of the world, where a major portion of the produce is simply bartered, correct estimate of national income will not be possible, because it will always work out less than the real level of income. Thus the definition advanced by Pigou has a limited scope.

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Fisher's Definition:

Fisher adopted 'consumption' as the criterion of national income whereas Marshall and Pigou regarded it to be production. According to Fisher, "The National dividend or income consists solely of services as received by ultimate consumers, whether from their material or from the human environments. Thus, a piano, or an overcoat made for me this year is not a part of this year's income, but an addition to the capital. Only the services rendered to me during this year by these things are income."

Fisher's definition is considered to be better than that of Marshall or Pigou, because Fisher's definition provides an adequate concept of economic welfare which is dependent on consumption and consumption represents our standard of living.

It's Defects:

But from the practical point of view, this definition is less useful, because there are certain difficulties in measuring the goods and services in terms of money. First, it is more difficult to estimate the money value of net consumption than that of net production.

In one country there are several individuals who consume a particular good and that too at different places and, therefore, it is very difficult to estimate their total consumption in terms of money. Second, certain consumption goods are durable and last for many years.

If we consider the example of piano or overcoat, as given by Fisher, only the services rendered for use during one year by them will be included in income. If an overcoat costs Rs. 100 and lasts for ten years, Fisher will take into account only Rs. 100 as national income during one year, whereas Marshall and Pigou will include Rs. 100 in the national income for the year, when it is made.

Besides, it cannot be said with certainty that the overcoat will last only for ten years. It may last longer or for a shorter period. Third, the durable goods generally keep changing hands leading to a change in their ownership and value too.

It, therefore, becomes difficult to measure in money the service-value of these goods from the point of view of consumption. For instance, the owner of a Maruti car sells it at a price higher than its real price and the purchaser after using it for a number of years further sells it at its actual price.

Now the question is as to which of its price, whether actual or black market one, should we take into account, and afterwards when it is transferred from one person to another, which of its value according to its average age should be included in national income?

But the definitions advanced by Marshall, Pigou and Fisher are not altogether flawless. However, the Marshallian and Pigovian definitions tell us of the reasons influencing economic welfare, whereas Fisher's definition helps us compare economic welfare in different years.

Modern Definitions:

From the modern point of view, Simon Kuznets has defined national income as "the net output of commodities and services flowing during the year from the country's productive system in the hands of the ultimate consumers."

On the other hand, in one of the reports of United Nations, national income has been defined on the basis of the systems of estimating national income, as net national product, as addition to the shares of different factors, and as net national expenditure in a country in a year's time. In practice, while estimating national income, any of these three definitions may be adopted, because the same national income would be derived, if different items were correctly included in the estimate.

2. Concepts of National Income:

There are a number of concepts pertaining to national income and methods of measurement relating to them.

(A) Gross Domestic Product (GDP):

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices. Dernberg defines GDP at market price as "the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year."

There are three different ways to measure GDP:

Product Method, Income Method and Expenditure Method.

These three methods of calculating GDP yield the same result because National Product = National Income = National Expenditure.

1. The Product Method:

In this method, the value of all goods and services produced in different industries during the year is added up. This is also known as the value added method to GDP or GDP at factor cost by industry of origin. The following items are included in India in this: agriculture and allied services; mining; manufacturing, construction, electricity, gas and water supply; transport, communication and trade; banking and insurance, real estates and ownership of dwellings and business services; and public administration and defense and other services (or government services). In other words, it is the sum of gross value added.

2. The Income Method:

The people of a country who produce GDP during a year receive incomes from their work. Thus GDP by income method is the sum of all factor incomes: Wages and Salaries (compensation of employees) + Rent + Interest + Profit.

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3. Expenditure Method:

This method focuses on goods and services produced within the country during one year.

GDP by expenditure method includes:

(1) Consumer expenditure on services and durable and non-durable goods (C),

(2) Investment in fixed capital such as residential and non-residential building, machinery, and inventories (I),

(3) Government expenditure on final goods and services (G),

(4) Export of goods and services produced by the people of country (X),

(5) Less imports (M). That part of consumption, investment and government expenditure which is spent on imports is subtracted from GDP. Similarly, any imported component, such as raw materials, which is used in the manufacture of export goods, is also excluded.

Thus GDP by expenditure method at market prices = C+ I + G + (X – M), where (X-M) is net export which can be positive or negative.

(B) GDP at Factor Cost:

GDP at factor cost is the sum of net value added by all producers within the country. Since the net value added gets distributed as income to the owners of factors of production, GDP is the sum of domestic factor incomes and fixed capital consumption (or depreciation).

Thus GDP at Factor Cost = Net value added + Depreciation.

GDP at factor cost includes:

(i) Compensation of employees i.e., wages, salaries, etc.

(ii) Operating surplus which is the business profit of both incorporated and unincorporated firms. [Operating Surplus = Gross Value Added at Factor Cost—Compensation of Employees—Depreciation]

(iii) Mixed Income of Self- employed.

Conceptually, GDP at factor cost and GDP at market price must be identical/This is because the factor cost (payments to factors) of producing goods must equal the final value of goods and services at market prices. However, the market value of goods and services is different from the earnings of the factors of production.

In GDP at market price are included indirect taxes and are excluded subsidies by the government. Therefore, in order to arrive at GDP at factor cost, indirect taxes are subtracted and subsidies are added to GDP at market price.

Thus, GDP at Factor Cost = GDP at Market Price – Indirect Taxes + Subsidies.

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(C) Net Domestic Product (NDP):

NDP is the value of net output of the economy during the year. Some of the country's capital equipment wears out or becomes obsolete each year during the production process. The value of this capital consumption is some percentage of gross investment which is deducted from GDP. Thus Net Domestic Product = GDP at Factor Cost – Depreciation.

(D) Nominal and Real GDP:

When GDP is measured on the basis of current price, it is called GDP at current prices or nominal GDP. On the other hand, when GDP is calculated on the basis of fixed prices in some year, it is called GDP at constant prices or real GDP.

Nominal GDP is the value of goods and services produced in a year and measured in terms of rupees (money) at current (market) prices. In comparing one year with another, we are faced with the problem that the rupee is not a stable measure of purchasing power. GDP may rise a great deal in a year, not because the economy has been growing rapidly but because of rise in prices (or inflation).

On the contrary, GDP may increase as a result of fall in prices in a year but actually it may be less as compared to the last year. In both 5 cases, GDP does not show the real state of the economy. To rectify the underestimation and overestimation of GDP, we need a measure that adjusts for rising and falling prices.

This can be done by measuring GDP at constant prices which is called real GDP. To find out the real GDP, a base year is chosen when the general price level is normal, i.e., it is neither too high nor too low. The prices are set to 100 (or 1) in the base year.

Now the general price level of the year for which real GDP is to be calculated is related to the base year on the basis of the following formula which is called the deflator index:

Calculation of General Price Level

Suppose 1990-91 is the base year and GDP for 1999-2000 is Rs. 6, 00,000 crores and the price index for this year is 300.

Thus, Real GDP for 1999-2000 = Rs. 6, 00,000 x 100/300 = Rs. 2, 00,000 crores

(E) GDP Deflator:

GDP deflator is an index of price changes of goods and services included in GDP. It is a price index which is calculated by dividing the nominal GDP in a given year by the real GDP for the same year and multiplying it by 100. Thus,

Calculation of GDP deflator

It shows that at constant prices (1993-94), GDP in 1997-98 increased by 135.9% due to inflation (or rise in prices) from Rs. 1049.2 thousand crores in 1993-94 to Rs. 1426.7 thousand crores in 1997-98.

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(F) Gross National Product (GNP):

GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country, including net income from abroad.

GNP includes four types of final goods and services:

(1) Consumers' goods and services to satisfy the immediate wants of the people;

(2) Gross private domestic investment in capital goods consisting of fixed capital formation, residential construction and inventories of finished and unfinished goods;

(3) Goods and services produced by the government; and

(4) Net exports of goods and services, i.e., the difference between value of exports and imports of goods and services, known as net income from abroad.

In this concept of GNP, there are certain factors that have to be taken into consideration: First, GNP is the measure of money, in which all kinds of goods and services produced in a country during one year are measured in terms of money at current prices and then added together.

But in this manner, due to an increase or decrease in the prices, the GNP shows a rise or decline, which may not be real. To guard against erring on this account, a particular year (say for instance 1990-91) when prices be normal, is taken as the base year and the GNP is adjusted in accordance with the index number for that year. This will be known as GNP at 1990-91 prices or at constant prices.

Second, in estimating GNP of the economy, the market price of only the final products should be taken into account. Many of the products pass through a number of stages before they are ultimately purchased by consumers.

If those products were counted at every stage, they would be included many a time in the national product. Consequently, the GNP would increase too much. To avoid double counting, therefore, only the final products and not the intermediary goods should be taken into account.

Third, goods and services rendered free of charge are not included in the GNP, because it is not possible to have a correct estimate of their market price. For example, the bringing up of a child by the mother, imparting instructions to his son by a teacher, recitals to his friends by a musician, etc.

Fourth, the transactions which do not arise from the produce of current year or which do not contribute in any way to production are not included in the GNP. The sale and purchase of old goods, and of shares, bonds and assets of existing companies are not included in GNP because these do not make any addition to the national product, and the goods are simply transferred.

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Fifth, the payments received under social security, e.g., unemployment insurance allowance, old age pension, and interest on public loans are also not included in GNP, because the recipients do not provide any service in lieu of them. But the depreciation of machines, plants and other capital goods is not deducted from GNP.

Sixth, the profits earned or losses incurred on account of changes in capital assets as a result of fluctuations in market prices are not included in the GNP if they are not responsible for current production or economic activity.

For example, if the price of a house or a piece of land increases due to inflation, the profit earned by selling it will not be a part of GNP. But if, during the current year, a portion of a house is constructed anew, the increase in the value of the house (after subtracting the cost of the newly constructed portion) will be included in the GNP. Similarly, variations in the value of assets, that can be ascertained beforehand and are insured against flood or fire, are not included in the GNP.

Last, the income earned through illegal activities is not included in the GNP. Although the goods sold in the black market are priced and fulfill the needs of the people, but as they are not useful from the social point of view, the income received from their sale and purchase is always excluded from the GNP.

There are two main reasons for this. One, it is not known whether these things were produced during the current year or the preceding years. Two, many of these goods are foreign made and smuggled and hence not included in the GNP.

Three Approaches to GNP:

After having studied the fundamental constituents of GNP, it is essential to know how it is estimated. Three approaches are employed for this purpose. One, the income method to GNP; two, the expenditure method to GNP and three, the value added method to GNP. Since gross income equals gross expenditure, GNP estimated by all these methods would be the same with appropriate adjustments.

1. Income Method to GNP:

The income method to GNP consists of the remuneration paid in terms of money to the factors of production annually in a country.

Thus GNP is the sum total of the following items:

(i) Wages and Salaries:

Under this head are included all forms of wages and salaries earned through productive activities by workers and entrepreneurs. It includes all sums received or deposited during a year by way of all types of contributions like overtime, commission, provident fund, insurance, etc.

(ii) Rents:

Total rent includes the rents of land, shop, house, factory, etc. and the estimated rents of all such assets as are used by the owners themselves.

(iii) Interest:

Under interest comes the income by way of interest received by the individual of a country from different sources. To this is added, the estimated interest on that private capital which is invested and not borrowed by the businessman in his personal business. But the interest received on governmental loans has to be excluded, because it is a mere transfer of national income.

(iv) Dividends:

Dividends earned by the shareholders from companies are included in the GNP.

(v) Undistributed Corporate Profits:

Profits which are not distributed by companies and are retained by them are included in the GNP.

(vi) Mixed Incomes:

These include profits of unincorporated business, self-employed persons and partnerships. They form part of GNP.

(vii) Direct Taxes:

Taxes levied on individuals, corporations and other businesses are included in the GNP.

(viii) Indirect Taxes:

The government levies a number of indirect taxes, like excise duties and sales tax.

These taxes are included in the price of commodities. But revenue from these goes to the government treasury and not to the factors of production. Therefore, the income due to such taxes is added to the GNP.

(ix) Depreciation:

Every corporation makes allowance for expenditure on wearing out and depreciation of machines, plants and other capital equipment. Since this sum also is not a part of the income received by the factors of production, it is, therefore, also included in the GNP.

(x) Net Income Earned from Abroad:

This is the difference between the value of exports of goods and services and the value of imports of goods and services. If this difference is positive, it is added to the GNP and if it is negative, it is deducted from the GNP.

Thus GNP according to the Income Method = Wages and Salaries + Rents + Interest + Dividends + Undistributed Corporate Profits + Mixed Income + Direct Taxes + Indirect Taxes + Depreciation + Net Income from abroad.

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2. Expenditure Method to GNP:

From the expenditure view point, GNP is the sum total of expenditure incurred on goods and services during one year in a country.

It includes the following items:

(i) Private Consumption Expenditure:

It includes all types of expenditure on personal consumption by the individuals of a country. It comprises expenses on durable goods like watch, bicycle, radio, etc., expenditure on single-used consumers' goods like milk, bread, ghee, clothes, etc., as also the expenditure incurred on services of all kinds like fees for school, doctor, lawyer and transport. All these are taken as final goods.

(ii) Gross Domestic Private Investment:

Under this comes the expenditure incurred by private enterprise on new investment and on replacement of old capital. It includes expenditure on house construction, factory-buildings, and all types of machinery, plants and capital equipment.

In particular, the increase or decrease in inventory is added to or subtracted from it. The inventory includes produced but unsold manufactured and semi-manufactured goods during the year and the stocks of raw materials, which have to be accounted for in GNP. It does not take into account the financial exchange of shares and stocks because their sale and purchase is not real investment. But depreciation is added.

(iii) Net Foreign Investment:

It means the difference between exports and imports or export surplus. Every country exports to or imports from certain foreign countries. The imported goods are not produced within the country and hence cannot be included in national income, but the exported goods are manufactured within the country. Therefore, the difference of value between exports (X) and imports (M), whether positive or negative, is included in the GNP.

(iv) Government Expenditure on Goods and Services:

The expenditure incurred by the government on goods and services is a part of the GNP. Central, state or local governments spend a lot on their employees, police and army. To run the offices, the governments have also to spend on contingencies which include paper, pen, pencil and various types of stationery, cloth, furniture, cars, etc.

It also includes the expenditure on government enterprises. But expenditure on transfer payments is not added, because these payments are not made in exchange for goods and services produced during the current year.

Thus GNP according to the Expenditure Method=Private Consumption Expenditure (C) + Gross Domestic Private Investment (I) + Net Foreign Investment (X-M) + Government Expenditure on Goods and Services (G) = C+ I + (X-M) + G.

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As already pointed out above, GNP estimated by either the income or the expenditure method would work out to be the same, if all the items are correctly calculated.

3. Value Added Method to GNP:

Another method of measuring GNP is by value added. In calculating GNP, the money value of final goods and services produced at current prices during a year is taken into account. This is one of the ways to avoid double counting. But it is difficult to distinguish properly between a final product and an intermediate product.

For instance, raw materials, semi-finished products, fuels and services, etc. are sold as inputs by one industry to the other. They may be final goods for one industry and intermediate for others. So, to avoid duplication, the value of intermediate products used in manufacturing final products must be subtracted from the value of total output of each industry in the economy.

Thus, the difference between the value of material outputs and inputs at each stage of production is called the value added. If all such differences are added up for all industries in the economy, we arrive at the GNP by value added. GNP by value added = Gross value added + net income from abroad.

GDP by Value Added

The total value added equals the value of gross domestic product of the economy. Out of this value added, the major portion goes in the form wages and salaries, rent, interest and profits, a small portion goes to the government as indirect taxes and the remaining amount is meant for depreciation.

Gross Domestic Product

It's Importance:

The value added method for measuring national income is more realistic than the product and income methods because it avoids the problem of double counting by excluding the value of intermediate products. Thus this method establishes the importance of intermediate products in the national economy. Second, by studying the national income accounts relating to value added, the contribution of each production sector to the value of the GNP can be found out.

For instance, it can tell us whether agriculture is contributing more or the share of manufacturing is falling, or of the tertiary sector is increasing in the current year as compared to some previous years. Third, this method is highly useful because "it provides a means of checking the GNP estimates obtained by summing the various types of commodity purchases."

It's Difficulties:

However, difficulties arise in the calculation of value added in the case of certain public services like police, military, health, education, etc. which cannot be estimated accurately in money terms. Similarly, it is difficult to estimate the contribution made to value added by profits earned on irrigation and power projects.

GNP at Market Prices:

When we multiply the total output produced in one year by their market prices prevalent during that year in a country, we get the Gross National Product at market prices. Thus GNP at market prices means the gross value of final goods and services produced annually in a country plus net income from abroad. It includes the gross value of output of all items from (1) to (4) mentioned under GNP. GNP at Market Prices = GDP at Market Prices + Net Income from Abroad.

GNP at Factor Cost:

GNP at factor cost is the sum of the money value of the income produced by and accruing to the various factors of production in one year in a country. It includes all items mentioned above under income method to GNP less indirect taxes.

GNP at market prices always includes indirect taxes levied by the government on goods which raise their prices. But GNP at factor cost is the income which the factors of production receive in return for their services alone. It is the cost of production.

Thus GNP at market prices is always higher than GNP at factor cost. Therefore, in order to arrive at GNP at factor cost, we deduct indirect taxes from GNP at market prices. Again, it often happens that the cost of production of a commodity to the producer is higher than a price of a similar commodity in the market.

In order to protect such producers, the government helps them by granting monetary help in the form of a subsidy equal to the difference between the market price and the cost of production of the commodity. As a result, the price of the commodity to the producer is reduced and equals the market price of similar commodity.

For example if the market price of rice is Rs. 3 per kg but it costs the producers in certain areas Rs. 3.50. The government gives a subsidy of 50 paisa per kg to them in order to meet their cost of production. Thus in order to arrive at GNP at factor cost, subsidies are added to GNP at market prices.

GNP at Factor Cost = GNP at Market Prices – Indirect Taxes + Subsidies.

Net National Product (NNP):

NNP includes the value of total output of consumption goods and investment goods. But the process of production uses up a certain amount of fixed capital. Some fixed equipment wears out, its other components are damaged or destroyed, and still others are rendered obsolete through technological changes.

All this process is termed depreciation or capital consumption allowance. In order to arrive at NNP, we deduct depreciation from GNP. The word 'net' refers to the exclusion

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of that part of total output which represents depreciation. So NNP = GNP—Depreciation.

NNP at Market Prices:

Net National Product at market prices is the net value of final goods and services evaluated at market prices in the course of one year in a country. If we deduct depreciation from GNP at market prices, we get NNP at market prices. So NNP at Market Prices = GNP at Market Prices—Depreciation.

NNP at Factor Cost:

Net National Product at factor cost is the net output evaluated at factor prices. It includes income earned by factors of production through participation in the production process such as wages and salaries, rents, profits, etc. It is also called National Income. This measure differs from NNP at market prices in that indirect taxes are deducted and subsidies are added to NNP at market prices in order to arrive at NNP at factor cost. Thus

NNP at Factor Cost = NNP at Market Prices – Indirect taxes+ Subsidies

= GNP at Market Prices – Depreciation – Indirect taxes + Subsidies.

= National Income.

Normally, NNP at market prices is higher than NNP at factor cost because indirect taxes exceed government subsidies. However, NNP at market prices can be less than NNP at factor cost when government subsidies exceed indirect taxes.

Domestic Income:

Income generated (or earned) by factors of production within the country from its own resources is called domestic income or domestic product.

Domestic Income Includes:

(i) Wages and salaries, (ii) rents, including imputed house rents, (iii) interest, (iv) dividends, (v) undistributed corporate profits, including surpluses of public undertakings, (vi) mixed incomes consisting of profits of unincorporated firms, self-employed persons, partnerships, etc., and (vii) direct taxes.

Since domestic income does not include income earned from abroad, it can also be shown as: Domestic Income = National Income-Net income earned from abroad. Thus the difference between domestic income f and national income is the net income earned from abroad. If we add net income from abroad to domestic income, we get national income, i.e., National Income = Domestic Income + Net income earned from abroad.

But the net national income earned from abroad may be positive or negative. If exports exceed import, net income earned from abroad is positive. In this case, national income is greater than domestic income. On the other hand, when imports exceed exports, net

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income earned from abroad is negative and domestic income is greater than national income.

Private Income:

Private income is income obtained by private individuals from any source, productive or otherwise, and the retained income of corporations. It can be arrived at from NNP at Factor Cost by making certain additions and deductions.

The additions include transfer payments such as pensions, unemployment allowances, sickness and other social security benefits, gifts and remittances from abroad, windfall gains from lotteries or from horse racing, and interest on public debt. The deductions include income from government departments as well as surpluses from public undertakings, and employees' contribution to social security schemes like provident funds, life insurance, etc.

Thus Private Income = National Income (or NNP at Factor Cost) + Transfer Payments + Interest on Public Debt — Social Security — Profits and Surpluses of Public Undertakings.

Personal Income:

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in one year. Personal income is never equal to the national income, because the former includes the transfer payments whereas they are not included in national income.

Personal income is derived from national income by deducting undistributed corporate profits, profit taxes, and employees' contributions to social security schemes. These three components are excluded from national income because they do reach individuals.

But business and government transfer payments, and transfer payments from abroad in the form of gifts and remittances, windfall gains, and interest on public debt which are a source of income for individuals are added to national income. Thus Personal Income = National Income – Undistributed Corporate Profits – Profit Taxes – Social Security Contribution + Transfer Payments + Interest on Public Debt.

Personal income differs from private income in that it is less than the latter because it excludes undistributed corporate profits.

Thus Personal Income = Private Income – Undistributed Corporate Profits – Profit Taxes.

Disposable Income:

Disposable income or personal disposable income means the actual income which can be spent on consumption by individuals and families. The whole of the personal income cannot be spent on consumption, because it is the income that accrues before direct taxes have actually been paid. Therefore, in order to obtain disposable income, direct

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taxes are deducted from personal income. Thus Disposable Income=Personal Income – Direct Taxes.

But the whole of disposable income is not spent on consumption and a part of it is saved. Therefore, disposable income is divided into consumption expenditure and savings. Thus Disposable Income = Consumption Expenditure + Savings.

If disposable income is to be deduced from national income, we deduct indirect taxes plus subsidies, direct taxes on personal and on business, social security payments, undistributed corporate profits or business savings from it and add transfer payments and net income from abroad to it.

Thus Disposable Income = National Income – Business Savings – Indirect Taxes + Subsidies – Direct Taxes on Persons – Direct Taxes on Business – Social Security Payments + Transfer Payments + Net Income from abroad.

Real Income:

Real income is national income expressed in terms of a general level of prices of a particular year taken as base. National income is the value of goods and services produced as expressed in terms of money at current prices. But it does not indicate the real state of the economy.

It is possible that the net national product of goods and services this year might have been less than that of the last year, but owing to an increase in prices, NNP might be higher this year. On the contrary, it is also possible that NNP might have increased but the price level might have fallen, as a result national income would appear to be less than that of the last year. In both the situations, the national income does not depict the real state of the country. To rectify such a mistake, the concept of real income has been evolved.

In order to find out the real income of a country, a particular year is taken as the base year when the general price level is neither too high nor too low and the price level for that year is assumed to be 100. Now the general level of prices of the given year for which the national income (real) is to be determined is assessed in accordance with the prices of the base year. For this purpose the following formula is employed.

Real NNP = NNP for the Current Year x Base Year Index (=100) / Current Year Index

Suppose 1990-91 is the base year and the national income for 1999-2000 is Rs. 20,000 crores and the index number for this year is 250. Hence, Real National Income for 1999-2000 will be = 20000 x 100/250 = Rs. 8000 crores. This is also known as national income at constant prices.

Per Capita Income:

The average income of the people of a country in a particular year is called Per Capita Income for that year. This concept also refers to the measurement of income at current prices and at constant prices. For instance, in order to find out the per capita income for 2001, at current prices, the national income of a country is divided by the population of the country in that year.

Similarly, for the purpose of arriving at the Real Per Capita Income, this very formula is used.

Real per Capita Income

This concept enables us to know the average income and the standard of living of the people. But it is not very reliable, because in every country due to unequal distribution of national income, a major portion of it goes to the richer sections of the society and thus income received by the common man is lower than the per capita income.

Methods of Measuring National Income:

There are four methods of measuring national income. Which method is to be used depends on the availability of data in a country and the purpose in hand.

(1) Product Method:

According to this method, the total value of final goods and services produced in a country during a year is calculated at market prices. To find out the GNP, the data of all productive activities, such as agricultural products, wood received from forests, minerals received from mines, commodities produced by industries, the contributions to production made by transport, communications, insurance companies, lawyers, doctors, teachers, etc. are collected and assessed at market prices. Only the final goods and services are included and the intermediary goods and services are left out.

(2) Income Method:

According to this method, the net income payments received by all citizens of a country in a particular year are added up, i.e., net incomes that accrue to all factors of production by way of net rents, net wages, net interest and net profits are all added together but incomes received in the form of transfer payments are not included in it. The data pertaining to income are obtained from different sources, for instance, from income tax department in respect of high income groups and in case of workers from their wage bills.

(3) Expenditure Method:

According to this method, the total expenditure incurred by the society in a particular year is added together and includes personal consumption expenditure, net domestic investment, government expenditure on goods and services, and net foreign investment. This concept is based on the assumption that national income equals national expenditure.

(4) Value Added Method:

Another method of measuring national income is the value added by industries. The difference between the value of material outputs and inputs at each stage of production is the value added. If all such differences are added up for all industries in the economy, we arrive at the gross domestic product.

Difficulties or Limitations in Measuring National Income:

There are many conceptual and statistical problems involved in measuring national income by the income method, product method, and expenditure method.

We discuss them separately in the light of the three methods:

(A) Problems in Income Method:

The following problems arise in the computation of National Income by income method:

1. Owner-Occupied Houses:

A person who rents a house to another earns rental income, but if he occupies the house himself, will the services of the house-owner be included in national income. The services of the owner-occupied house are included in national income as if the owner sells to himself as a tenant its services.

For the purpose of national income accounts, the amount of imputed rent is estimated as the sum for which the owner-occupied house could have been rented. The imputed net rent is calculated as that portion of the amount that would have accrued to the house-owner after deducting all expenses.

2. Self-Employed Persons:

Another problem arises with regard to the income of self-employed persons. In their case, it is very difficult to find out the different inputs provided by the owner himself. He might be contributing his capital, land, labour and his abilities in the business. But it is not possible to estimate the value of each factor input to production. So he gets a mixed income consisting of interest, rent, wage and profits for his factor services. This is included in national income.

3. Goods Meant for Self-Consumption:

In under-developed countries like India, farmers keep a large portion of food and other goods produced on the farm for self-consumption. The problem is whether that part of the produce which is not sold in the market can be included in national income or not. If the farmer were to sell his entire produce in the market, he will have to buy what he needs for self-consumption out of his money income. If, instead he keeps some produce for his self-consumption, it has money value which must be included in national income.

4. Wages and Salaries Paid in Kind:

Another problem arises with regard to wages and salaries paid in kind to the employees in the form of free food, lodging, dress and other amenities. Payments in kind by employers are included in national income. This is because the employees would have

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received money income equal to the value of free food, lodging, etc. from the employer and spent the same in paying for food, lodging, etc.

(B) Problems in Product Method:

The following problems arise in the computation of national income by product method:

1. Services of Housewives:

The estimation of the unpaid services of the housewife in the national income presents a serious difficulty. A housewife renders a number of useful services like preparation of meals, serving, tailoring, mending, washing, cleaning, bringing up children, etc.

She is not paid for them and her services are not including in national income. Such services performed by paid servants are included in national income. The national income is, therefore, underestimated by excluding the services of a housewife.

The reason for the exclusion of her services from national income is that the love and affection of a housewife in performing her domestic work cannot be measured in monetary terms. That is why when the owner of a firm marries his lady secretary, her services are not included in national income when she stops working as a secretary and becomes a housewife.

When a teacher teaches his own children, his work is also not included in national income. Similarly, there are a number of goods and services which are difficult to be assessed in money terms for the reason stated above, such as painting, singing, dancing, etc. as hobbies.

2. Intermediate and Final Goods:

The greatest difficulty in estimating national income by product method is the failure to distinguish properly between intermediate and final goods. There is always the possibility of including a good or service more than once, whereas only final goods are included in national income estimates. This leads to the problem of double counting which leads to the overestimation of national income.

3. Second-hand Goods and Assets:

Another problem arises with regard to the sale and purchase of second-hand goods and assets. We find that old scooters, cars, houses, machinery, etc. are transacted daily in the country. But they are not included in national income because they were counted in the national product in the year they were manufactured.

If they are included every time they are bought and sold, national income would increase many times. Similarly, the sale and purchase of old stocks, shares, and bonds of companies are not included in national income because they were included in national income when the companies were started for the first time. Now they are simply financial transactions and represent claims.

But the commission or fees charged by the brokers in the repurchase and resale of old shares, bonds, houses, cars or scooters, etc. are included in national income. For these are the payments they receive for their productive services during the year.

4. Illegal Activities:
Income earned through illegal activities like gambling, smuggling, illicit extraction of wine, etc. is not included in national income. Such activities have value and satisfy the wants of the people but they are not considered productive from the point of view of society. But in countries like Nepal and Monaco where gambling is legalised, it is included in national income. Similarly, horse-racing is a legal activity in England and is included in national income.

5. Consumers' Service:
There are a number of persons in society who render services to consumers but they do not produce anything tangible. They are the actors, dancers, doctors, singers, teachers, musicians, lawyers, barbers, etc. The problem arises about the inclusion of their services in national income since they do not produce tangible commodities. But as they satisfy human wants and receive payments for their services, their services are included as final goods in estimating national income.

6. Capital Gains:
The problem also arises with regard to capital gains. Capital gains arise when a capital asset such as a house, some other property, stocks or shares, etc. is sold at higher price than was paid for it at the time of purchase. Capital gains are excluded from national income because these do not arise from current economic activities. Similarly, capital losses are not taken into account while estimating national income.

7. Inventory Changes:
All inventory changes (or changes in stocks) whether positive or negative are included in national income. The procedure is to take changes in physical units of inventories for the year valued at average current prices paid for them.

The value of changes in inventories may be positive or negative which is added or subtracted from the current production of the firm. Remember, it is the change in inventories and not total inventories for the year that are taken into account in national income estimates.

8. Depreciation:
Depreciation is deducted from GNP in order to arrive at NNP. Thus depreciation lowers the national income. But the problem is of estimating the current depreciated value of, say, a machine, whose expected life is supposed to be thirty years. Firms calculate the depreciation value on the original cost of machines for their expected life. This does not solve the problem because the prices of machines change almost every year.

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9. Price Changes:

National income by product method is measured by the value of final goods and services at current market prices. But prices do not remain stable. They rise or fall. When the price level rises, the national income also rises, though the national production might have fallen.

On the contrary, with the fall in the price level, the national income also falls, though the national production might have increased. So price changes do not adequately measure national income. To solve this problem, economists calculate the real national income at a constant price level by the consumer price index.

(C) Problems in Expenditure Method:

The following problems arise in the calculation of national income by expenditure method:

(1) Government Services:

In calculating national income by, expenditure method, the problem of estimating government services arises. Government provides a number of services, such as police and military services, administrative and legal services. Should expenditure on government services be included in national income?

If they are final goods, then only they would be included in national income. On the other hand, if they are used as intermediate goods, meant for further production, they would not be included in national income. There are many divergent views on this issue.

One view is that if police, military, legal and administrative services protect the lives, property and liberty of the people, they are treated as final goods and hence form part of national income. If they help in the smooth functioning of the production process by maintaining peace and security, then they are like intermediate goods that do not enter into national income.

In reality, it is not possible to make a clear demarcation as to which service protects the people and which protects the productive process. Therefore, all such services are regarded as final goods and are included in national income.

(2) Transfer Payments:

There arises the problem of including transfer payments in national income. Government makes payments in the form of pensions, unemployment allowance, subsidies, interest on national debt, etc. These are government expenditures but they are not included in national income because they are paid without adding anything to the production process during the current year.

For instance, pensions and unemployment allowances are paid to individuals by the government without doing any productive work during the year. Subsidies tend to lower the market price of the commodities. Interest on national or public debt is also

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considered a transfer payment because it is paid by the government to individuals and firms on their past savings without any productive work.

(3) Durable-use Consumers' Goods:
Durable-use consumers' goods also pose a problem. Such durable-use consumers' goods as scooters, cars, fans, TVs, furniture's, etc. are bought in one year but they are used for a number of years. Should they be included under investment expenditure or consumption expenditure in national income estimates? The expenditure on them is regarded as final consumption expenditure because it is not possible to measure their used up value for the subsequent years.

But there is one exception. The expenditure on a new house is regarded as investment expenditure and not consumption expenditure. This is because the rental income or the imputed rent which the house-owner gets is for making investment on the new house. However, expenditure on a car by a household is consumption expenditure. But if he spends the amount for using it as a taxi, it is investment expenditure.

(4) Public Expenditure:
Government spends on police, military, administrative and legal services, parks, street lighting, irrigation, museums, education, public health, roads, canals, buildings, etc. The problem is to find out which expenditure is consumption expenditure and which investment expenditure is.

Expenses on education, museums, public health, police, parks, street lighting, civil and judicial administration are consumption expenditure. Expenses on roads, canals, buildings, etc. are investment expenditure. But expenses on defence equipment are treated as consumption expenditure because they are consumed during a war as they are destroyed or become obsolete. However, all such expenses including the salaries of armed personnel are included in national income.

5. Importance of National Income Analysis:
The national income data have the following importance:

1. For the Economy:
National income data are of great importance for the economy of a country. These days the national income data are regarded as accounts of the economy, which are known as social accounts. These refer to net national income and net national expenditure, which ultimately equal each other.

Social accounts tell us how the aggregates of a nation's income, output and product result from the income of different individuals, products of industries and transactions of international trade. Their main constituents are inter-related and each particular account can be used to verify the correctness of any other account.

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2. National Policies:

National income data form the basis of national policies such as employment policy, because these figures enable us to know the direction in which the industrial output, investment and savings, etc. change, and proper measures can be adopted to bring the economy to the right path.

3. Economic Planning:

In the present age of planning, the national data are of great importance. For economic planning, it is essential that the data pertaining to a country's gross income, output, saving and consumption from different sources should be available. Without these, planning is not possible.

4. Economic Models:

The economists propound short-run as well as long-run economic models or long-run investment models in which the national income data are very widely used.

5. Research:

The national income data are also made use of by the research scholars of economics. They make use of the various data of the country's input, output, income, saving, consumption, investment, employment, etc., which are obtained from social accounts.

6. Per Capita Income:

National income data are significant for a country's per capita income which reflects the economic welfare of the country. The higher the per capita income, the higher the economic welfare of the country.

7. Distribution of Income:

National income statistics enable us to know about the distribution of income in the country. From the data pertaining to wages, rent, interest and profits, we learn of the disparities in the incomes of different sections of the society. Similarly, the regional distribution of income is revealed.

It is only on the basis of these that the government can adopt measures to remove the inequalities in income distribution and to restore regional equilibrium. With a view to removing these personal and regional disequibria, the decisions to levy more taxes and increase public expenditure also rest on national income statistics.

6. Inter-Relationship among Different Concept of National Income

The inter-relationship among the various concept of national income can be shown in the form of equations as under:

Inter-Relationship among different concept of National Income

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1.	Gross National Product (GNP)	= Gross National Expenditure (GNE)
2.	Gross Domestic Product (GDP)	= GNP – Net Income from abroad.
3.	GNP at Market Prices	= GNP at Factor Cost + Indirect Taxes – Subsidies
4.	NNP at Market Prices	= GNP at Market Prices – Depreciation or Capital Consumption Allowance
5.	Net Domestic Product (NDP) at Market Prices	= NNP at Market Prices – Net Factor Income from abroad
6.	NNP at Factor Cost or National Income or National Product	= NNP at Market Prices – Indirect Taxes + Subsidies
7.	NDP at Factor Cost or Domestic Income or Domestic Product	= National Income – Net Factor Income from abroad
8.	Private Income	= NNP at Factor Cost + Government and Business Transfer Payments + Current Transfers from abroad in the form of Gifts and Remittances + Windfall Gains + Net Factor Income from abroad + Interest on Public Debt and Consumer Interest – Social Security Contribution – Income from Government Departments and property – Profits and Surpluses of Public Corporations (or Undertakings) Or = Income from Domestic Product accruing to Private Sector + Interest on Public Dept + Net Factor Income from abroad + Transfer Payments + Current Transfers from the rest of the world (or abroad)
9.	Income from Domestic Product accruing to Private Sector	= NDP at Factor Cost – Income from Domestic Product accruing to Government Departments – Saving of Non-Departmental Enterprises.
10.	Personal Income	= Private Income – Saving of Private Corporate Sector (or Undistributed Corporate Profits) – Corporation Tax (or Profit Taxes)
11.	Personal Disposable Income or Disposable Income	= Personal Income – Direct Taxes paid by Households (or Direct Personal Taxes) and Miscellaneous Fees, Fines, etc. Or = NDP at Factor Cost + Transfer Payments + Net Factor Income from abroad – Corporation Tax – Undistributed Corporate Profits – Social Security Payments – Direct Personal Taxes Or = National Income at Factor Cost + Transfer Payments + Net Income from abroad – Corporate Tax – undistributed Corporate Profits – Social Security payments – Direct Personal Taxes – Indirect Taxes + Subsidies.

Jandhan, AAdhar Mobile (JAM)

Pradhan Mantri Jan-Dhan Yojana (IPA: Pradhān Mantrī Jana Dhan Yōjanā) (Hindi: प्रधानमंत्री जन धन योजना, English: Prime Minister's People Money Scheme) (PMJDY) is India's National Mission for Financial Inclusion to ensure access to financial services, namely Banking Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable manner. This financial inclusion campaign was launched by the Prime Minister of India Narendra Modi on 28 August 2014 He had announced this scheme on his first Independence Day speech on 15 August 2014.

Run by Department of Financial Services, Ministry of Finance, on the inauguration day, 1.5 Crore (15 million) bank accounts were opened under this scheme. Guinness World Records Recognises the Achievements made under PMJDY, Guinness World Records Certificate says "The most bank accounts opened in 1 week as a part of financial inclusion campaign is 18,096,130 and was achieved by Banks in India from 23 to 29 August 2014". By 1 February 2017, over 27 crore (270 million) bank accounts were opened and almost ₹665 billion (US$10 billion) were deposited under the scheme.

In a run up to the formal launch of this scheme, the Prime Minister personally mailed to Chairmans of all PSU banks to gear up for the gigantic task of enrolling over 7.5 crore (75 million) households and to open their accounts. In this email he categorically declared that a bank account for each household was a "national priority".

The scheme has been started with a target to provide 'universal and clear access to banking facilities' starting with "Basic Banking Accounts" with overdraft facility of ₹5,000 (US$74) after six months and RuPay Debit card with inbuilt accident insurance cover of ₹1 lakh (US$1,500) and RuPay Kisan Card. In next phase, micro insurance & pension etc. will also be added.

Under the scheme:

Account holders will be provided bank accounts with no minimum balance.

1. RuPay debit cards will be issued.
2. Accidental insurance cover of ₹1 lakh (US$1,500).
3. After six months of opening of the bank account, holders will be eligible for ₹5,000 (US$74) overdraft from the bank.
4. With the introduction of new technology introduced by National Payments Corporation of India (NPCI), a person can transfer funds, check balance through a normal phone which was earlier limited only to smart phones.
5. Mobile banking for the poor would be available through National Unified USSD Platform (NUUP) for which all banks and mobile companies have come together[4]

Performance:

Due to the preparations done in the run-up, as mentioned above, on the inauguration day, 1.5 Crore (15 million) bank accounts were opened. The Prime Minister said on this occasion- "Let us celebrate today as the day of financial freedom." By September 2014, 3.02 crore accounts were opened under the scheme, amongst Public sector banks, SBI had opened 30 lakh (3 million) accounts, followed by Punjab National Bank with 20.24 lakh (2 million) accounts, Canara Bank 16.21 lakh (1.62 million) accounts, Central

Bank of India 15.98 lakh (1.59 million) accounts and Bank of Baroda with 14.22 lakh (1.42 million) accounts.

It was reported that total of 7 Crore (70 million) bank accounts have been opened with deposits totaling more than ₹50 billion (US$740 million) as of 6 November 2014. As the government met the target, Union Finance Minister Arun Jaitley has revised the target for opening of bank accounts under the Pradhan Mantri Jan Dhan Yojana (PMJDY), the ambitious financial inclusion scheme launched by the government, from 7.5 crore to 10 crore by 26 January 2015. On 20 January 2015, the scheme entered into Guinness book of world records setting new record for 'The most bank accounts opened in one week'.

The number of accounts opened under the scheme reached 255 million (including 57 million zero balance accounts) by November 2016. The amount of deposits rose to ₹380.47 billion (US$5.7 billion) by April 2016.] 19 lakh householders have availed the overdraft facility of ₹2.56 billion (US$38 million) by May 2016. As per the 26.11.2016 status total account deposits balance is Rs.64250/-

Uttar Pradesh and West Bengal have got 29% of the total deposits under the scheme, whereas Kerala and Goa became the first states in the country to provide one basic bank account to every household.

The balance in Jan Dhan accounts rose by more than ₹270 billion (US$4.0 billion) between 9 November 2016 and 23 November 2016.

Criticism:

The scheme has been criticized by opposition as an effort to please voters that has created unnecessary work-burden on the public-sector banks. It has been claimed that the poor deserves food more than bank accounts and financial security. Further, these accounts have not yet added considerable profits to PSU banks. According to the experts, offers like zero balance, free insurance and overdraft facility would result in duplication. Many individuals who already have bank accounts may have had accounts created for themselves, lured by the insurance covers and overdraft facilities. As per the scheme, a very few people are eligible to get the life insurance worth ₹30,000 (US$450) with a validity of just five years. The claimed overdraft facility has been completely left upon the banks. As per the government notice, only those people would get the overdraft facility whose transaction record is satisfactory and financially.

Aadhaar is a 12 digit unique-identity number issued to all Indian residents based on their biometric and demographic data. The data is collected by the Unique Identification Authority of India (UIDAI), a statutory authority established on 12 July 2016 by the Government of India, under the Ministry of Electronics and Information Technology, under the provisions of the Aadhaar Act 2016.

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Aadhaar is the world's largest biometric ID system, with over 1.123 billion enrolled members as of 28 February 2017. As of this date, over 99% of Indians aged 18 and above had been enrolled in Aadhaar.

Aadhaar is not a proof of citizenship, and does not itself grant any rights to domicile in India.

Prior to the enactment of the Act, UIDAI functioned as an attached office of Planning Commission (now NITI Aayog) since 28 January 2009. On 3 March 2016, a money bill was introduced in the Parliament to give legislative backing to Aadhaar. On 11 March 2016, the Aadhaar Act 2016 was passed in the Lok Sabha. On 26 March 2016, this Act was notified in the Gazette of India.

Some civil liberty groups, like Citizens Forum for Civil Liberties and Indian Social Action Forum (INSAF), have opposed the project on privacy concerns.

The Unique Identification Authority of India (UIDAI) is a statutory authority established on 12 July 2016 by the Government of India under the Ministry of Electronics and Information Technology, under the provisions of the Aadhaar Act 2016.

The UIDAI is mandated to assign a 12-digit unique identification (UID) number (termed as Aadhaar) to all the residents of India. The implementation of UID scheme entails generation and assignment of UID to residents; defining mechanisms and processes for interlinking UID with partner databases; operation and management of all stages of UID life cycle; framing policies and procedures for updation mechanism and defining usage and applicability of UID for delivery of various services among others. The number is linked to the resident's basic demographic and biometric information such as photograph, ten fingerprints and two iris scans, which are stored in a centralised database.

The Unique Identification Authority of India (UIDAI) was initially set up by the Government of India in January 2009, as an attached office under aegis of Planning Commission vide its a gazette notification.[11] As per the notification, the UIDAI was given the responsibility to lay down plan and policies to implement UID scheme, to own and operate the UID database and be responsible for its updation and maintenance on an ongoing basis.

The UIDAI data center is located at Industrial Model Township (IMT), Manesar.

Starting with issuing of first UID in September 2010, the UIDAI has been targeting to issue an Aadhaar number to all the residents that (a) is robust enough to eliminate duplicate and fake identities, and (b) can be verified and authenticated in an easy and cost-effective way online anywhere, anytime. The Government of India in a notification dated 16 December 2010 recognizes the letter issued by Unique Identification Authority of India (UIDAI) containing details of name, address and Aadhaar number, as an

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officially valid document. It neither aims to replace any existing identity cards nor it is a cognizance of citizenship. Aadhaar neither confers citizenship nor guarantees rights, benefits, or entitlements. Aadhaar is a random number which never starts with a 0 or 1, and is not loaded with profiling or intelligence into identity numbers that makes it insusceptible to fraud and theft. The unique ID would also qualify for as a valid ID while availing various government services, like a LPG connection or subsidised ration or kerosene from PDS or benefits under NSAP or pension schemes, e-sign, digital locker, Universal Account Number (UAN) under EPFO; and for some other services, like a SIM card or opening a bank account. According to the UIDAI website, any Aadhaar holder or service provider can verify an Aadhaar number for its genuineness through a user-friendly service of UIDAI called Aadhaar Verification Service (AVS) available on its website. Also, a resident already enrolled under National Population Register is not required to enrol again for Aadhaar.

Enrollment:

As of 12 March 2017, 1.127 billion Aadhaar numbers had been issued. Over 99% of the 18+ aged population was covered as of this date.

Data below is sourced from the State-Wise Saturation Report on the Public Data Portal as of 28 February 2017. Percentage figures are with respect to 2015 estimated population.

Rank	State / Union Territory	Population	AADHAARs Issued	% of Population
	INDIA	**1,278,229,800**	**1,122,553,603**	**88%**
1	Delhi	17,720,573	20,846,334	118%
2	Haryana	26,816,977	27,565,296	103%
3	Telangana	37,253,813	37,997,961	102%
4	Punjab	29,303,888	29,756,585	102%
5	Himachal Pradesh	7,252,406	7,359,276	101%
6	Lakshadweep	68,149	68,983	101%
7	Chandigarh	1,115,584	1,116,319	100%
8	Goa	1,541,892	1,527,883	99%
9	Kerala	35,315,493	34,977,329	99%
10	Chhattisgarh	27,014,896	26,400,345	98%
11	Dadra & Nagar Haveli	362,649	354,215	98%

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Rank	State / Union Territory	Population	AADHAARs Issued	% of Population
	INDIA	**1,278,229,800**	**1,122,553,603**	**88%**
12	Puducherry	1,316,320	1,284,128	98%
13	Andhra Pradesh	52,229,924	50,722,016	97%
14	A & N Islands	401,882	389,333	97%
15	Jharkhand	34,869,720	33,778,892	97%
16	Uttarakhand	10,700,897	10,308,862	96%
17	Maharashtra	118,861,427	111,570,155	94%
18	Tripura	3,882,999	3,643,270	94%
19	Karnataka	64,660,412	60,236,826	93%
20	Madhya Pradesh	76,789,374	71,468,080	93%
21	Gujarat	62,100,000	57,101,842	92%
22	Sikkim	642,776	589,595	92%
23	Tamil Nadu	76,304,287	68,617,594	90%
24	West Bengal	96,622,186	85,733,856	89%
25	Rajasthan	72,583,213	63,891,456	88%
26	Odisha	44,369,413	38,876,522	88%
27	Uttar Pradesh	211,105,381	175,142,905	83%
28	Daman & Diu	256,937	206,419	80%
29	Bihar	109,798,353	85,016,105	77%
30	Manipur	2,878,911	1,958,818	68%
31	Jammu Kashmir	13,273,505	8,877,651	67%
32	Arunachal Pradesh	1,462,443	932,864	64%
33	Mizoram	1,154,010	657,939	57%
34	Nagaland	2,094,963	1,151,075	55%
35	Meghalaya	3,135,150	278,906	9%
36	Assam	32,968,997	2,147,968	7%

From the beginning of the project in 2009 through November 2016, the government spent a total of ₹82.772 billion (US$1.2 billion) on the Aadhaar project.

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Expenditure by UIDAI (by year)	
Fiscal year	**Expenditure**
2009-10	₹262 million (US$3.9 million)
2010-11	₹2.684 billion (US$40 million)
2011-12	₹11.875 billion (US$180 million)
2012-13	₹13.387 billion (US$200 million)
2013-14	₹15.444 billion (US$230 million)
2014-15	₹16.153 billion (US$240 million)
2015-16	₹16.791 billion (US$250 million)
2016-17 (through Nov 2016)	₹6.175 billion (US$92 million)
Total	**₹82.772 billion (US$1.2 billion)**

The budgeted amount for the project was reduced to ₹9.990 billion (US$150 million) in FY16-17 from ₹20.00 billion (US$300 million) in FY15-16, given the high enrolled percentage.

Previous identity Card Programs

In 1999 after the Kargil war, the Kargil Review Committee, headed by security analyst K. Subrahmanyam, was formed to study the state of national security. It submitted its report to the then Prime Minister, Atal Bihari Vajpayee on 7 January 2000. Among its various recommendations, was the proposal that citizens in villages in border region be issued identity cards on a priority basis, later such ID cards should be issued to all people living in border states.

A Group of Ministers (GoM), headed by L. K. Advani, was formed to study the recommendations and examine possible implemenatation. The GoM submitted its report in May 2001. It had accepted the recommendation for an id card. The report said the a "multi-purpose National Identity Card" project would be started soon. The card would be first issued in border villages and then elsewhere. In late September 2001, the Ministry of External Affairs proposed that a mandatory national identity card be issued. This announcement came after reports that some people had multiple Indian passports with different details. This was attributed to the lack of computerisation between the passport centres. In December 2003, the Citizenship (Amendment) Bill, 2003 was introduced in the Lok Sabha by L. K. Advani. It primarily aims to provide various rights to persons of Indian origin.[31] However, the bill also introduced the Clause 14 (a) that said "The Central Government may compulsorily register every citizen of India and issue national identity card to him."

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2009-2014

The UIDAI was established on 28 January 2009 after the Planning Commission issued a notification. On 23 June 2009, Nandan Nilekani, the co-founder of Infosys, was appointed by the then government to head the project. He was given the newly created position of the Chairman of UIDAI which was equivalent to a Cabinet minister. In April 2010, the logo and the brand name *Aadhaar* was launched by Nilekani. In May 2010, Nilakani said he would support a legislation to protect the data held by the UIDAI.

In July 2010, UIDAI published a list 15 of agencies which were qualified to provide training to personnel to be involved in the enrollment process. It also published a list of 220 agencies which were qualified to take part in the enrollment process. Before this, the project had been only 20 states and with LIC of India and State Bank of India as qualified registrars. This announcement introduced several private firms. It was estimated that to achieve the target of enrolling 40% of the population in two years, 31,019 personnel would be required and 155 training centres would be required to train them. It was also estimated that 4,431 enrollment centres and 22,157 enrollment stations would have to be established.

On 7 February 2012, the UIDAI launched an online verification system for Aadhar numbers. Using the system banks, telecom companies and government departments could enter an Aadhaar number and verify if the person was a resident of India.

On 26 November 2012, Prime Minister Manmohan Singh launched an Aadhaar-linked direct benefit transfer scheme. The project aimed to eliminate leakages in the system by directly transferring the money to the bank account of the recipient. The project was to be introduced in 51 districts on 1 January 2013 and then slowly expanded to cover all of India.

In late November 2012, a former Karnataka High Court judge, Justice K S Puttaswamy, and a lawyer, Parvesh Khanna, filed a Public Interest Litigation (PIL) against the government in the Supreme Court of India. They contented that the government was implementing the project without any legislative backing.[43] In December 2011, the Parliamentary Standing Committee on Finance, led by Yashwant Sinha, rejected the National Identification Authority of India Bill, 2010 in its then present form and suggested modifications. It termed the project "unethical and violative of Parliament's prerogatives". On 23 September 2013, the Supreme Court issued an interim order saying that the government cannot deny a service to anyone who does not possess Aadhaar, as it is voluntary.

In late September 2013, following the Supreme Court verdict, Union Minister of State for Parliamentary Affairs and Planning Rajeev Shukla said that the National Identification Authority of India Bill, 2010 would be attempted to be passed in the winter session of the Parliament. On 9 October 2013, the National Payments

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Corporation of India launched an Aadhaar-based remittance system. Using the system funds could be transferred to any Aadhaar-linked bank accounts, if only the Aadhaar number was known. It was announced that an SMS could be used for amounts up to ₹5,000 (US$74) and for amounts over that a mobile bank app could be used. By this time around 44 million Aadhaar numbers had been issued.

In March 2014, Nandan Nilekani resigned as the Chairman to contest in the general election on an Indian National Congress nomination from Bangalore South. His responsibilities taken over by 1981-batch IAS officer Vijay Madan, who was given an extension of his term as the director-general and mission director by the government. Nilekani lost to Ananth Kumar.

2014-2015

Before elections in March 2014, BJP national spokesperson Meenakshi Lekhi and general secretary Ananth Kumar had criticised the project for issuing Aadhaar to illegal immigrants. Lekhi pointed out that project continued to be run even after a parliamentary committee voted againist and despite the Supreme Court order. Subramanian Swamy, another BJP leader and economist, said that UIDAI was a useless scheme and Nilekani should be prosecuted for wasting resources by hiring US firms.

On 10 June 2014, the new government disbanded four Cabinet Committees to streamline the decision making process; among them was also the Cabinet Committee on Aadhaar. Also in June 2014, the IT Department held a meeting with the secretaries of the states to receive feedback on the project.

On 1 July 2014, the former UIDAI Chairman Nandan Nilekani met with the Prime Minister Narendra Modi and Finance Minister Arun Jaitley to convince them of the project's merits. On 5 July 2014, Modi announced that his government retain the project and asked official to look into linking the project with passports. The Budget, allotted ₹20.3964 billion (US$300 million) to the project for the fiscal year 2014-15. It was a substantial increase from the previous year's ₹15.50 billion (US$230 million). Also in July, it was reported that UIDAI would hire an advertising agency and spend about ₹300 million (US$4.5 million) on an advertising campaign.

On 10 September 2014, the Cabinet Committee on Economic Affairs gave approval to the Phase-V of the UIDAI project, starting the enrollment process in Uttar Pradesh, Bihar, Chhattisgarh and Uttarakhand. The Union Cabinet allocated ₹12 billion (US$180 million) to the project to reach the target of 1 billion enrollment by 2015 end.

On 18 June 2015, in a high-level review meeting on the progress of the UID project and DBT scheme, Prime Minister Narendra Modi asked the officials to accelerate the delivery of benefits and expand the applications of the Aadhaar (UID) platform. He also

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asked them to examine the possibility of incentivizing the states, through a one-time sharing of a portion of the savings. It was reported that the government was saving up to 14-15% in the direct benefit transfers of subsidies on LPG to the beneficiaries through Aadhaar.

Finding the experience with DBT scheme in LPG "very encouraging" with a reported savings to the tune of ₹127 billion (US$1.9 billion) to the public exchequer this year, Finance Minister Arun Jaitley on 5 July 2015, said, "If we can realize the government's JAM—Jan Dhan, Aadhaar, Mobile—vision we can ensure that money goes directly and more quickly into the pockets of the poor and from the savings we achieve, we can put even more money for the poor. If we can be careful in our design and implementation, we can extend DBT to other commodities, so that the poor get more money to spend for their upliftment." [63]

In March 2015, the Aadhaar-linked DigiLocker service was launched, using which Aadhaar-holders can scan and save their documents on the cloud, and can share it with the government officials whenever required without any need to carry them.

2016-present

During the budget presentation on 29 February 2016, Finance Minister Arun Jaitley announced that a bill will be introduced within a week to provide legislative support to the Aadhaar. On 3 March 2016, the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Bill, 2016 was introduced in the Parliament as a money bill by Jaitley. The decision to introduce it as a money bill was criticised by the opposition parties. Ghulam Nabi Azad, an INC leader, wrote in a letter to the Jaitley that the ruling party, BJP was attempting to bypass the Rajya Sabha, as they did not have the majority in the upper house. A money bill is only required to pass in the lower house Lok Sabha. Tathagata Satpathy of Biju Janata Dal (BJD) raised concerns that the project could be used for mass surveillance or ethnic cleansing in the future.

On 11 March 2016, the Aadhaar (Targeted Delivery of Financial and other Subsidies, benefits and services) Act, 2016, was passed in the Lok Sabha.[6] During the Rajya Sabha debate on 16 March, Sitaram Yechury of CPI-M said that bill should not have been passed when the issue right to privacy was still in the Supreme Court. On 16 March 2016, the bill was returned to the Lok Sabha by the Rajya Sabha with some suggested amendments. The Lok Sabha was free to accept or reject the amendments. But, Lok Sabha rejected the amendments.

It is used for unique identification. Nowadays it became mandatory for all our basic needs. In states like Tamil Nadu, it is made mandate for providing ration. Also it is used for forensic purposes since it is a bio-metric identification

Aadhaar project has been linked to some public subsidy and unemployment benefit schemes like the domestic LPG scheme and MGNREGS. In these Direct Benefit

Transfer schemes, the subsidy money is directly transferred to a bank account which is Aadhaar-linked.

On 29 July 2011, the Ministry of Petroleum and Natural Gas signed a memorandum of understanding with UIDAI. The Ministry had hoped the ID system would help them eliminate loss of the subsidised kerosene and LPG. In May 2012, the government announced that it will begin issuing Aadhaar-linked MGNREGS cards. On 26 November 2012, a pilot project was launched in 51 district.

Under the original policy for liquified petroleum gas subsidies, the customers bought gas cylinders from retailers at subsidised prices, and the government compensated companies for their losses. Under the current Direct Benefit Transfer of LPG (DBTL), introduced in 2013, customers had to buy at the full price, and the subsidy would be then directly credited to their Aadhaar-linked bank accounts. This scheme, however, did not take off, as in September 2013, a Supreme Court order put a halt on it. Subsequently, GOI constituted a committee to review the "Direct Benefits Transfer for LPG Scheme" to study the shortcomings in the scheme and recommend changes. The DBTL scheme was modified later as PAHAL by the new government in November 2014. Under PAHAL, subsidies could be credited to one's bank account even if the one did not have an Aadhaar number. Official data show that cooking gas consumption during the January–June period grew at a slower 7.82%, nearly four percentage points less than 11.4% growth in the same period last year.

The PAHAL scheme has covered 118.9 million of the 145.4 million active LPG consumers till March, as stated by the Petroleum Minister in the Parliament. Thereby, the DBT has become a "game changer" for India, claimed the Chief Economic Adviser to the Finance Ministry, Government of India, Arvind Subramanian, for in case of LPG subsidy, DBT had resulted in a 24% reduction in the sale of subsidized LPG, as "ghost beneficiaries" had been excluded. The savings to the government were to the tune of ₹127 billion (US$1.9 billion) in 2014-15. The success of the modified scheme helped fuel marketing companies save almost ₹80 billion (US$1.2 billion) from November 2014 to June 2015, said oil company officials. The DBT for the public distribution system (PDS) will be rolled out in September 2015.

Prime Minister Narendra Modi has asked for integration of all land records with Aadhaar at the earliest, emphasising at his monthly PRAGATI (Pro-Active Governance And Timely Implementation) meeting on 23 March 2016 that this is extremely important to monitor the successful implementation of the Pradhan Mantri Fasal Bima Yojana or crop insurance scheme.

Aadhaar-Enabled Biometric Attendance Systems

In July 2014, Aadhaar-enabled biometric attendance systems (AEBAS) was introduced in government offices. The system was introduced to check late arrival and absenteeism of government employees. The public could see the daily in and out of employees on the website *attendance.gov.in*. However, in October 2014, the website was closed to the public but is now (as on 24 March 2016) active and open to public access. The employees use the last four digits (last eight digits for government employee registring as on August 2016) of their Aadhaar number and their fingerprints, for authentication.

Other Uses by Central Government Agencies

In November 2014, it was reported the Ministry for External Affairs was considering making Aadhaar a mandatory requirement for passport holders.[84] In February 2015, it was reported that people with Aadhaar number will get their passports issued within 10 days, as it allowed the verification process to be easier by checking if applicant had any criminal records in the National Crime Records Bureau database. In May 2015, it was announced that the Ministry of External Affairs was testing the linking of passports to the Aadhaar database.

In October 2014, the Department of Electronics and Information Technology said that they were considering linking Aadhaar to SIM cards. In November 2014, the Department of Telecom asked all telecom operators to collect Aadhaar from all new applicants of SIM cards. On 4 March 2015, Aadhaar-linked SIM cards began to be sold in some cities in a pilot project. The purchase could activate the SIM at the time of purchase by submitting his Aadhaar number and pressing his fingerprints on a machine. It is part of the Digital India plan. The Digital India project aims to provide all government services to citizens electronically and is expected to be completed by 2018.

In July 2014, Employees' Provident Fund Organisation of India (EPFO) began linking provident fund accounts with Aadhaar numbers. In November 2014, EPFO became an UIDAI registrar and began issuing Aadhaar number to provident fund subscribers. In December 2014, Labour Minister Bandaru Dattatreya clarified that an Aadhaar number was not necessary for any provident fund transaction.

In August 2014, Prime Minister Modi directed the Planning Commission of India to enroll all prisoners in India under UIDAI.

In December 2014, it was proposed by the Minister for Women and Child Development Maneka Gandhi that Aadhaar should be made mandatory for men to create a profile on matrimonial websites, to prevent fake profiles. In July 2015, the Department of Electronics and Information Technology (DeitY) called a meeting of meeting of various matrimonial sites and other stakeholders discuss the use of Aadhaar to prevent fake profile and protect women from exploitation.

On 3 March 2015, the National Electoral Roll Purification and Authentication Programme (NERPAP) of the Election Commission was started. It aims to link the Elector's Photo Identity Card (EPIC) with the Aadhaar number of the registered voter. It is aims to create an error-free voter identification system in India, especially by removing duplications.

Other Uses by States

In Hyderabad region of Telangana state, Aadhaar numbers were linked to ration cards to remove duplicate ration cards. The project was started in July 2012 and was carried out despite the 2013 Supreme Court order. More than 63,932 ration cards in the white category, and 2,29,757 names were removed from its database in the drive between July 2012 and September 2014. In August 2012, Andhra Pradesh, asked citizens to surrender illegal ration cards, before it began to link them with Aadhaar numbers. By September 2014, 15 lakh illegal ration cards had been surrendered. In April 2015, the state of Maharashtra began enrolling all school students in the state in the Aadhaar project to implement the Right to Education Act properly.

Electronic-Know Your Customer (e-KYC) using Aadhar card is also being introduced to activate mobile connections instantly to check Aadhar Card Status.

Feasibility Concerns

In October 2010, R. Ramakumar, an economist at the Tata Institute of Social Sciences, wrote in an editorial for *The Hindu* that the project was being implemented without any cost-benefit or feasibility studies to ensure whether the project will meet its stipulated goals. He also pointed the government was obscuring the security aspects of Aadhaar and focusing on the social benefit schemes. He quoted former chief of the Intelligence Bureau Ajit Doval who had said that originally Aadhaar aimed to weed out illegal aliens.[27]

In March 2011, Rajanish Dass of IIM Ahmedabad's Computer and Information Systems Group, published a paper titled "Unique Identity Project in India: A divine dream or a miscalculated heroism". Dass claimed that even if enrollment is voluntary, it is being made mandatory by indirect means. He pointed out that essential schemes like the National Food Security Act, 2013 was being linked to UIDAI. He also pointed the feasibility of a project of this size had not been studied and raised concerns about the quality of the biometric data being collected. He cited another researcher Usha Ramanathan that UIDAI will ultimately have to become profit-making to sustain itself.

On 9 November 2012, the National Institute of Public Finance and Policy published a paper titled *A cost-benefit analysis of Aadhaar*. The paper claimed that by 2015-16 the benefits of the project will surpass the costs, and by 2020-21 the total benefit would be ₹251 billion (US$3.7 billion) against the total expenditure of ₹48.35 billion (US$720 million). The benefits would come from plugging leakages in various subsidy and social benefit schemes.

In March 2016, the International Institute for Sustainable Development released a report that the benefit from Aadhaar-linked LPG subsidy scheme for 2014-15 was ₹140

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million (US$2.1 million) and for 2015-16 was ₹1.209 billion (US$18 million). This sum was much lower than the number stated by Finance Minister Arun Jaitley in the Lok Sabha. He had said in March 2016 that the government had saved ₹150 billion (US$2.2 billion) from the scheme. The paper said that the government was also including the savings from the efforts of oil marketing companies (OMCs) prior to the introduction of Aadhaar. The method used by the OMCs to weed out duplicates and ghost customers was 15–20 times more effective than the Aadhaar-based method.

Lack of Legislation and Privacy Concerns

In late November 2012, a former Karnataka High Court judge, Justice K. S. Puttaswamy, and a lawyer, Parvesh Khanna, filed a Public Interest Litigation (PIL) against the government in the Supreme Court of India. They had contended that government was implementing the project without any legislative backing. They pointed out that the National Identification Authority of India Bill, 2010 which introduced in the Rajya Sabha was still pending. They said that since UIDAI was running on only an executive order issued on 28 January 2009, it cannot collect biometric data of citizens as it would be a violation of privacy under Article 21 of the Constitution.

On 23 September 2013, the Supreme Court issued an interim order saying that "no person should suffer for not getting the Aadhaar card in spite of the authority making it mandatory". The court noted that the government had said that Aadhaar is voluntary.

On 2 February 2015, the Supreme Court asked the new government to clarify its stance on the project. This was in response to a new PIL filed by Mathew Thomas, a former army officer. Thomas had claimed that government was ignoring previous orders while pushing ahead with the project and that the project was unconstitutional as it allowed profiling of citizens. The government in a reply on 12 February said that it will continue the project. On 16 July 2015, the government requested the Supreme Court to revoke its order, saying that it intends to use Aadhaar for various services. On 21 July 2015, the Court noted that some states were insisting on Aadhaar for benefits despite its order.

On 11 August 2015, the Supreme Court directed the government to widely publicise in print and electronic media that Aadhaar is not mandatory for any welfare scheme. The Court also referred the petitions claiming Aadhaar is unconstitutional to a Constitutional Bench.

Legality of Sharing Data with Law Enforcement

In 2013 Goa, the CBI was trying to solve the case of a rape of a schoolgirl. It approached a Goa local court saying that they had acquired some fingerprints from the scene and they could be matched with the UIDAI database. The court asked UIDAI to hand over all data of all persons in Goa to CBI.

The UIDAI appealed in the Bombay High Court saying that accepting such a request would set precedent for several more such requests. The High Court rejected the argument and on 26 February 2014 in an interim order directed Central Forensic Science Laboratory (CFSL) to study technological capability of the database to see if it can solve such a crime. The UIDAI then appealed in the Supreme Court. It argued that the chance of a false positive was 0.057% and with 600 million people in its database it would result in hundreds of thousands of false results.

The Supreme Court, on 24 March 2014, restrained the central government and the Unique Identification Authority of India from sharing data with any third party or agency, whether government or private, without the consent of the Aadhaar-holder in writing. Vide another interim order dated 16 March 2015, the Supreme Court of India has directed the Union of India and States and all their functionaries should adhere to the order passed by this court on 23 September 2013. It observed that some government agencies were still treating Aadhaar as mandatory and asked all agencies to issue notifications clarifying that it was not mandatory.

Land Allotment Dispute

In September 2013, the Delhi Development Authority accepted a complaint from the India Against Corruption activist group and cancelled a land allotment to UIDAI. The land was previously owned by BSNL, and MTNL had also laid claims on it. It was of an estimated ₹9 billion (US$130 million) value, but it had been allotted to UIDAI at a very cheap rate.

The issue of constructing UIDAI HQs and UIDAI Regional Office, Delhi's building was resolved with Department of Telecom (DoT). Following which, the Ministry of Urban Development has issued a notification on 21 May 2015 clearing the titles of the land in favour of UIDAI including land use.

Security Concerns

In an August 2009 interview with the *Tehelka*, former chief of the Intelligence Bureau (IB), Ajit Doval, said that it was originally intended to flush out illegal immigrants, but social security benefits were later added to avoid privacy concerns. In December 2011, the Parliamentary Standing Committee on Finance, led by Yashwant Sinha, rejected the National Identification Authority of India Bill, 2010 and suggested modifications. It expressed objections to the issuing of Aadhaar numbers to illegal immigrants. The Committee said that the project was being implemented in an unplanned manner and by bypassing the Parliament.

In May 2013, deputy director general of UIDAI, Ashok Dalwai, admitted that there had been some errors in the registration process. Some people had received Aadhaar cards with wrong photographs or fingerprints. According to Aloke Tikku of *Hindustan Times*, some officials of the Intelligence Bureau (IB) had criticised the UIDAI project in

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September 2013. The unnamed IB officials have said that Aadhaar number cannot be treated as a credible proof of residence. As under the liberal pilot phase, where a person claims to live was accepted as the address and recorded.

Gajanan Khergamker in a commentary in *Tehelka* has argued that the Aadhaar threatens to legitimise the illegals living in the country. He said that frequently local bureaucrats and politicians give away documents like ration cards to illegal immigrants for political or personal gains. He pointed out that the Genetic Information Nondiscrimination Act of US prohibits discrimination based on collected biomedical data, but India has no such safeguards for its citizens. He said the data being collected was worth fortunes and India was a "sitting duck" without proper protective legislation.

Overlaps with National Population Register

The Aadhaar and the similar National Population Register (NPR) projects have been reported to be having conflicts. In January 2012, it was reported that UIDAI will share its data with NPR and NPR will continue to collect its own data. In January 2013, then Home Minister Sushilkumar Shinde said that Aadhaar was not an identity card but a number, while NPR was necessary for national security purposes. The 2013 Supreme Court order did not affect the NPR project as it was not linked to any subsidy.

In July 2014, a meeting was held to discuss the possibility of merging the two projects Aadhaar and NPR, or making them complementary. The meeting was attended by Home Minister Rajnath Singh, Law and Justice and Telecom Minister Ravi Shankar Prasad and Minister of State for Planning Rao Inderjit Singh. However, later in the same month, Rao Inderjit Singh told the Lok Sabha that no plan to merge the two projects has been made.

Mobile Banking:

Mobile banking is a service provided by a bank or other financial institution that allows its customers to conduct financial transactions remotely using a mobile device such as a mobile phone or tablet. It uses software, usually called an app, provided by the financial institution for the purpose. Mobile banking is usually available on a 24-hour basis. Some financial institutions have restrictions on which accounts may be accessed through mobile banking, as well as a limit on the amount that can be transacted.

Transactions through mobile banking may include obtaining account balances and lists of latest transactions, electronic bill payments, and funds transfers between a customer's or another's accounts. Some apps also enable copies of statements to be downloaded and sometimes printed at the customer's premises; and some banks charge a fee for mailing hardcopies of bank statements.

From the bank's point of view, mobile banking reduces the cost of handling transactions by reducing the need for customers to visit a bank branch for non-cash withdrawal and

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deposit transactions. Mobile banking does not handle transactions involving cash, and a customer needs to visit an ATM or bank branch for cash withdrawals or deposits. Many apps now have a remote deposit option; using the device's camera to digitally transmit cheques to their financial institution.

Mobile banking differs from mobile payments, which involves the use of a mobile device to pay for goods or services either at the point of sale or remotely, analogously to the use of a debit or credit card to effect an EFTPOS payment.

The earliest mobile banking services used SMS, a service known as SMS banking. With the introduction of smart phones with WAP support enabling the use of the mobile web in 1999, the first European banks started to offer mobile banking on this platform to their customers.

Mobile banking before 2010 was most often performed via SMS or the mobile web. Apple's initial success with iPhone and the rapid growth of phones based on Google's Android (operating system) have led to increasing use of special mobile apps, downloaded to the mobile device. With that said, advancements in web technologies such as HTML5, CSS3 and JavaScript have seen more banks launching mobile web based services to complement native applications. A recent study (May 2012) by Mapa Research suggests that over a third of banks have mobile device detection upon visiting the banks' main website. A number of things can happen on mobile detection such as redirecting to an app store, redirection to a mobile banking specific website or providing a menu of mobile banking options for the user to choose from.

A Mobile Banking Conceptual -

In one academic model, mobile banking is defined as:

Mobile Banking refers to provision and availment of banking- and financial services with the help of mobile telecommunication devices.The scope of offered services may include facilities to conduct bank and stock market transactions, to administer accounts and to access customised information."

According to this model mobile banking can be said to consist of three inter-related concepts:

- Mobile accounting
- Mobile brokerage
- Mobile financial information services

Most services in the categories designated *accounting* and *brokerage* are transaction-based. The non-transaction-based services of an informational nature are however essential for conducting transactions - for instance, balance inquiries might be needed before committing a money remittance. The accounting and brokerage services are therefore offered invariably in combination with information services. Information services, on the other hand, may be offered as an independent module.

Mobile banking may also be used to help in business situations as well as financial

Typical mobile banking services may include:

Account Information

1. Mini-statements and checking of account history
2. Alerts on account activity or passing of set thresholds
3. Monitoring of term deposits
4. Access to loan statements
5. Access to card statements
6. Mutual funds / equity statements
7. Insurance policy management

Transaction

1. Funds transfers between the customer's linked accounts
2. Paying third parties, including bill payments and third party fund transfers(see, e.g., FAST)
3. Check Remote Deposit

Investments

1. Portfolio management services
2. Real-time stock quotes
3. Personalized alerts and notifications on security prices

Support

1. Status of requests for credit, including mortgage approval, and insurance coverage
2. Check (cheque) book and card requests
3. Exchange of data messages and email, including complaint submission and tracking
4. ATM Location

Content Services

1. General information such as weather updates, news
2. Loyalty-related offers
3. Location-based services

A report by the US Federal Reserve (March 2012) found that 21 percent of mobile phone owners had used mobile banking in the past 12 months.[5] Based on a survey

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conducted by Forrester, mobile banking will be attractive mainly to the younger, more "tech-savvy" customer segment. A third of mobile phone users say that they may consider performing some kind of financial transaction through their mobile phone. But most of the users are interested in performing basic transactions such as querying for account balance and making bill payment.

Future Functionalities in Mobile Banking

Based on the 'International Review of Business Research Papers' from World business Institute, Australia, following are the key functional trends possible in world of Mobile Banking.

With the advent of technology and increasing use of smartphone and tablet based devices, the use of Mobile Banking functionality would enable customer connect across entire customer life cycle much comprehensively than before. With this scenario, current mobile banking objectives of say building relationships, reducing cost, achieving new revenue stream will transform to enable new objectives targeting higher level goals such as building brand of the banking organization. Emerging technology and functionalities would enable to create new ways of lead generation, prospecting as well as developing deep customer relationship and mobile banking world would achieve superior customer experience with bi-directional communications. Among digital channels, mobile banking is a clear IT investment priority in 2013 as retail banks attempt to capitalise on the features unique to mobile, such as location-based services.[6]

Illustration of objective based functionality enrichment In Mobile Banking

- Communication enrichment: - Video Interaction with agents, advisors.
- Pervasive Transactions capabilities: - Comprehensive “Mobile wallet”
- Customer Education: - “Test drive” for demos of banking services
- Connect with new customer segment: - Connect with Gen Y – Gen Z using games and social network ambushed to surrogate bank’s offerings
- Content monetization: - Micro level revenue themes such as music, e-book download
- Vertical positioning: - Positioning offerings over mobile banking specific industries
- Horizontal positioning: - Positioning offerings over mobile banking across all the industries
- Personalization of corporate banking services: - Personalization experience for multiple roles and hierarchies in corporate banking as against the vanilla based segment based enhancements in the current context.
- Build Brand: - Built the bank’s brand while enhancing the “Mobile real estate”.

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Key challenges in developing a sophisticated mobile banking application are :

Handset Accessibility

There are a large number of different mobile phone devices and it is a big challenge for banks to offer a mobile banking solution on any type of device. Some of these devices support Java ME and others support SIM Application Toolkit, a WAP browser, or only SMS.

Initial interoperability issues however have been localized, with countries like India using portals like "R-World" to enable the limitations of low end java based phones, while focus on areas such as South Africa have defaulted to the USSD as a basis of communication achievable with any phone.

The desire for interoperability is largely dependent on the banks themselves, where installed applications(Java based or native) provide better security, are easier to use and allow development of more complex capabilities similar to those of internet banking while SMS can provide the basics but becomes difficult to operate with more complex transactions.

There is a myth that there is a challenge of interoperability between mobile banking applications due to perceived lack of common technology standards for mobile banking. In practice it is too early in the service lifecycle for interoperability to be addressed within an individual country, as very few countries have more than one mobile banking service provider. In practice, banking interfaces are well defined and money movements between banks follow the IS0-8583 standard. As mobile banking matures, money movements between service providers will naturally adopt the same standards as in the banking world.

In January 2009, Mobile Marketing Association (MMA) Banking Sub-Committee, chaired by CellTrust and VeriSign Inc., published the Mobile Banking Overview for financial institutions in which it discussed the advantages and disadvantages of Mobile Channel Platforms such as Short Message Services (SMS), Mobile Web, Mobile Client Applications, SMS with Mobile Web and Secure SMS.

Security

As with most internet-connected devices, as well as mobile-telephony devices, cybercrime rates are escalating year-on-year. The types of cybercrimes which may affect mobile-banking might range from unauthorized use while the owner is using the toilet, to remote-hacking, or even jamming or interference via the internet or telephone network datastreams. In the banking world, currency rates may change by the millisecond.

Security of financial transactions, being executed from some remote location and transmission of financial information over the air, are the most complicated challenges that need to be addressed jointly by mobile application developers, wireless network service providers and the banks' IT departments.

The following aspects need to be addressed to offer a secure infrastructure for financial transaction over wireless network :

1. Physical part of the hand-held device. If the bank is offering smart-card based security, the physical security of the device is more important.
2. Security of any thick-client application running on the device. In case the device is stolen, the hacker should require at least an ID/Password to access the application.
3. Authentication of the device with service provider before initiating a transaction. This would ensure that unauthorized devices are not connected to perform financial transactions.
4. User ID / Password authentication of bank's customer.
5. Encryption of the data being transmitted over the air.
6. Encryption of the data that will be stored in device for later / off-line analysis by the customer.

One-time password (OTPs) are the latest tool used by financial and banking service providers in the fight against cyber fraud. Instead of relying on traditional memorized passwords, OTPs are requested by consumers each time they want to perform transactions using the online or mobile banking interface. When the request is received the password is sent to the consumer's phone via SMS. The password is expired once it has been used or once its scheduled life-cycle has expired.

Because of the concerns made explicit above, it is extremely important that SMS gateway providers can provide a decent quality of service for banks and financial institutions in regards to SMS services. Therefore, the provision of service level agreements (SLAs) is a requirement for this industry; it is necessary to give the bank customer delivery guarantees of all messages, as well as measurements on the speed of delivery, throughput, etc. SLAs give the service parameters in which a messaging solution is guaranteed to perform.

Scalability and Reliability

Another challenge for the CIOs and CTOs of the banks is to scale-up the mobile banking infrastructure to handle exponential growth of the customer base. With mobile banking, the customer may be sitting in any part of the world (true anytime, anywhere banking) and hence banks need to ensure that the systems are up and running in a true 24 x 7 fashion. As customers will find mobile banking more and more useful, their expectations from the solution will increase. Banks unable to meet the performance and reliability expectations may lose customer confidence. There are systems such as Mobile Transaction Platform which allow quick and secure mobile enabling of

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various banking services. Recently in India there has been a phenomenal growth in the use of Mobile Banking applications, with leading banks adopting Mobile Transaction Platform and the Central Bank publishing guidelines for mobile banking operations.

Application Distribution

Due to the nature of the connectivity between bank and its customers, it would be impractical to expect customers to regularly visit banks or connect to a web site for regular upgrade of their mobile banking application. It will be expected that the mobile application itself check the upgrades and updates and download necessary patches (so called "Over The Air" updates). However, there could be many issues to implement this approach such as upgrade / synchronization of other dependent components.

User Adoption

It should be noted that studies have shown that a huge concerning factor of having mobil banking more widely used, is a banking customer's unwillingness to adapt. Many consumers, whether they are misinformed or not, do not want to begin using mobile banking for several reasons. These can include the learning curve associated with new technology, having fears about possible security compromises, just simply not wanting to start using technology, etc.

Personalization

It would be expected from the mobile application to support personalization such as :

1. Preferred Language
2. Date / Time format
3. Amount format
4. Default transactions
5. Standard Beneficiary list
6. Alerts

This is a list of countries by mobile banking usage as measured by the percentage of people who had non-SMS mobile banking transactions in the previous three months. The data is sourced from Bain, Research Now and Bain along with GMI NPS surveys in 2012.

Rank	Country/Territory	Usage in 2012
1	South Korea	47%
2	China	42%
3	Hong Kong	41%
4	Singapore	38%

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Rank	Country/Territory	Usage in 2012
5	India	43%
6	Spain	34%
7	United States	32%
8	Mexico	30%
9	Australia	27%
10	France	26%
11	United Kingdom	26%
12	Thailand	24%
13	Canada	22%
14	Germany	14%
15	Pakistan	9%

African nations such as Kenya would rank highly if SMS mobile banking were included in the above list. Kenya has 38% of the population as subscribers to M-Pesa as of 2011. Though as of 2016 mobile banking applications have seen a tremendous growth in kenyan banking sector who have capitalised on android play store and apple store to put their applications. Kenyan banks like Equity Bank Kenya Limited Eazzy banking application and The Co-operative Bank Mco-op cash application have proved to be a success mobile banking applications.

Mobile banking is used in many parts of the world with little or no infrastructure, especially remote and rural areas. This aspect of mobile commerce is also popular in countries where most of their population is unbanked. In most of these places, banks can only be found in big cities, and customers have to travel hundreds of miles to the nearest bank.

In Iran, banks such as Parsian, Tejarat, Pasargad Bank, Mellat, Saderat, Sepah, Edbi, and Bankmelli offer the service. Banco Industrial provides the service in Guatemala. Citizens of Mexico can access mobile banking with Omnilife, Bancomer and MPower Venture. Kenya's Safaricom (part of the Vodafone Group) has the M-Pesa Service, which is mainly used to transfer limited amounts of money, but increasingly used to pay utility bills as well. In 2009, Zain launched their own mobile money transfer business, known as ZAP, in Kenya and other African countries. Several other players in Kenya such as Tangerine, MobiKash and Funtrench Limited also have network-independent mobile money transfer. In Somalia, the many telecom companies provide mobile banking, the most prominent being Hormuud Telecom and its ZAAD service.

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Telenor Pakistan has also launched a mobile banking solution, in coordination with Taameer Bank, under the label Easy Paisa, which was begun in Q4 2009. Eko India Financial Services, the business correspondent of State Bank of India (SBI) and ICICI Bank, provides bank accounts, deposit, withdrawal and remittance services, micro-insurance, and micro-finance facilities to its customers (nearly 80% of whom are migrants or the unbanked section of the population) through mobile banking.[12]

In a year of 2010, mobile banking users soared over 100 percent in Kenya, China, Brazil and United States with 200 percent, 150 percent, 110 percent and 100 percent respectively.

Dutch Bangla Bank launched the very first mobile banking service in Bangladesh on 31 March 2011. This service is launched with 'Agent' and 'Network' support from mobile operators, Banglalink and Citycell. Sybase 365, a subsidiary of Sybase, Inc. has provided software solution with their local partner Neurosoft Technologies Ltd. There are around 160 million people in Bangladesh, of which, only 13 per cent have bank accounts. With this solution, Dutch-Bangla Bank can now reach out to the rural and unbanked population, of which, 45 per cent are mobile phone users. Under the service, any mobile handset with subscription to any of the six existing mobile operators of Bangladesh would be able to utilize the service. Under the mobile banking services, bank-nominated Banking agent performs banking activities on its behalf, like opening mobile banking accounts, providing cash services (receipts and payments) and dealing with small credits. Cash withdrawal from a mobile account can also be done from an ATM validating each transaction by 'mobile phone & PIN' instead of 'card & PIN'. Other services that are being delivered through mobile banking system are person-to-person (e.g. fund transfer), person-to-business (e.g. merchant payment, utility bill payment), business-to-person (e.g. salary/commission disbursement), government-to-person (disbursement of government allowance) transactions.

In May 2012, Laxmi Bank Limited launched the very first mobile banking in Nepal with its product Mobile Khata. Mobile Khata currently runs on a third-party platform called Hello Paisa that is interoperable with all the telecoms in Nepal viz. Nepal Telecom, NCell, Smart Tel and UTL, and is also interoperable with various banks in the country. The initial joining members to the platform after Laxmi Bank Limited were Siddartha Bank, Bank of Kathmandu, Commerz and Trust Bank Nepal and International Leasing and Finance Company.

Barclays offers a service called Barclays Pingit, and Hello Money offering services in Africa, allowing transfer of money from the United Kingdom to many parts of the world with a mobile phone. Pingit is owned by a consortium of banks. In April 2014, the UK Payments Council launched the Paym mobile payment system, allowing mobile payments between customers of several banks and building societies using the recipient's mobile phone number.

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Make in India Campaign:

Make in India is an initiative launched by the Government of India to encourage multi-national, as well as national companies to manufacture their products in India. It was launched by Prime Minister Narendra Modi on 25 September 2014. India emerged, after initiation of the programme in 2015, as the top destination globally for foreign direct investment (FDI), surpassing the United States of America as well as the People's Republic of China. In 2015, India received US$63 billion in FDI.

Prime Minister Narendra Modi launched "Make in India" on 25 September 2014 in a function at the Vigyan Bhavan. On 29 December 2014, a workshop was organised by the Department of Industrial Policy and Promotion which was attended by PM Modi, his cabinet ministers and chief secretaries of states as well as various industry leaders.

The major objective behind the initiative is to focus on job creation and skill enhancement in 25 sectors of the economy.[4] The initiative also aims at high quality standards and minimising the impact on the environment. The initiative hopes to attract capital and technological investment in India.

The campaign was designed by Wieden+Kennedy. Under the initiative, brochures on the 25 sectors and a web portal were released. Before the initiative was launched, foreign equity caps in various sectors had been relaxed. The application for licenses was made available online and the validity of licenses was increased to three years. Various other norms and procedures were also relaxed.

In August 2014, the Cabinet of India allowed 49% foreign direct investment (FDI) in the defence sector and 100% in railwaysinfrastructure. The defence sector previously allowed 26% FDI and FDI was not allowed in railways. This was in hope of bringing down the military imports of India. Earlier, one Indian company would have held the 51% stake, this was changed so that multiple companies could hold the 51%.

Between September 2014 and November 2015, the government received ₹1.20 lakh crore (US$18 billion) worth of proposals from companies interested in manufacturing electronics in India.

24.8% of smartphones shipped in the country in the April–June quarter of 2015 were made in India, up from 19.9% the previous quarter.

India emerged, after initiation of the programme in 2015 as the top destination globally for foreign direct investment, surpassing the United States of America as well as the People's Republic of China.

With the demand for electronic hardware expected to rise rapidly to US$400 billion by 2020, India has the potential to become an electronic manufacturing hub. The government is targeting to achieve net zero imports of electronics by 2020 by creating a level playing field and providing an enabling environment.

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Make in India focuses on the following twenty-five sectors of the economy:

- Automobiles
- Automobile Components
- Aviation
- Biotechnology
- Chemicals
- Construction
- Defence manufacturing
- Electrical Machinery
- Electronic systems
- Food Processing
- Information Technology and Business Process Management
- Leather
- Media and Entertainment
- Mining
- Oil and Gas
- Pharmaceuticals
- Ports and Shipping
- Railways
- Renewable Energy
- Roads and Highways
- Space and astronomy
- Textiles and Garments
- Thermal Power
- Tourism and Hospitality
- Wellness

As per the new Govt. Policy 100% FDI is permitted in all the above sectors, except for space (74%), defence (49%) and news media (26%).

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Ease of Doing Business:

India ranks 130th out of 190 countries in the World Bank's 2016 ease of doing business index, covering the period from June 2014 and June 2015. India was ranked 134th in the 2015 index.

In February 2017, the government appointed the United Nations Development Programme (UNDP) and the National Productivity Council to "to sensitise actual users and get their feedback on various reform measures". The World Bank does not consider reforms initiated by a government in its ease of doing business index, but instead considers feedback from actual beneficiaries of those reforms. The move is intended to take advantage of this fact to improve India's ranking on the index, and marks a shift from India's previous policy of questioning the World Bank's ranking methodology. In particular, the government criticised the World Bank's decision to survey only two cities - Delhi and Mumbai - and use it to rank the whole of India.

A survey of 17 Indian cities in the World Bank's *Doing Business in India 2009* report ranked Ludhiana, Hyderabad, Bhubaneshwar, Gurgaon, and Ahmedabad as the top five easiest cities to do business in India.

In January 2015, the Spice Group said it would start a mobile phone manufacturing unit in Uttar Pradesh with an investment of ₹5 billion (US$74 million). A memorandum of understanding was signed between the Spice Group and the Government of Uttar Pradesh.

In January 2015, Hyun Chil Hong, the President & CEO of Samsung South Asia, met with Kalraj Mishra, Union Minister for Micro, Small and Medium Enterprises (MSME), to discuss a joint initiative under which 10 "MSME-Samsung Technical Schools" will be established in India. In February, Samsung said that will manufacture the Samsung Z1 in its plant in Noida.

In February 2015, Hitachi said it was committed to the initiative. It said that it would increase its employees in India from 10,000 to 13,000 and it would try to increase its revenues from India from ¥100 billion in 2013 to ¥210 billion. It said that an auto-component plant will be set up in Chennai in 2016.

In February 2015, Huawei opened a new research and development (R&D) campus in Bengaluru. It had invested US$170 million to establish the research and development centre. It is also in the process of setting up a Telecom hardware manufacturing plant in Chennai, the approvals of which have been granted by the central government. Also in February, Marine Products Export Development Authority said that it was interested in supplying shrimp eggs to shrimp farmers in India under the initiative.

In February 2015, Xiaomi began initial talks with the Andhra Pradesh government to begin manufacturing smartphones at a Foxconn-run facility in Sri City. On 11 August 2015, the company announced that the first manufacturing unit was operational and

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introduced the Xiaomi Redmi 2 Prime, a smartphone that was assembled at the facility. Xiaomi India chief executive Manu Jain stated, "We announced our Make in India plans in the beginning of this year 2015. We thought it would take us two years to set up this manufacturing plant. But surprisingly we were able to set up everything and our production started within seven months."

In June 2015, France-based LH Aviation signed an MoU with OIS Advanced Technologies to set up a manufacturing plant in India to manufacture drones.

July–December 2015

On 8 August 2015, Foxconn announced that it would invest US$5 billion over five years to set up a research and development and hi-tech semiconductor manufacturing facility in Maharashtra. Less than a week earlier, General Motors had announced that it would invest US$1 billion to begin manufacturing automobiles in the state.

On 18 August 2015, Lenovo announced that it had begun manufacturing Motorola smartphones at a plant in Sriperumbudur near Chennai, run by Singapore-based contract manufacturer Flextronics International Ltd. The plant has separate manufacturing lines for Lenovo and Motorola, as well as quality assurance, and product testing. The first smartphone manufactured at the facility was the 4G variant of the Motorola Moto E (2nd generation).

On 16 October 2015, Boeing chairman James McNerney said that the company could assemble fighter planes and either the Apache or Chinook defence helicopter in India. The company is also willing to manufacture the F/A-18 Super Hornet in India if the Indian Air Force (IAF) were to purchase it.

In November 2015, Taiwan's Wistron Corp, which makes devices for companies such as Blackberry, HTC and Motorola, announced that it would begin manufacturing the devices at a new factory in Noida, Uttar Pradesh. A company spokesperson stated, "The government's 'Make in India' campaign, coupled with the country's growing consumption, makes an excellent case for the Indian manufacturing sector to emerge as a global manufacturing hub across sectors."

On 30 November 2015, the Ministry of Railways signed formal agreements with Alstom and GE Transport worth ₹400 billion (US$5.9 billion) to set-up locomotive manufacturing factories in Madhepura and Marhaura in Bihar.

In December 2015, Qualcomm announced that it was starting a "Design in India" programme to help mentor up to ten Indian hardware companies with the potential to come up with innovative solutions and help them reach scale. Qualcomm chairman had promised Prime Minister Modi that they would do so during the latter's visit to Silicon Valley in September 2015. As part of the programme, the company will set up an Innovation Lab in Bengaluru to provide technical and engineering support to the selected companies. In the same month, Micromax announced that it would start three

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new manufacturing units in Rajasthan, Telangana and Andhra Pradesh at a cost of ₹3 billion (US$45 million). The plants will begin functioning in 2016, and will each employ 3,000-3,500 people.

Following Japanese Prime Minister Shinzo Abe's visit to India in December 2015, it was announced that Japan would set up a US$12 billion fund for Make in India related projects called the "Japan-India Make-in-India Special Finance Facility". In late December, phone manufacturer Vivo Mobile India began manufacturing smartphones at a plant in Greater Noida. The plant employs 2,200 people.

A defence deal was signed during Prime Minister Narendra Modi's visit to Russia in December 2015 which will see the Kamov Ka-226 multi-role helicopter being built in India. This is widely seen as the first defence deal to be actually signed under the Make in India campaign.

Make in India Week

A "Make in India Week" event was held at the MMRDA Grounds at the Bandra-Kurla Complex in Mumbai from 13 February 2016. The week long multi-sectoral industrial was attended by 2500 international and 8000 domestic, foreign government delegations from 68 countries and business teams from 72 countries. 17 Indian states, mostly BJP-ruled, also held expos. At the close of the event, DIPP Secretary Amitabh Kant stated that it had received over ₹15.2 lakh crore (US$230 billion) worth of investment commitments and investment inquiries worth ₹1.5 lakh crore (US$22 billion). Maharashtra led all other states receiving ₹8 lakh crore (US$120 billion) of investments.

Planning

In August 2015, Hindustan Aeronautics Limited (HAL) began talks with Russia's Irkut Corp to transfer technology of 332 components of the Sukhoi Su-30MKI fighter aircraft under the Make in India program. These components, also called line replacement units (LRUs) refer to both critical and non-critical components and fall into four major heads such as Radio and Radar; Electrical & Electronics System; Mechanical System and Instrument System.

The Ministry of Defence is auctioning a ₹600 billion (US$8.9 billion) contract to design and build a Fighting Infantry Combat Vehicle (FICV) in India. The contract will be awarded in 2016.

In February 2016, Lockheed Martin stated that it was "ready to manufacture F-16 in India and support the Make in India initiative", although it did not announce any time frame. In February 2017, Lockheed stated that it intended to manufacture the F-16 Block-70 aircraft with a local partner in India, if the Indian Air Force agreed to purchase the aircraft.

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"*Zero Defect Zero Effect*" is a slogan coined by Prime Minister of India, Narendra Modi which signifies production mechanisms wherein products have no defects and the process through which product is made has zero adverse environmental and ecological effects. The slogan also aims to prevent products developed from India from being rejected by the global market.

Aarisa Pitha of Jharkhand,Gumla, Gushtaba of Kashmir, Chicken Curry of Punjab, Khakhra and Khandvi of Gujarat, Bamboo Steam Fish, Vada and Medhu Vada of Karnataka, Khaja and Inarsa of Bihar and Kebab of Uttar Pradesh and Puran poli of Maharashtra have been selected as traditional regional food to be promoted in the campaign.

The 35th edition of the India International Trade Fair (IITF) held at Pragati Maidan in November 2015, had *Make in India* as its theme.

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Module - 3

Economical Environment

Money Supply-

Four Measures of Money Supply in India

In economics, the money supply or money stock, is the total amount of monetary assets available in an economy at a specific time. There are several ways to define "money", but standard measures usually include currency in circulation and demand deposits (depositors' easily accessed assets on the books of financial institutions).

Money supply data are recorded and published, usually by the government or the central bank of the country. Public and private sector analysts have long monitored changes in money supply because of the belief that it affects the price level, inflation, the exchange rate and the business cycle.

That relation between money and prices is historically associated with the quantity theory of money. There is strong empirical evidence of a direct relation between money-supply growth and long-term price inflation, at least for rapid increases in the amount of money in the economy. For example, a country such as Zimbabwe which saw extremely rapid increases in its money supply also saw extremely rapid increases in prices (hyperinflation). This is one reason for the reliance on monetary policy as a means of controlling inflation.[5][6]

The nature of this causal chain is the subject of contention. Some heterodox economists argue that the money supply is endogenous (determined by the workings of the economy, not by the central bank) and that the sources of inflation must be found in the distributional structure of the economy.[7]

In addition, those economists seeing the central bank's control over the money supply as feeble say that there are two weak links between the growth of the money supply and the inflation rate. First, in the aftermath of a recession, when many resources are underutilized, an increase in the money supply can cause a sustained increase in real production instead of inflation. Second, if the velocity of money (i.e., the ratio between nominal GDP and money supply) changes, an increase in the money supply could have either no effect, an exaggerated effect, or an unpredictable effect on the growth of nominal GDP.

The supply of money means the total stock of money (paper notes, coins and demand deposits of bank) in circulation which is held by the public at any particular point of time.

Briefly money supply is the stock of money in circulation on a specific day. Thus two components of money supply are

(i) Currency (Paper notes and coins)

(ii) Demand deposits of commercial banks.

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Again it needs to be noted that (like difference between stock and supply of a commodity) total stock of money is different from total supply of money.

Supply of money is only that part of total stock of money which is held by the public at a particular point of time. In other words, money held by its users (and not producers) in spendable form at a point of time is termed as money supply.

The stock of money held by government and the banking system are not included because they are suppliers or producers of money and cash balances held by them are not in actual circulation. In short, money supply includes currency held by public and net demand deposits in banks.

Sources of Money Supply:
(i) Government (which Issues one-rupee notes and all other coins)

(ii) RBI (which issues paper currency)

(iii) Commercial banks (which create credit on the basis of demand deposits).

(b) Alternative measures of Money Supply (money stock):

In India Reserve Bank of India uses four alternative measures of money supply called M1, M2, M3 and M4. Among these measures M1 is the most commonly used measure of money supply because its components are regarded most liquid assets. Each measure is briefly explained below.

(i) M1 = C + DD + OD. Here C denotes currency (paper notes and coins) held by public, DD stands for demand deposits in banks and OD stands for other deposits in RBI. Demand deposits are deposits which can be withdrawn at any time by the account holders. Current account deposits are included in demand deposits.

But savings account deposits are not included in DD because certain conditions are imposed on the amount of withdrawals and number of withdrawals. OD stands for other deposits with the RBI which includes demand deposits of public financial institutions, demand deposits of foreign central banks and international financial institutions like IMF, World Bank, etc.

(ii) M2 = M1 (detailed above) + saving deposits with Post Office Saving Banks

(ii) M3= M1 + Net Time-deposits of Banks

(iii) M4 = M3 + Total deposits with Post Office Saving Organisation (excluding NSC)

In fact, a great deal of debate is still going on as to what constitutes money supply. Savings deposits of post offices are not a part of money supply because they do not serve as medium of exchange due to lack of cheque facility. Similarly, fixed deposits in commercial banks are not counted as money. Therefore, M1 and M2 may be treated as measures of narrow money whereas M3 and M4 as measures of broad money.

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In practice, M1 is widely used as measure of money supply which is also called aggregate monetary resources of the society. All the above four measures represent different degrees of liquidity, with M4 being the most liquid and M4 is being the least liquid. It may be noted that liquidity means ability to convert an asset into money quickly and without loss of value.

Some of the important measures of money supply in India are as follows:

There are four measures of money supply in India which are denoted by M1, M2, M3 and M4. This classification was introduced by the Reserve Bank of India (RBI) in April 1977. Prior to this till March 1968, the RBI published only one measure of the money supply, M or defined as currency and demand deposits with the public. This was in keeping with the traditional and Keynesian views of the narrow measure of the money supply.

From April 1968, the RBI also started publishing another measure of the money supply which it called Aggregate Monetary Resources (AMR). This included M1 plus time deposits of banks held by the public. This was a broad measure of money supply which was in line with Friedman's view. But since April 1977, the RBI has been publishing data on four measures of the money supply which are discussed as under.

M1. The first measure of money supply, M1 consists of:

(i) Currency with the public which includes notes and coins of all denominations in circulation excluding cash on hand with banks:

(ii) Demand deposits with commercial and cooperative banks, excluding inter-bank deposits; and

(iii) 'Other deposits' with RBI which include current deposits of foreign central banks, financial institutions and quasi-financial institutions such as IDBI, IFCI, etc., other than of banks, IMF, IBRD, etc. The RBI characterizes as narrow money.

M2. The second measure of money supply is M2 which consists of M1 plus post office savings bank deposits. Since savings bank deposits of commercial and cooperative banks are included in the money supply, it is essential to include post office savings bank deposits. The majority of people in rural and urban India have preference for post office deposits from the safety viewpoint than bank deposits.

M3. The third measure of money supply in India is M3, which consists of M1, plus time deposits with commercial and cooperative banks, excluding interbank time deposits. The RBI calls M3 as broad money.

M4. The fourth measure of money supply is M4 which consists of M3 plus total post office deposits comprising time deposits and demand deposits as well. This is the broadest measure of money supply.

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Of the four inter-related measures of money supply for which the RBI publishes data, it is M3 which is of special significance. It is M3 which is taken into account in formulating macroeconomic objectives of the economy every year. Since M1 is narrow money and includes only demand deposits of banks along-with currency held by the public, it overlooks the importance of time deposits in policy making. That is why, the RBI prefers M3 which includes total deposits of banks and currency with the public in credit budgeting for its credit policy. It is on the estimates of increase in M3 that the effects of money supply on prices and growth of national income are estimated. In fact is an empirical measure of money supply in India, as is the practice in developed countries. The Chakravarty Committee also recommended the use of M3 for monetary targeting without any reason.

Monetary Policy: Meaning, Objectives and Instruments of Monetary Policy

Meaning of Monetary Policy:

Monetary policy refers to the credit control measures adopted by the central bank of a country.

Johnson defines monetary policy "as policy employing central bank's control of the supply of money as an instrument for achieving the objectives of general economic policy." G.K. Shaw defines it as "any conscious action undertaken by the monetary authorities to change the quantity, availability or cost of money."

For an effective anti-cyclical monetary policy, bank rate, open market operations, reserve ratio and selective control measures are required to be adopted simultaneously. But it has been accepted by all monetary theorists that (i) the success of monetary policy is nil in a depression when business confidence is at its lowest ebb; and (ii) it is successful against inflation. The monetarists contend that as against fiscal policy, monetary policy possesses greater flexibility and it can be implemented rapidly.

Objectives or Goals of Monetary Policy:

The following are the principal objectives of monetary policy:

1. Full Employment:

Full employment has been ranked among the foremost objectives of monetary policy. It is an important goal not only because unemployment leads to wastage of potential output, but also because of the loss of social standing and self-respect.

2. Price Stability:

One of the policy objectives of monetary policy is to stabilise the price level. Both economists and laymen favour this policy because fluctuations in prices bring uncertainty and instability to the economy.

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3. Economic Growth:

One of the most important objectives of monetary policy in recent years has been the rapid economic growth of an economy. Economic growth is defined as "the process whereby the real per capita income of a country increases over a long period of time."

4. Balance of Payments:

Another objective of monetary policy since the 1950s has been to maintain equilibrium in the balance of payments.

Instruments of Monetary Policy:

The instruments of monetary policy are of two types: first, quantitative, general or indirect; and second, qualitative, selective or direct. They affect the level of aggregate demand through the supply of money, cost of money and availability of credit. Of the two types of instruments, the first category includes bank rate variations, open market operations and changing reserve requirements. They are meant to regulate the overall level of credit in the economy through commercial banks. The selective credit controls aim at controlling specific types of credit. They include changing margin requirements and regulation of consumer credit. We discuss them as under:

Bank Rate Policy:

The bank rate is the minimum lending rate of the central bank at which it rediscounts first class bills of exchange and government securities held by the commercial banks. When the central bank finds that inflationary pressures have started emerging within the economy, it raises the bank rate. Borrowing from the central bank becomes costly and commercial banks borrow less from it.

The commercial banks, in turn, raise their lending rates to the business community and borrowers borrow less from the commercial banks. There is contraction of credit and prices are checked from rising further. On the contrary, when prices are depressed, the central bank lowers the bank rate.

It is cheap to borrow from the central bank on the part of commercial banks. The latter also lower their lending rates. Businessmen are encouraged to borrow more. Investment is encouraged. Output, employment, income and demand start rising and the downward movement of prices is checked.

Open Market Operations:

Open market operations refer to sale and purchase of securities in the money market by the central bank. When prices are rising and there is need to control them, the central bank sells securities. The reserves of commercial banks are reduced and they are not in a position to lend more to the business community.

Further investment is discouraged and the rise in prices is checked. Contrariwise, when recessionary forces start in the economy, the central bank buys securities. The reserves

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of commercial banks are raised. They lend more. Investment, output, employment, income and demand rise and fall in price is checked.

Changes in Reserve Ratios:
This weapon was suggested by Keynes in his Treatise on Money and the USA was the first to adopt it as a monetary device. Every bank is required by law to keep a certain percentage of its total deposits in the form of a reserve fund in its vaults and also a certain percentage with the central bank.

When prices are rising, the central bank raises the reserve ratio. Banks are required to keep more with the central bank. Their reserves are reduced and they lend less. The volume of investment, output and employment are adversely affected. In the opposite case, when the reserve ratio is lowered, the reserves of commercial banks are raised. They lend more and the economic activity is favourably affected.

Selective Credit Controls:
Selective credit controls are used to influence specific types of credit for particular purposes. They usually take the form of changing margin requirements to control speculative activities within the economy. When there is brisk speculative activity in the economy or in particular sectors in certain commodities and prices start rising, the central bank raises the margin requirement on them.

The result is that the borrowers are given less money in loans against specified securities. For instance, raising the margin requirement to 60% means that the pledger of securities of the value of Rs 10,000 will be given 40% of their value, i.e. Rs 4,000 as loan. In case of recession in a particular sector, the central bank encourages borrowing by lowering margin requirements.

Monetary policy is the process by which the monetary authority of a country, like the central bank or currency board, controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency. Further goals of a monetary policy are usually to contribute to economic growth and stability, to lower unemployment, and to maintain predictable exchange rates with other currencies.

Monetary economics provides insight into how to craft an optimal monetary policy. Since the 1970s, monetary policy has generally been formed separately from fiscal policy, which refers to taxation, government spending, and associated borrowing.

Monetary policy is referred to as either being expansionary or contractionary. Expansionary policy is when a monetary authority uses its tools to stimulate the economy. An expansionary policy increases the total supply of money in the economy more rapidly than usual. It is traditionally used to try to combat unemployment in a recession by lowering interest rates in the hope that easy credit will entice businesses into expanding. Also, this increases the aggregate demand (the overall demand for all

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goods and services in an economy), which boosts growth as measured by gross domestic product (GDP). Expansionary monetary policy usually diminishes the value of the currency, thereby decreasing the exchange rate.[5]

The opposite of expansionary monetary policy is contractionary monetary policy, which slows the rate of growth in the money supply or even shrinks it. This slows economic growth to prevent inflation. Contractionary monetary policy can lead to increased unemployment and depressed borrowing and spending by consumers and businesses, which can eventually result in an economic recession; it should hence be well managed and conducted with care.

Monetary policy is associated with interest rates and availability of credit. Instruments of monetary policy have included short-term interest rates and bank reserves through the monetary base. For many centuries there were only two forms of monetary policy: (i) Decisions about coinage; (ii) Decisions to print paper money to create credit. Interest rates, while now thought of as part of monetary authority, were not generally coordinated with the other forms of monetary policy during this time. Monetary policy was seen as an executive decision, and was generally in the hands of the authority with seigniorage, or the power to coin. With the advent of larger trading networks came the ability to set the price between gold and silver, and the price of the local currency to foreign currencies. This official price could be enforced by law, even if it varied from the market price.

Paper money called "jiaozi" originated from promissory notes in 7th century China. Jiaozi did not replace metallic currency, and were used alongside the copper coins. The successive Yuan Dynasty was the first government to use paper currency as the predominant circulating medium. In the later course of the dynasty, facing massive shortages of specie to fund war and their rule in China, they began printing paper money without restrictions, resulting in hyperinflation.

With the creation of the Bank of England in 1694, which acquired the responsibility to print notes and back them with gold, the idea of monetary policy as independent of executive action began to be established. The goal of monetary policy was to maintain the value of the coinage, print notes which would trade at par to specie, and prevent coins from leaving circulation. The establishment of central banks by industrializing nations was associated then with the desire to maintain the nation's peg to the gold standard, and to trade in a narrow band with other gold-backed currencies. To accomplish this end, central banks as part of the gold standard began setting the interest rates that they charged, both their own borrowers, and other banks that required liquidity. The maintenance of a gold standard required almost monthly adjustments of interest rates. The gold standard is a system under which the price of the national currency is measured in units of gold bars and is kept constant by the government's promise to buy or sell gold at a fixed price in terms of the base currency. The gold standard might be regarded as a special case of "fixed exchange rate" policy, or as a special type of commodity price level targeting. Nowadays this type of monetary policy is no longer used by any country.

During the period 1870–1920, the industrialized nations set up central banking systems, with one of the last being the Federal Reserve in 1913. By this point the role of the central bank as the "lender of last resort" was understood. It was also increasingly understood that interest rates had an effect on the entire economy, in no small part because of the marginal revolution in economics, which demonstrated how people would change a decision based on a change in the economic trade-offs.

Monetarist economists long contended that the money-supply growth could affect the macroeconomy. These included Milton Friedman who early in his career advocated that government budget deficits during recessions be financed in equal amount by money creation to help to stimulate aggregate demand for output. Later he advocated simply increasing the monetary supply at a low, constant rate, as the best way of maintaining low inflation and stable output growth. However, when U.S. Federal Reserve Chairman Paul Volcker tried this policy, starting in October 1979, it was found to be impractical, because of the highly unstable relationship between monetary aggregates and other macroeconomic variables. Even Milton Friedman later acknowledged that direct money supply targeting was less successful than he had hoped.

Therefore, monetary decisions today take into account a wider range of factors, such as:

- short-term interest rates;
- long-term interest rates;
- velocity of money through the economy;
- exchange rates;
- credit quality;
- bonds and equities (corporate ownership and debt);
- government versus private sector spending/savings;
- international capital flows of money on large scales;
- financial derivatives such as options, swaps, futures contracts, etc.

Traditional tools

The central bank influences interest rates by expanding or contracting the monetary base, which consists of currency in circulation and banks' reserves on deposit at the central bank. Central banks have three main tools of monetary policy: open market operations, the discount rate and the reserve requirements.

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The most commonly used tool by which the central bank can affect the monetary base is by open market operations. This entails managing the quantity of money in circulation through the buying and selling of various financial instruments, such as treasury bills, company bonds, or foreign currencies, in exchange for money on deposit at the central bank. Those deposits are convertible to currency, so all of these purchases or sales result in more or less base currency entering or leaving market circulation. For example, if the central bank wishes to lower interest rates (executing expansionary monetary policy), it purchases government debt, thereby increasing the amount of cash in circulation or crediting banks' reserve accounts. Commercial banks then have more money to lend, so they reduce lending rates, making loans less expensive. Cheaper credit card interest rates boost consumer spending. Additionally, when business loans are more affordable, companies can expand to keep up with consumer demand. They ultimately hire more workers, whose incomes rise, which in its turn also increases the demand. This tool is usually enough to stimulate demand and drive economic growth to a healthy rate. Usually, the short-term goal of open market operations is to achieve a specific short-term interest rate target. In other instances, monetary policy might instead entail the targeting of a specific exchange rate relative to some foreign currency or else relative to gold. For example, in the case of the USA the Federal Reserve targets the federal funds rate, the rate at which member banks lend to one another overnight; however, the monetary policy of China is to target the exchange rate between the Chinese renminbi and a basket of foreign currencies.

If the open market operations do not lead to the desired effects, a second tool can be used: the central bank can lower the interest rate it charges on discounts or overdrafts (loans from the central bank to commercial banks, see discount window). If the interest rate on such transactions is sufficiently low, commercial banks can borrow from the central bank to meet reserve requirements and use the additional liquidity to expand their balance sheets, increasing the credit available to the economy.

A third alternative is to change the reserve requirements. The reserve requirement refers to the proportion of total assets that banks must keep on hand overnight, either in its vaults or at the central bank. Banks only maintain a small portion of their assets as cash available for immediate withdrawal; the rest is invested in illiquid assets like mortgages and loans. Lowering the reserve requirement frees up funds for banks to increase loans or buy other profitable assets. This is expansionary because it creates credit. However, even though this tool immediately increases liquidity, central banks rarely change the reserve requirement because it is expensive and requires a lot of new policies and procedures, disrupting member banks. The use of open market operations is therefore preferred.

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Other: Unconventional monetary policy at the zero bound

Other forms of monetary policy, particularly used when interest rates are at or near 0% and there are concerns about deflation or deflation is occurring, are referred to as **unconventional monetary policy**. These include credit easing, quantitative easing, forward guidance, and signaling. In credit easing, a central bank purchases private sector assets to improve liquidity and improve access to credit. Signaling can be used to lower market expectations for lower interest rates in the future. For example, during the credit crisis of 2008, the US Federal Reserve indicated rates would be low for an "extended period", and the Bank of Canada made a "conditional commitment" to keep rates at the lower bound of 25 basis points (0.25%) until the end of the second quarter of 2010.

Further heterodox monetary policy proposals include the idea of helicopter money whereby central banks would create money without assets as counterpart in their balance sheet. The money created could be distributed directly to the population as a citizen's dividend. This option has been increasingly discussed since March 2016 after the ECB's president Mario Draghi said he found the concept "very interesting".

A **nominal anchor** for monetary policy is a single variable or device which the central bank uses to pin down expectations of private agents about the nominal price level or its path or about what the central bank might do with respect to achieving that path. Monetary regimes combine long-run nominal anchoring with flexibility in the short run. Nominal variables used as anchors primarily include exchange rate targets, money supply targets, and inflation targets with interest rate policy.[18]

Types

In practice, to implement any type of monetary policy the main tool used is modifying the amount of base money in circulation. The monetary authority does this by buying or selling financial assets (usually government obligations). These open market operations change either the amount of money or its liquidity (if less liquid forms of money are bought or sold). The multiplier effect of fractional reserve banking amplifies the effects of these actions.

Constant market transactions by the monetary authority modify the supply of currency and this impacts other market variables such as short-term interest rates and the exchange rate.

The distinction between the various types of monetary policy lies primarily with the set of instruments and target variables that are used by the monetary authority to achieve their goals.

Monetary Policy:	Target Market Variable:	Long Term Objective:
Inflation Targeting	Interest rate on overnight	A given rate of change in the CPI

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	debt	
Price Level Targeting	Interest rate on overnight debt	A specific CPI number
Monetary Aggregates	The growth in money supply	A given rate of change in the CPI
Fixed Exchange Rate	The spot price of the currency	The spot price of the currency
Gold Standard	The spot price of gold	Low inflation as measured by the gold price
Mixed Policy	Usually interest rates	Usually unemployment + CPI change

The different types of policy are also called **monetary regimes**, in parallel to exchange-rate regimes. A fixed exchange rate is also an exchange-rate regime; The Gold standard results in a relatively fixed regime towards the currency of other countries on the gold standard and a floating regime towards those that are not. Targeting inflation, the price level or other monetary aggregates implies floating exchange rate unless the management of the relevant foreign currencies is tracking exactly the same variables (such as a harmonized consumer price index).

In economics, an expansionary fiscal policy includes higher spending and tax cuts, that encourage economic growth. In turn, an expansionary monetary policy is one that seeks to increase the size of the money supply. As usual, inciting of money supply is aimed at lowering the interest rates on purpose to achieve economic growth by increase of economic activity. Conversely, contractionary monetary policy seeks to reduce the size of the money supply. In most nations, monetary policy is controlled by either a central bank or a finance ministry. Neoclassical and Keynesian economics significantly differ on the effects and effectiveness of monetary policy on influencing the **real** economy; there is no clear consensus on how monetary policy affects real economic variables (aggregate output or income, employment). Both economic schools accept that monetary policy affects monetary variables (price levels, interest rates).

Inflation Targeting/Inflation and Interest Rate Targets

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

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

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As the Fisher Effect model explains, the equation linking inflation with interest rates (both foreign and abroad) is the following:

Π = i - r

Where π is the inflation at home, i is the home interest rate set by the central bank, and r is the real world interest rate. Using i as an anchor, central banks can influence π. However, a necessary assumption for this equation to hold, is that the world real interest rate is constant. Central banks can choose to maintain a fixed interest rates at all times, or to keep a constant interest rate until the real world interest rate changes. The duration of this policy varies, because of the simplicity associated with changing the nominal interest rate.

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

Changes to the interest rate target are made in response to various market indicators in an attempt to forecast economic trends and in so doing keep the market on track towards achieving the defined inflation target. For example, one simple method of inflation targeting called the Taylor rule adjusts the interest rate in response to changes in the inflation rate and the output gap. The rule was proposed by John B. Taylor of Stanford University.

The inflation targeting approach to monetary policy approach was pioneered in New Zealand. It has been used in Australia, Brazil, Canada, Chile, Colombia, the Czech Republic, Hungary, New
Zealand, Norway, Iceland, India, Philippines, Poland, Sweden, South Africa, Turkey, and the United Kingdom.

Price Level Targeting

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

Uncertainty in price levels can create uncertainty around price and wage setting activity for firms and workers, and undermines any information that can be gained from relative prices, as it is more difficult for firms to determine if a change in the price of a good or service is because of inflation or other factors, such as an increase in the efficiency of factors of production, if inflation is high and volatile. An increase

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in inflation also leads to a decrease in the demand for money, as it reduces the incentive to hold money and increases transaction costs and shoe leather costs.

Monetary Aggregates/Money Supply Targeting

In the 1980s, several countries used an approach based on a constant growth in the money supply. This approach was refined to include different classes of money and credit (M0, M1 etc.). In the US this approach to monetary policy was discontinued with the selection of Alan Greenspan as Fed Chairman.

This Approach is Also Sometimes Called Monetarism.

Central banks might choose to set a money supply growth target as a nominal anchor to keep prices stable in the long term. The quantity theory, is a long run model, which links price levels to money supply and demand. Using this equation, we can rearrange to see the following:

$\Pi = \mu - g$

Where π is the inflation, μ is the money supply growth rate and g is the real output growth. This equation suggests that controlling the money supply's growth rate can ultimately lead to price stability in the long run. To use this nominal anchor, a central bank would need to set μ equal to a constant and commit to maintaining this target.

However, the money supply growth rate is considered a weak policy, because there is no way to target real output growth, As a result, a higher output growth rate will result in a too low level of inflation. A low output growth rate will result in inflation that would be higher than the desired level.

While monetary policy typically focuses on a price signal of one form or another, this approach is focused on monetary quantities. As these quantities could have a role on the economy and business cycles depending on the households' risk aversion level, money is sometimes explicitly added in the central bank's reaction function. Recently, however, central banks are shifting away from policies that focus on money supply targeting, because of the uncertainty that real output growth introduces. Some central banks, like the ECB, are choosing to combine money supply anchor with other targets.

Fixed Exchange Rate Targeting

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

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

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Under a system of fixed-convertibility, currency is bought and sold by the central bank or monetary authority on a daily basis to achieve the target exchange rate. This target rate may be a fixed level or a fixed band within which the exchange rate may fluctuate until the monetary authority intervenes to buy or sell as necessary to maintain the exchange rate within the band. (In this case, the fixed exchange rate with a fixed level can be seen as a special case of the fixed exchange rate with bands where the bands are set to zero.)

Under a system of fixed exchange rates maintained by a currency board every unit of local currency must be backed by a unit of foreign currency (correcting for the exchange rate). This ensures that the local monetary base does not inflate without being backed by hard currency and eliminates any worries about a run on the local currency by those wishing to convert the local currency to the hard (anchor) currency.

Under dollarization, foreign currency (usually the US dollar, hence the term "dollarization") is used freely as the medium of exchange either exclusively or in parallel with local currency. This outcome can come about because the local population has lost all faith in the local currency, or it may also be a policy of the government (usually to rein in inflation and import credible monetary policy).

Theoretically, using Relative PPP, the rate of depreciation must equal the inflation differential.

$(E_{(H/F)})/(E_{H/F}) = \Pi_H + \Pi_F$

which implies that:

$\Pi_H = (E_{(H/F)})/(E_{H/F}) + \Pi_F$

where the subscript "H" denotes the home country and "F" indicates the foreign country. The anchor variable is the rate of depreciation, (E(H/F))/ (EH/F) . Therefore, the rate of inflation at home must equal the rate of inflation in the foreign country plus the rate of depreciation of the exchange rate of home’s currency, relative to the other.

With a strict fixed exchange rate or a peg, the rate of depreciation of the exchange rate is set equal to zero, such as in currency unions. In the case of a crawling peg, the rate is set equal to constant. With a limited flexible band, the rate of depreciation is allowed to fluctuate within a given range.

By fixing the rate of depreciation, PPP theory concludes that the home country’s inflation rate must depend on the foreign country. For example, a two percent increase in inflation at home raises the foreign country’s inflation by two percent. Countries may decide to use a fixed exchange rate monetary regime in order to take advantage of price stability and control inflation. In practice, more than half of nation’s monetary regimes use fixed exchange rate anchoring.

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

In Practice

Nominal anchors are possible with various exchange rate regimes.

Type of Nominal Anchor	Compatible Exchange Rate Regimes
Exchange Rate Target	Currency Union/Countries without own currency, Pegs/Bands/Crawls, Managed Floating
Money Supply Target	Managed Floating, Freely Floating
Inflation Target (+ Interest Rate Policy)	Managed Floating, Freely Floating

Following the collapse of Bretton Woods, nominal anchoring has grown in importance for monetary policy makers and inflation reduction. Particularly, governments sought to use anchoring in order to curtail rapid and high inflation during the 1970s and 1980s. By the 1990s, countries began to explicitly set credible nominal anchors. In addition, many countries chose a mix of more than one target, as well as implicit targets. As a result, global inflation rates have, on average, decreased gradually since the 1970s and central banks have gained credibility and increasing independence.

The Global Financial Crisis of 2008 has sparked controversy over the use and flexibility of inflation nominal anchoring. Many economists argue that inflation targets are currently set too low by many monetary regimes. During the crisis, many inflation anchoring countries reached the lower bound of zero rates, resulting in inflation rates decreasing to almost zero or even deflation.

Implications

The anchors discussed in this article suggest that keeping inflation at the desired level is feasible by setting a target interest rate, money supply growth rate, price level, or rate of depreciation. However, these anchors are only valid if a central bank commits to maintaining them. This, in turn, requires that the central bank abandons their monetary policy autonomy in the long run. Should a central bank use one of these anchors to maintain a target inflation rate, they would have to forfeit using other policies. On that note, it is important to mention that using these anchors may prove more complicated for certain exchange rate regimes. Freely floating or managed floating regimes, have more options to affect their inflation, because they enjoy more flexibility than a pegged currency or a country without a currency. The latter regimes would have to implement

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an exchange rate target to influence their inflation, as none of the other instruments are available to them.

The short-term effects of monetary policy can be influenced by the degree to which announcements of new policy are deemed credible. In particular, when an anti-inflation policy is announced by a central bank, in the absense of credibility in the eyes of the public inflationary expectations will not drop, and the short-run effect of the announcement and a subsequent sustained anti-inflation policy is likely to be a combination of somewhat lower inflation and higher unemployment (see Phillips curve#NAIRU and rational expectations). But if the policy announcement is deemed credible, inflationary expectations will drop commensurately with the announced policy intent, and inflation is likely to come down more quickly and without so much of a cost in terms of unemployment.

Thus there can be an advantage to having the central bank be independent of the political authority, to shield it from the prospect of political pressure to reverse the direction of the policy. But even with a seemingly independent central bank, a central bank whose hands are not tied to the anti-inflation policy might be deemed as not fully credible; in this case there is an advantage to be had by the central bank being in some way bound to follow through on its policy pronouncements, lending it credibility.

In International Economics

Optimal monetary policy in international economics is concerned with the question of how monetary policy should be conducted in interdependent open economies. The classical view holds that international macroeconomic interdependence is only relevant if it affects domestic output gaps and inflation, and monetary policy prescriptions can abstract from openness without harm. This view rests on two implicit assumptions: a high responsiveness of import prices to the exchange rate, i.e. producer currency pricing (PCP), and frictionless international financial markets supporting the efficiency of flexible price allocation. The violation or distortion of these assumptions found in empirical research is the subject of a substantial part of the international optimal monetary policy literature. The policy trade-offs specific to this international perspective are threefold:

First, research suggests only a weak reflection of exchange rate movements in import prices, lending credibility to the opposed theory of local currency pricing (LCP). The consequence is a departure from the classical view in the form of a trade-off between output gaps and misalignments in international relative prices, shifting monetary policy to CPI inflation control and real exchange rate stabilization.

Second, another specificity of international optimal monetary policy is the issue of strategic interactions and competitive devaluations, which is due to cross-border spillovers in quantities and prices. Therein, the national authorities of different countries

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face incentives to manipulate the terms of trade to increase national welfare in the absence of international policy coordination. Even though the gains of international policy coordination might be small, such gains may become very relevant if balanced against incentives for international noncooperation.

Third, open economies face policy trade-offs if asset market distortions prevent global efficient allocation. Even though the real exchange rate absorbs shocks in current and expected fundamentals, its adjustment does not necessarily result in a desirable allocation and may even exacerbate the misallocation of consumption and employment at both the domestic and global level. This is because, relative to the case of complete markets, both the Phillips curve and the loss function include a welfare-relevant measure of cross-country imbalances. Consequently, this results in domestic goals, e.g. output gaps or inflation, being traded-off against the stabilization of external variables such as the terms of trade or the demand gap. Hence, the optimal monetary policy in this case consists of redressing demand imbalances and/or correcting international relative prices at the cost of some inflation.

Corsetti, Dedola and Leduc (2011) summarize the status quo of research on international monetary policy prescriptions: "Optimal monetary policy thus should target a combination of inward-looking variables such as output gap and inflation, with currency misalignment and cross-country demand misallocation, by leaning against the wind of misaligned exchange rates and international imbalances." This is main factor in country money status.

In Developing Countries

Developing countries may have problems establishing an effective operating monetary policy. The primary difficulty is that few developing countries have deep markets in government debt. The matter is further complicated by the difficulties in forecasting money demand and fiscal pressure to levy the inflation tax by expanding the base rapidly. In general, the central banks in many developing countries have poor records in managing monetary policy. This is often because the monetary authority in developing countries are mostly not independent of the government, so good monetary policy takes a backseat to the political desires of the government or are used to pursue other non-monetary goals. For this and other reasons, developing countries that want to establish credible monetary policy may institute a currency board or adopt dollarization. This can avoid interference from the government and may lead to the adoption of monetary policy as carried out in the anchor nation. Recent attempts at liberalizing and reform of financial markets (particularly the recapitalization of banks and other financial institutions in Nigeria and elsewhere) are gradually providing the latitude required to implement monetary policy frameworks by the relevant central banks.

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Recent Trends:

Transparency

Beginning with New Zealand in 1990, central banks began adopting formal, public inflation targets with the goal of making the outcomes, if not the process, of monetary policy more transparent. In other words, a central bank may have an inflation target of 2% for a given year, and if inflation turns out to be 5%, then the central bank will typically have to submit an explanation. The Bank of England exemplifies both these trends. It became independent of government through the Bank of England Act 1998 and adopted an inflation target of 2.5% RPI, revised to 2% of CPI in 2003. The European Central Bank adopted, in 1998, a definition of price stability within the Eurozone as inflation of under 2% HICP. In 2003, this was revised to inflation below, but close to, 2% over the medium term. Since then, the target of 2% has become common for other major central banks, including the Federal Reserve (since January 2012) and Bank of Japan (since January 2013).

Effect on Business Cycles

There continues to be some debate about whether monetary policy can (or should) smooth business cycles. A central conjecture of Keynesian economics is that the central bank can stimulate aggregate demand in the short run, because a significant number of prices in the economy are fixed in the short run and firms will produce as many goods and services as are demanded (in the long run, however, money is neutral, as in the neoclassical model). However, some economists from the new classical school contend that central banks cannot affect business cycles.

Behavioral Monetary Policy

Conventional macroeconomic models assume that all agents in an economy are fully rational. A rational agent has clear preferences, models uncertainty via expected values of variables or functions of variables, and always chooses to perform the action with the optimal expected outcome for itself among all feasible actions – they maximize their utility. Monetary policy analysis and decisions hence traditionally rely on this New Classical approach. However, as studied by the field of behavioral economics that takes into account the concept of bounded rationality, people often deviate from the way that these neoclassical theories assume. Humans are generally not able to react fully rational to the world around them– they do not make decisions in the rational way commonly envisioned in standard macroeconomic models. People have time limitations, cognitive biases, care about issues like fairness and equity and follow rules of thumb (heuristics).

This has implications for the conduct of monetary policy. Monetary policy is the final outcome of a complex interaction between monetary institutions, central banker preferences and policy rules, and hence human decision-making plays an important role. It is more and more recognized that the standard rational approach does not provide an optimal foundation for monetary policy actions. These models fail to address

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important human anomalies and behavioral drivers that explain monetary policy decisions.

An example of a behavioral bias that characterizes the behavior of central bankers is loss aversion: for every monetary policy choice, losses loom larger than gains, and both are evaluated with respect to the status quo. One result of loss aversion is that when gains and losses are symmetric or nearly so, risk aversion may set in. Loss aversion can be found in multiple contexts in monetary policy. The "hard fought" battle against the Great Inflation, for instance, might cause a bias against policies that risk greater inflation. Another common finding in behavioral studies is that individuals regularly offer estimates of their own ability, competence, or judgments that far exceed an objective assessment: they are overconfident. Central bank policymakers may fall victim to overconfidence in managing the macroeconomy in terms of timing, magnitude, and even the qualitative impact of interventions. Overconfidence can result in actions of the central bank that are either "too litte" or "too much". When policymakers believe their actions will have larger effects than objective analysis would indicate, this results in too little intervention. Overconfidence can, for instance, cause problems when relying on interest rates to gauge the stance of monetary policy: low rates might mean that policy is easy, but they could also signal a weak economy.

These are examples of how behavioral phenomena may have a substantial influence on monetary policy. Monetary policy analyses should thus account for the fact that policymakers (or central bankers) are individuals and prone to biases and temptations that can sensibly influence their ultimate choices in the setting of macroeconomic and/or interest rate targets.

Inflation: Types, Causes and Effects

Almost everyone is sure that he knows what inflation exactly is, but it remains a source of great deal of confu-sion because it is difficult to define it unam-biguously.

Meaning of Inflation:

In economics, inflation is a sustained increase in the general price level of goods and services in an economy over a period of time resulting in a loss of value of currency. When the price level rises, each unit of currency buys fewer goods and services. Consequently, inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy. A chief measure of price inflation is the inflation rate, the annualized percentage change in a general price index, usually the consumer price index, over time. The opposite of inflation is deflation.

Inflation affects economies in various positive and negative ways. The negative effects of inflation include an increase in the opportunity cost of holding money, uncertainty over future inflation which may discourage investment and savings, and if inflation

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were rapid enough, shortages of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include reducing the real burden of public and private debt, keeping nominal interest rates above zero so that central banks can adjust interest rates to stabilize the economy, and reducing unemployment due to nominal wage rigidity.

Economists generally believe that high rates of inflation and hyperinflation are caused by an excessive growth of the money supply. However, money supply growth does not necessarily cause inflation. Some economists maintain that under the conditions of a liquidity trap, large monetary injections are like "pushing on a string". Views on which factors determine low to moderate rates of inflation are more varied. Low or moderate inflation may be attributed to fluctuations in real demand for goods and services, or changes in available supplies such as during scarcities. However, the consensus view is that a long sustained period of inflation is caused by money supply growing faster than the rate of economic growth.

Today, most economists favor a low and steady rate of inflation. Low (as opposed to zero or negative) inflation reduces the severity of economic recessions by enabling the labor market to adjust more quickly in a downturn, and reduces the risk that a liquidity trap prevents monetary policy from stabilizing the economy. The task of keeping the rate of inflation low and stable is usually given to monetary authorities. Generally, these monetary authorities are the central banks that control monetary policy through the setting of interest rates, through open market operations, and through the setting of banking reserve requirements

Inflation is often defined in terms of its supposed causes. Inflation exists when money supply exceeds available goods and services. Or inflation is attributed to budget deficit financing. A deficit budget may be financed by the additional money creation. But the situation of monetary expansion or budget deficit may not cause price level to rise. Hence the difficulty of defining ‘inflation’.

Inflation may be defined as ‘a sustained upward trend in the general level of prices’ and not the price of only one or two goods. G. Ackley defined inflation as ‘a persistent and appreciable rise in the general level or aver-age of prices’. In other words, inflation is a state of rising prices, but not high prices.

It is not high prices but rising price level that con-stitute inflation. It constitutes, thus, an over-all increase in price level. It can, thus, be viewed as the devaluing of the worth of money. In other words, inflation reduces the purchasing power of money. A unit of money now buys less. Inflation can also be seen as a recurring phenomenon.

While measuring inflation, we take into ac-count a large number of goods and services used by the people of a country and then cal-culate average increase in the prices of those goods and services over a period of time. A small rise in prices or a sudden rise in prices is not inflation since they may reflect the short term workings of the market.

It is to be pointed out here that inflation is a state of disequilib-rium when there occurs a sustained rise in price level. It is inflation if the prices of most goods go up. Such rate of increases in prices may be both slow and rapid. However, it is difficult to detect whether there is an upward trend in prices and whether this trend is sus-tained. That is why inflation is difficult to define in an unambiguous sense.

Let's measure inflation rate. Suppose, in December 2007, the consumer price index was 193.6 and, in December 2008, it was 223.8. Thus, the inflation rate during the last one year was

223.8- 193.6/ 193.6 x 100 = 15.6

As inflation is a state of rising prices, de-flation may be defined as a state of falling prices but not fall in prices. Deflation is, thus, the opposite of inflation, i.e., a rise in the value of money or purchasing power of money. Disinflation is a slowing down of the rate of inflation.

2. Types of Inflation:

As the nature of inflation is not uniform in an economy for all the time, it is wise to distin-guish between different types of inflation. Such analysis is useful to study the distribu-tional and other effects of inflation as well as to recommend anti-inflationary policies. Infla-tion may be caused by a variety of factors. Its intensity or pace may be different at different times. It may also be classified in accordance with the reactions of the government toward inflation.

Thus, one may observe different types of inflation in the contemporary society:

A. On the Basis of Causes:

(i) Currency Inflation:

This type of infla-tion is caused by the printing of cur-rency notes.

(ii) Credit Inflation:

Being profit-making institutions, commercial banks sanction more loans and advances to the public than what the economy needs. Such credit expansion leads to a rise in price level.

(iii) Deficit-Induced Inflation:

The budget of the government reflects a deficit when expenditure exceeds revenue. To meet this gap, the government may ask the central bank to print additional money. Since pumping of additional money is required to meet the budget deficit, any price rise may the be called the deficit-induced inflation.

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(iv) Demand-Pull Inflation:

An increase in aggregate demand over the available output leads to a rise in the price level. Such inflation is called demand-pull in-flation (henceforth DPI). But why does aggregate demand rise? Classical economists attribute this rise in aggre-gate demand to money supply. If the supply of money in an economy ex-ceeds the available goods and services, DPI appears. It has been described by Coulborn as a situation of "too much money chasing too few goods."

Keynesians hold a different argu-ment. They argue that there can be an autonomous increase in aggregate de-mand or spending, such as a rise in con-sumption demand or investment or government spending or a tax cut or a net increase in exports (i.e., C + I + G + X – M) with no increase in money sup-ply. This would prompt upward adjust-ment in price. Thus, DPI is caused by monetary factors (classical adjustment) and non-monetary factors (Keynesian argument).

DPI can be explained in terms of Fig. 4.2, where we measure output on the horizontal axis and price level on the vertical axis. In Range 1, total spending is too short of full employment out-put, YF. There is little or no rise in the price level. As demand now rises, out-put will rise. The economy enters Range 2, where output approaches towards full employment situation. Note that in this region price level begins to rise. Ul-timately, the economy reaches full em-ployment situation, i.e., Range 3, where output does not rise but price level is pulled upward. This is demand-pull in-flation. The essence of this type of in-flation is that "too much spending chas-ing too few goods."

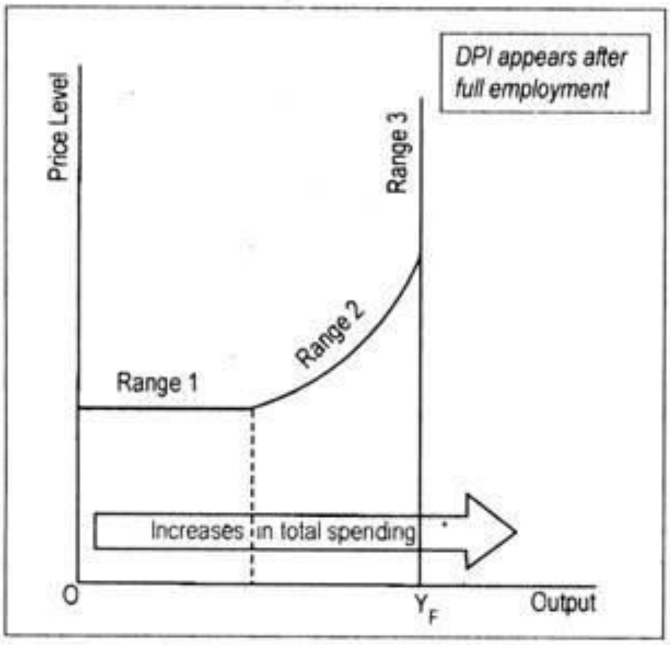

Fig. 4.2: Demand-pull Inflation

Demand-Pull Inflation

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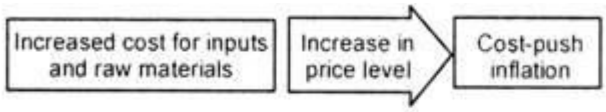
(V) Cost-Push Inflation:

Inflation in an economy may arise from the overall increase in the cost of production. This type of inflation is known as cost-push inflation (henceforth CPI). Cost of pro-duction may rise due to an increase in the prices of raw materials, wages, etc. Often trade unions are blamed for wage rise since wage rate is not completely market-determinded. Higher wage means high cost of production. Prices of commodities are thereby increased.

A wage-price spiral comes into opera-tion. But, at the same time, firms are to be blamed also for the price rise since they simply raise prices to expand their profit margins. Thus, we have two im-portant variants of CPI wage-push in-flation and profit-push inflation.

Any-way, CPI stems from the leftward shift of the aggregate supply curve:



B. On the Basis of Speed or Intensity:

(i) Creeping or Mild Inflation:

If the speed of upward thrust in prices is slow but small then we have creeping inflation. What speed of annual price rise is a creeping one has not been stated by the economists. To some, a creeping or mild inflation is one when annual price rise varies between 2 p.c. and 3 p.c. If a rate of price rise is kept at this level, it is con-sidered to be helpful for economic development. Others argue that if annual price rise goes slightly beyond 3 p.c. mark, still then it is considered to be of no danger.

(ii) Walking Inflation:

If the rate of annual price increase lies between 3 p.c. and 4 p.c., then we have a situation of walking inflation. When mild inflation is allowed to fan out, walking inflation appears. These two types of inflation may be described as ‘moderate inflation’.

Often, one-digit inflation rate is called ‘moder-ate inflation’ which is not only predict-able, but also keep people’s faith on the monetary system of the country. Peoples’ confidence get lost once moderately maintained rate of inflation goes out of control and the economy is then caught with the galloping inflation.

(iii) Galloping and Hyperinflation:

Walking inflation may be converted into running inflation. Running inflation is danger-ous. If it is not controlled, it may ulti-mately be converted to galloping or hyperinflation. It is an extreme form of inflation when an economy gets shatter-ed.”Inflation in the double or triple digit range of 20, 100 or 200 p.c. a year is labelled “galloping inflation”.

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(iv) Government's Reaction to Inflation:

In-flationary situation may be open or suppressed. Because of anti-infla-tionary policies pursued by the govern-ment, inflation may not be an embar-rassing one. For instance, increase in income leads to an increase in con-sumption spending which pulls the price level up.

If the consumption spending is countered by the govern-ment via price control and rationing device, the inflationary situation may be called a suppressed one. Once the government curbs are lifted, the sup-pressed inflation becomes open infla-tion. Open inflation may then result in hyperinflation.

3. Causes of Inflation:

Inflation is mainly caused by excess demand/ or decline in aggregate supply or output. Former leads to a rightward shift of the aggregate demand curve while the latter causes aggregate supply curve to shift left-ward. Former is called demand-pull inflation (DPI), and the latter is called cost-push infla-tion (CPI). Before describing the factors, that lead to a rise in aggregate demand and a de-cline in aggregate supply, we like to explain "demand-pull" and "cost-push" theories of inflation.

(i) Demand-Pull Inflation Theory:

There are two theoretical approaches to the DPI—one is classical and other is the Keynesian.

According to classical economists or mon-etarists, inflation is caused by an increase in money supply which leads to a rightward shift in negative sloping aggregate demand curve. Given a situation of full employment, classi-cists maintained that a change in money supply brings about an equiproportionate change in price level.

That is why monetarists argue that inflation is always and everywhere a monetary phenomenon. Keynesians do not find any link between money supply and price level causing an upward shift in aggregate demand.

According to Keynesians, aggregate demand may rise due to a rise in consumer demand or investment demand or govern-ment expenditure or net exports or the com-bination of these four components of aggreate demand. Given full employment, such in-crease in aggregate demand leads to an up-ward pressure in prices. Such a situation is called DPI. This can be explained graphically.

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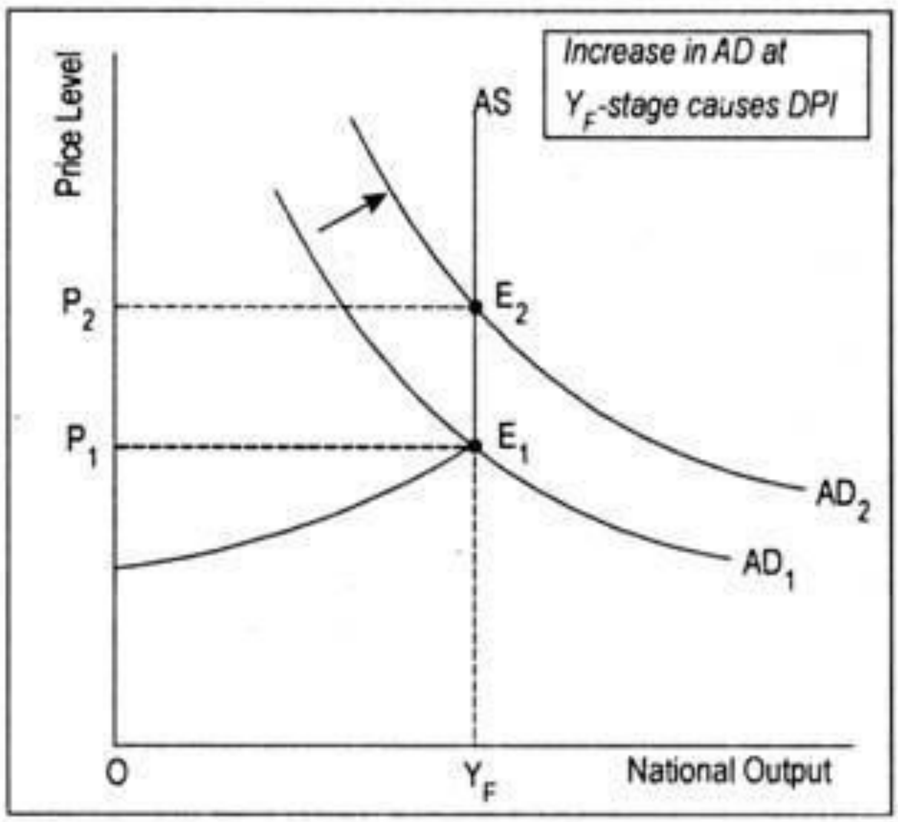

Fig. 4.3: DPI: Shifts in AD Curve

DPI: Shifts in AD Curve

Just like the price of a commodity, the level of prices is determined by the interaction of aggregate demand and aggregate supply. In Fig. 4.3, aggregate demand curve is negative sloping while aggregate supply curve before the full employment stage is positive sloping and becomes vertical after the full employ-ment stage is reached. AD1 is the initial aggregate demand curve that intersects the aggregate supply curve AS at point E1.

The price level, thus, determined is OP1. As ag-gregate demand curve shifts to AD2, price level rises to OP2. Thus, an increase in aggre-gate demand at the full employment stage leads to an increase in price level only, rather than the level of output. However, how much price level will rise following an increase in aggregate demand depends on the slope of the AS curve.

(ii) Causes of Demand-Pull Inflation:

DPI originates in the monetary sector. Mon-etarists' argument that "only money matters" is based on the assumption that at or near full employment excessive money supply will in-crease aggregate demand and will, thus, cause inflation.

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An increase in nominal money supply shifts aggregate demand curve rightward. This enables people to hold excess cash bal-ances. Spending of excess cash balances by them causes price level to rise. Price level will continue to rise until aggregate demand equals aggregate supply.

Keynesians argue that inflation originates in the non-monetary sector or the real sector. Aggregate demand may rise if there is an increase in consumption expenditure following a tax cut. There may be an autonomous increase in business investment or government expendi-ture. Government expenditure is inflationary if the needed money is procured by the gov-ernment by printing additional money.

In brief, increase in aggregate demand i.e., in-crease in (C + I + G + X – M) causes price level to rise. However, aggregate demand may rise following an increase in money supply gen-erated by the printing of additional money (classical argument) which drives prices up-ward. Thus, money plays a vital role. That is why Milton Friedman argues that inflation is always and everywhere a monetary phenom-enon.

There are other reasons that may push ag-gregate demand and, hence, price level up-wards. For instance, growth of population stimulates aggregate demand. Higher export earnings increase the purchasing power of the exporting countries. Additional purchasing power means additional aggregate demand. Purchasing power and, hence, aggregate de-mand may also go up if government repays public debt.

Again, there is a tendency on the part of the holders of black money to spend more on conspicuous consumption goods. Such tendency fuels inflationary fire. Thus, DPI is caused by a variety of factors.

(iii) Cost-Push Inflation Theory:

In addition to aggregate demand, aggregate supply also generates inflationary process. As inflation is caused by a leftward shift of the aggregate supply, we call it CPI. CPI is usu-ally associated with non-monetary factors. CPI arises due to the increase in cost of produc-tion. Cost of production may rise due to a rise in cost of raw materials or increase in wages.

However, wage increase may lead to an in-crease in productivity of workers. If this hap-pens, then the AS curve will shift to the right- ward not leftward—direction. We assume here that productivity does not change in spite of an increase in wages.

Such increases in costs are passed on to consumers by firms by rais-ing the prices of the products. Rising wages lead to rising costs. Rising costs lead to rising prices. And, rising prices again prompt trade unions to demand higher wages. Thus, an inflationary wage-price spiral starts. This causes aggregate supply curve to shift leftward.

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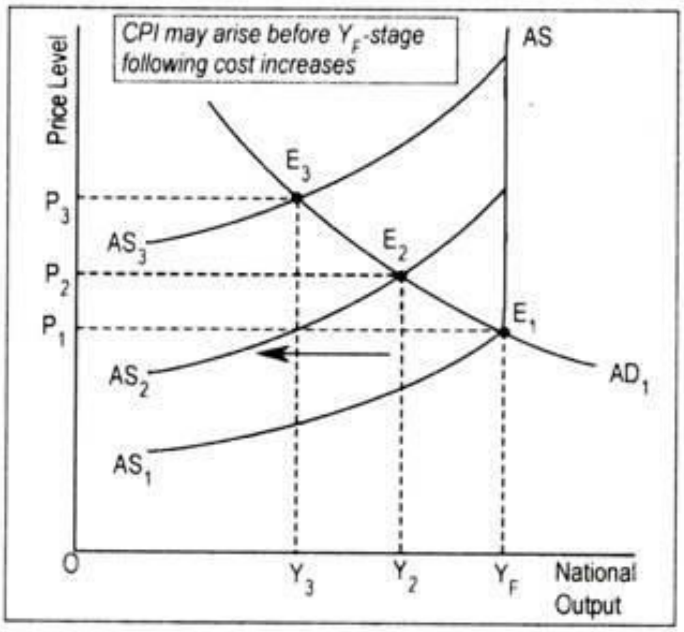

Fig. 4.4: CPI: Shifts in AS Curve

CPI Shifts in AS Curve

This can be demonstrated graphically where AS1 is the initial aggregate supply curve. Below the full employment stage this AS curve is positive sloping and at full em-ployment stage it becomes perfectly inelastic.

Intersection point (E1) of AD1 and AS1 curves determine the price level (OP1). Now there is a leftward shift of aggregate supply curve to AS2. With no change in aggregate demand, this causes price level to rise to OP2 and output to fall to OY2. With the reduction in output, employment in the economy de-clines or unemployment rises. Further shift in AS curve to AS3 results in a higher price level (OP3) and a lower volume of aggregate out-put (OY3). Thus, CPI may arise even below the full employment (YF) stage.

(iv) Causes of Cost-Push Inflation:

It is the cost factors that pull the prices up-ward. One of the important causes of price rise is the rise in price of raw materials. For in-stance, by an administrative order the govern-ment may hike the price of petrol or diesel or freight rate. Firms buy these inputs now at a higher price. This leads to an upward pres-sure on cost of production.

Not only this, CPI is often imported from outside the economy. Increase in the price of petrol by OPEC com-pels the government to increase the price of petrol and diesel. These two important raw materials are needed by every sector, espe-cially the transport sector. As a result, trans-port costs go up resulting in higher general price level.

Again, CPI may be induced by wage-push inflation or profit-push inflation. Trade unions demand higher money wages as a compen-sation against inflationary price rise.

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If in-crease in money wages exceed labour produc-tivity, aggregate supply will shift upward and leftward. Firms often exercise power by push-ing prices up independently of consumer de-mand to expand their profit margins.

Fiscal policy changes, such as increase in tax rates also leads to an upward pressure in cost of production. For instance, an overall in-crease in excise tax of mass consumption goods is definitely inflationary. That is why govern-ment is then accused of causing inflation.

Finally, production setbacks may result in decreases in output. Natural disaster, gradual exhaustion of natural resources, work stop-pages, electric power cuts, etc., may cause ag-gregate output to decline. In the midst of this output reduction, artificial scarcity of any goods created by traders and hoarders just simply ignite the situation.

Inefficiency, corruption, mismanagement of the economy may also be the other reasons. Thus, inflation is caused by the interplay of various factors. A particular factor cannot be held responsible for any inflationary price rise.

4. Effects of Inflation:

People's desires are inconsistent. When they act as buyers they want prices of goods and services to remain stable but as sellers they expect the prices of goods and services should go up. Such a happy outcome may arise for some individuals; "but, when this happens, others will be getting the worst of both worlds."

When price level goes up, there is both a gainer and a loser. To evaluate the conse-quence of inflation, one must identify the na-ture of inflation which may be anticipated and unanticipated. If inflation is anticipated, peo-ple can adjust with the new situation and costs of inflation to the society will be smaller.

In reality, people cannot predict accurately fu-ture events or people often make mistakes in predicting the course of inflation. In other words, inflation may be unanticipated when people fail to adjust completely. This creates various problems.

One can study the effects of unanticipated inflation under two broad head-ings:

(a) Effect on distribution of income and wealth; and

(b) Effect on economic growth.

(a) Effects of Inflation on Distribution of Income and Wealth:

During inflation, usu-ally people experience rise in incomes. But some people gain during inflation at the ex-pense of others. Some individuals gain be-cause their money incomes rise more rapidly than the prices and some lose because prices rise more rapidly than their incomes during inflation. Thus, it redistributes income and wealth.

Though no conclusive evidence can be cited, it can be asserted that following catego-ries of people are affected by inflation differ-ently:

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(I) Creditors and Debtors:

Borrowers gain and lenders lose during inflation because debts are fixed in rupee terms. When debts are repaid their real value declines by the price level increase and, hence, creditors lose. An individual may be interested in buying a house by taking loan of Rs. 7 lakh from an in-stitution for 7 years.

The borrower now wel-comes inflation since he will have to pay less in real terms than when it was borrowed. Lender, in the process, loses since the rate of interest payable remains unaltered as per agree-ment. Because of inflation, the borrower is given ‘dear’ rupees, but pays back ‘cheap’ ru-pees. However, if in an inflation-ridden economy creditors chronically loose, it is wise not to advance loans or to shut down business.

Never does it happen. Rather, the loan-giving institution makes adequate safeguard against the erosion of real value. Above all, banks do not pay any interest on current account but charges interest on loans.

(Ii) Bond and Debenture-Holders:

In an economy, there are some people who live on interest income—they suffer most. Bondhold-ers earn fixed interest income: These people suffer a reduction in real income when prices rise. In other words, the value of one’s sav-ings decline if the interest rate falls short of inflation rate. Similarly, beneficiaries from life insurance programmes are also hit badly by inflation since real value of savings deterio-rate.

(Iii) Investors:

People who put their money in shares during inflation are expected to gain since the possibility of earning of business profit brightens. Higher profit induces own-ers of firm to distribute profit among inves-tors or shareholders.

(Iv) Salaried People and Wage-Earners:

Any-one earning a fixed income is damaged by in-flation. Sometimes, unionised worker suc-ceeds in raising wage rates of white-collar workers as a compensation against price rise. But wage rate changes with a long time lag. In other words, wage rate increases always lag behind price increases. Naturally, inflation results in a reduction in real purchasing power of fixed income-earners.

On the other hand, people earning flexible incomes may gain during inflation. The nominal incomes of such people outstrip the general price rise. As a re-sult, real incomes of this income group in-crease.

(V) Profit-Earners, Speculators and Black Marketers:

It is argued that profit-earners gain from inflation. Profit tends to rise during inflation. Seeing inflation, businessmen raise the prices of their products. This results in a bigger profit. Profit margin, however, may not be high when the rate of inflation climbs to a high level.

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However, speculators dealing in business in essential commodities usually stand to gain by inflation. Black marketers are also ben-efited by inflation.

Thus, there occurs a redistribution of in-come and wealth. It is said that rich becomes richer and poor becomes poorer during infla-tion. However, no such hard and fast gener-alisation can be made. It is clear that someone wins and someone loses during inflation.

These effects of inflation may persist if in-flation is unanticipated. However, the redistributive burdens of inflation on income and wealth are most likely to be minimal if inflation is anticipated by the people. With anticipated inflation, people can build up their strategies to cope with inflation.

If the annual rate of inflation in an economy is anticipated correctly people will try to protect them against losses resulting from inflation. Workers will demand 10 p.c. wage increase if inflation is expected to rise by 10 p.c.

Similarly, a percent-age of inflation premium will be demanded by creditors from debtors. Business firms will also fix prices of their products in accordance with the anticipated price rise. Now if the en-tire society “learn to live with inflation”, the redistributive effect of inflation will be mini-mal.

However, it is difficult to anticipate prop-erly every episode of inflation. Further, even if it is anticipated it cannot be perfect. In addi-tion, adjustment with the new expected infla-tionary conditions may not be possible for all categories of people. Thus, adverse redistributive effects are likely to occur.

Finally, anticipated inflation may also be costly to the society. If people’s expectation regarding future price rise become stronger they will hold less liquid money. Mere hold-ing of cash balances during inflation is unwise since its real value declines. That is why peo-ple use their money balances in buying real estate, gold, jewellery, etc. Such investment is referred to as unproductive investment. Thus, during inflation of anticipated variety, there occurs a diversion of resources from priority to non-priority or unproductive sectors.

(b) Effect on Production and Economic Growth:

Inflation may or may not result in higher output. Below the full employment stage, inflation has a favourable effect on production. In general, profit is a rising function of the price level. An inflationary situation gives an incen-tive to businessmen to raise prices of their prod-ucts so as to earn higher volume of profit. Ris-ing price and rising profit encourage firms to make larger investments.

As a result, the multi-plier effect of investment will come into opera-tion resulting in a higher national output. How-ever, such a favourable effect of inflation will be temporary if wages and production costs rise very rapidly.

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Further, inflationary situation may be as-sociated with the fall in output, particularly if inflation is of the cost-push variety. Thus, there is no strict relationship between prices and output. An increase in aggregate demand will increase both prices and output, but a supply shock will raise prices and lower output.

Inflation may also lower down further pro-duction levels. It is commonly assumed that if inflationary tendencies nurtured by experi-enced inflation persist in future, people will now save less and consume more. Rising sav-ing propensities will result in lower further outputs.

One may also argue that inflation creates an air of uncertainty in the minds of business community, particularly when the rate of in-flation fluctuates. In the midst of rising infla-tionary trend, firms cannot accurately estimate their costs and revenues. That is, in a situa-tion of unanticipated inflation, a great deal of risk element exists.

It is because of uncertainty of expected inflation, investors become reluc-tant to invest in their business and to make long-term commitments. Under the circum-stance, business firms may be deterred in in-vesting. This will adversely affect the growth performance of the economy.

However, slight dose of inflation is neces-sary for economic growth. Mild inflation has an encouraging effect on national output. But it is difficult to make the price rise of a creep-ing variety. High rate of inflation acts as a dis-incentive to long run economic growth. The way the hyperinflation affects economic growth is summed up here. We know that hyper-inflation discourages savings.

A fall in savings means a lower rate of capital forma-tion. A low rate of capital formation hinders economic growth. Further, during excessive price rise, there occurs an increase in unpro-ductive investment in real estate, gold, jewel-lery, etc. Above all, speculative businesses flourish during inflation resulting in artificial scarcities and, hence, further rise in prices.

Again, following hyperinflation, export earn-ings decline resulting in a wide imbalances in the balance of payment account. Often gallop-ing inflation results in a ‘flight’ of capital to foreign countries since people lose confidence and faith over the monetary arrangements of the country, thereby resulting in a scarcity of resources. Finally, real value of tax revenue also declines under the impact of hyperinfla-tion. Government then experiences a shortfall in investible resources.

Thus economists and policymakers are unanimous regarding the dangers of high price rise. But the consequence of hyperinfla-tion are disastrous. In the past, some of the world economies (e.g., Germany after the First World War (1914-1918), Latin American coun-tries in the 1980s) had been greatly ravaged by hyperinflation.

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The German Inflation of 1920s was also Catastrophic:

During 1922, the German price level went up 5,470 per cent. In 1923, the situation wors-ened; the German price level rose 1,300,000,000 (1.3 billion) times. By October of 1923, the post-age in the lightest letter sent from Germany to the United States was 200,000 marks. But-ter cost 1.5 million marks per pound, meat 2 million marks, a loaf of bread 200,000 marks, and an egg 60,000 marks! Prices increased so rapidly that waiters changed the prices on the menu several times during the course of a lunch!! Sometimes, customers had to pay the double price listed on the menu when they observed it first!!! A photograph of the period shows a German housewife starting the fire in her kitchen stove with paper money and children playing with bundles of paper money tied together into building blocks!

Currently (September 2008), Indian economy experienced an inflation rate of al-most 13 p.c.—an unprecedented one over the last 16 or 17 years. However, an all-time record in price rise in India was struck in 1974-75 when it rose more than 25 p.c. Anyway, peo-ple are ultimately harassed by the high dose of inflation. That is why, it is said that 'infla-tion is our public enemy number one.' Rising inflation rate is a sign of failure on the part of the government.

Fiscal Policy

Definition: Fiscal policy is government spending and taxation that influences the economy. Elected officials should coordinate with monetary policy to create healthy economic growth. They usually don't. Why? Fiscal policy reflects the priorities of individual lawmakers. They focus on the needs of their constituencies. These local needs overrule national economic priorities. As a result, fiscal policy is hotly debated, whether at the federal, state, county or municipal level.

Fiscal policy means the use of taxation and public expenditure by the government for stabilisation or growth. According to Culbarston, "By fiscal policy we refer to government actions affecting its receipts and expenditures which we ordinarily taken as measured by the government's receipts, its surplus or deficit." The government may offset undesirable variations in private consumption and investment by compensatory variations of public expenditures and taxes.

Arthur Smithies defines fiscal policy as "a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment." Though the ultimate aim of fiscal policy in the long-run stabilisation of the economy, yet it can be achieved by moderating short-run economic fluctuations. In this context, Otto Eckstein defines fiscal policy as "changes in taxes and expenditures which aim at short-run goals of full employment and price-level stability."

In economics and political science, **fiscal policy** is the use of government revenue collection (mainly taxes) and expenditure (spending) to influence the economy. According to Keynesian economics, when the government changes the levels of taxation and government spending, it influences aggregate demand and the level of economic activity. Fiscal policy often attempts to stabilize the economy over the course of the business cycle.

Changes in the level and composition of taxation and government spending can affect the following macroeconomic variables, amongst others, in an economy:

- Aggregate demand and the level of economic activity;
- Savings and investment in the economy;
- Income distribution.

Fiscal policy can be distinguished from monetary policy, in that fiscal policy deals with taxation and government spending and is often administered by an executive under laws of a legislature, whereas monetary policy deals with the money supply, lending rates and interest rates and is often administered by a central bank.

The three main Stances of Fiscal Policy Are:

- **Neutral fiscal policy** is usually undertaken when an economy is in equilibrium. Government spending is fully funded by tax revenue and overall the budget outcome has a neutral effect on the level of economic activity.
- **Expansionary fiscal policy** involves government spending exceeding tax revenue, and is usually undertaken during recessions. It is also known as reflationary fiscal policy.
- **Contractionary fiscal policy** occurs when government spending is lower than tax revenue, and is usually undertaken to pay down government debt.

However, these definitions can be misleading because, even with no changes in spending or tax laws at all, cyclic fluctuations of the economy cause cyclic fluctuations of tax revenues and of some types of government spending, altering the deficit situation; these are not considered to be policy changes. Therefore, for purposes of the above definitions, "government spending" and "tax revenue" are normally replaced by "cyclically adjusted government spending" and "cyclically adjusted tax revenue". Thus, for example, a government budget that is balanced over the course of the business cycle is considered to represent a neutral fiscal policy stance.

Methods of Funding

Governments spend money on a wide variety of things, from the military and police to services like education and healthcare, as well as transfer payments such as welfare benefits. This expenditure can be funded in a number of different ways:

- Taxation
- Seigniorage, the benefit from printing money
- Borrowing money from the population or from abroad
- Consumption of fiscal reserves
- Sale of fixed assets (e.g., land)

Borrowing

A fiscal deficit is often funded by issuing bonds, like treasury bills or consols and gilt-edged securities. These pay interest, either for a fixed period or indefinitely. If the interest and capital requirements are too large, a nation may default on its debts, usually to foreign creditors. Public debt or borrowing refers to the government borrowing from the public.

Consuming Prior Surpluses

A fiscal surplus is often saved for future use, and may be invested in either local currency or any financial instrument that may be traded later once resources are needed; notice, additional debt is not needed. For this to happen, the marginal propensity to save needs to be strictly positive.

Another possibility is that the government might decide to increase its own spending – say, by building more highways. The idea is that the additional government spending creates jobs and lowers the unemployment rate.

Governments use fiscal policy to influence the level of aggregate demand in the economy, in an effort to achieve economic objectives of price stability, full employment, and economic growth. Keynesian economics suggests that increasing government spending and decreasing tax rates are the best ways to stimulate aggregate demand, and decreasing spending & increasing taxes after the economic boom begins. Keynesians argue this method be used in times of recession or low economic activity as an essential tool for building the framework for strong economic growth and working towards full employment. In theory, the resulting deficits would be paid for by an expanded economy during the boom that would follow; this was the reasoning behind the New Deal.

Governments can use a budget surplus to do two things: to slow the pace of strong economic growth, and to stabilize prices when inflation is too high. Keynesian theory posits that removing spending from the economy will reduce levels of aggregate demand and contract the economy, thus stabilizing prices.

But economists still debate the effectiveness of fiscal stimulus. The argument mostly centers on crowding out: whether government borrowing leads to higher interest rates that may offset the stimulative impact of spending. When the government runs a budget deficit, funds will need to come from public borrowing (the issue of government

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bonds), overseas borrowing, or monetizing the debt. When governments fund a deficit with the issuing of government bonds, interest rates can increase across the market, because government borrowing creates higher demand for credit in the financial markets. This causes a lower aggregate demand for goods and services, contrary to the objective of a fiscal stimulus. Neoclassical economists generally emphasize crowding out while Keynesians argue that fiscal policy can still be effective especially in a liquidity trap where, they argue, crowding out is minimal.

Some classical and neoclassical economists argue that crowding out completely negates any fiscal stimulus; this is known as the Treasury View[*citation needed*], which Keynesian economics rejects. The Treasury View refers to the theoretical positions of classical economists in the British Treasury, who opposed Keynes' call in the 1930s for fiscal stimulus. The same general argument has been repeated by some neoclassical economists up to the present.

In the classical view, the expansionary fiscal policy also decreases net exports, which has a mitigating effect on national output and income. When government borrowing increases interest rates it attracts foreign capital from foreign investors. This is because, all other things being equal, the bonds issued from a country executing expansionary fiscal policy now offer a higher rate of return. In other words, companies wanting to finance projects must compete with their government for capital so they offer higher rates of return. To purchase bonds originating from a certain country, foreign investors must obtain that country's currency. Therefore, when foreign capital flows into the country undergoing fiscal expansion, demand for that country's currency increases. The increased demand causes that country's currency to appreciate. Once the currency appreciates, goods originating from that country now cost more to foreigners than they did before and foreign goods now cost less than they did before. Consequently, exports decrease and imports increase.

Some economists oppose the discretionary use of fiscal stimulus because of the inside lag (the time lag involved in implementing it), which is almost inevitably long because of the substantial legislative effort involved. Further, the outside lag between the time of implementation and the time that most of the effects of the stimulus are felt could mean that the stimulus hits an already-recovering economy and exacerbates the ensuing boom rather than stimulating the economy when it needs it.

Some economists are concerned about potential inflationary effects driven by increased demand engendered by a fiscal stimulus. In theory, fiscal stimulus does not cause inflation when it uses resources that would have otherwise been idle. For instance, if a fiscal stimulus employs a worker who otherwise would have been unemployed, there is no inflationary effect; however, if the stimulus employs a worker who otherwise would have had a job, the stimulus is increasing labor demand while labor supply remains fixed, leading to wage inflation and therefore price inflation.

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Types of Fiscal Policy

There are two types of fiscal policy. The first, and most widely-used, is **expansionary**. It stimulates economic growth. It's most critical at the contractionary phase of the business cycle. That's when voters are clamoring for relief from a recession.

How does it work? The government either spends more, cuts taxes, or does both if it can. The idea is to put more money into consumers' hands, so they spend more. That jumpstarts demand, which keeps businesses running, and hopefully adds jobs. Of course, there is a debate about which works better. Advocates of supply-side economics prefer tax cuts. They say it frees up businesses to hire more workers to pursue business ventures. For more, see Do Tax Cuts Create Jobs?

Advocates of demand-side economics say additional spending is more effective than tax cuts. Examples include as public works projects, unemployment benefits, and food stamps.

The money goes into the pockets of consumers, who go right out and buy the things businesses produce. For more, see Unemployment Solutions, How Extended Unemployment Benefits Boost the Economy and 14 Ways to Create Jobs.

Expansionary fiscal policy is usually impossible for state and local government.

That's because they often are mandated to keep a balanced budget. If they haven't created a surplus during the boom times, they must cut spending to match lower tax revenue during a recession. That makes it worse.

Fortunately, the Federal government has no such constraints, so it can use expansionary policy when needed. Unfortunately, it also means Congress has created budget deficits during boom times. That's despite a national debt ceiling. As a result, the critical debt-to-GDP ratio has exceeded 100%.

The second type, **contractionary fiscal policy**, is rarely used. That's because its goal is to slow economic growth. Why would you ever want to do that? One reason only, and that's to stamp out inflation. That's because the long-term impact of inflationcan damage the standard of living as much as a recession.

The tools of contractionary fiscal policy are used in reverse. Taxes are increased, and spending is cut. You can imagine how wildly unpopular this is among voters. Thus, it's hardly ever used. Fortunately, monetary policy is effective in preventing inflation.

Tools of Fiscal Policy

The first tool is taxation. That includes income, capital gains from investments, property, sales, or just about anything else.

Taxes provide the major revenue source that funds the government. The downside of taxes is that whatever or whoever is taxed has less income to spend themselves. That

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makes taxes unpopular. Find out exactly how the U.S. Federal budget is funded in Federal Income and Taxes.

The second tool is government spending. That includes subsidies, transfer payments including welfare programs, public works projects, and government salaries. Whoever receives the funds has more money to spend. That increases demand and economic growth.

The Federal government is losing its ability to use discretionary fiscal policy.

Each year, more of the budget must go to mandated programs. As the population ages, the costs of Medicare, Medicaid, and Social Security are rising. Changing mandatory fiscal policy requires an Act of Congress, and that takes a long time. One exception was the ARRA, or Economic Stimulus Act, which Congress passed quickly. That's because legislators knew they must stop the worst recession since the Great Depression.

Fiscal Policy vs. Monetary Policy

Monetary policy is when a nation's central bank changes the money supply. It increases it with expansionary monetary policy and decreases it with contractionary monetary policy. It has many tools it can use, but it primarily relies on raising or lowering the Fed funds rate. This benchmark rates then guides all interest rates. When interest rates are high, the money supply contracts, the economy cools down, and inflation is prevented. When interest rates are low, the money supply expands, the economy heats up, and a recession is usually avoided.

Monetary policy works faster than fiscal policy. The Fed can just vote to raise or lower rates at its regularly FOMC meeting. It may take about six months for the impact of the rate cut to percolate throughout the economy.

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Module - 4

L.P.G

Liberalization, Privatization and Globalization

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CONCEPT OF LIBERALIZATION

Globalization and privatization have become the buzzwords in the current economic scenario. The concepts of liberalization, globalization and privatization are actually closely related to one another. This LPG phenomenon was first initiated in the Indian Economy in 1990 when the Indian Economy experienced a severe crisis. There was decline in the country's export earnings, national income and industrial output. The government had to seek aid from IMF to resolve it's debt problem. That is when the government decided to introduce the New Industrial Policy (NIP) in 1991 to start liberalizing the Indian economy. Liberalization means elimination of state control over economic activities. It implies greater autonomy to the business enterprises in decision-making and removal of government interference. It was believed that the market forces of demand and supply would automatically operate to bring about greater efficiency and the economy would recover. This was to be done internally by introducing reforms in the real and financial sectors of the economy and externally by relaxing state control on foreign investments and trade. With the NIP' 1991 the Indian Government aimed at integrating the country's economy with the world economy, improving the efficiency and productivity of the public sector. For attaining this objective, existing government regulations and restrictions on industry were removed. The major aspects of liberalization in India were ; 1.Abolition of licensing : NIP'1991 abolished licensing for most industries except 6 industries of strategic significance. They include alcohol, cigarettes, industrial explosives, defense products ,drugs and pharmaceuticals, hazardous chemicals and certain others reserved for the public sector. This would encourage setting up of new industries and shift focus to productive activities. 2.Liberalization of Foreign Investment : While earlier prior approval was required by foreign companies, now automatic approvals were given for Foreign Direct Investment (FDI) to flow into the country. A list of high-priority and investment-intensive industries were delicensed and could invite up to 100% FDI including sectors such as hotel and tourism, infrastructure, software development .etc. Use of foreign brand name or trade mark was permitted for sale of goods. 3.Relaxation of Locational Restrictions : There was no requirement anymore for obtaining approval from the Central Government for setting up industries anywhere in the country except those specified under compulsory licensing or in cities with population exceeding1 million. Polluting industries were required to be located 25 kms away from the city peripheries if the city population was greater than 1 million. 4.Liberalization of Foreign Technology imports : In projects where imported capital goods are required, automatic license would be given for foreign technology imports up to 2 million US dollars. No permissions would be required for hiring foreign technicians and foreign testing of indigenously developed technologies. 5.Phased Manufacturing Programmes :Under PMP any enterprise had to progressively substitute imported inputs, components with domestically produced inputs under local content policy. However NIP'1991 abolished PMP for all industrial

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enterprises. Foreign Investment Promotion Board (FIPB) was set up to speed up approval for foreign investment proposals. 6.Public Sector Reforms : Greater autonomy was given to the PSUs (Public Sector Units) through the MOUs (Memorandum of Understanding) restricting interference of the government officials and allowing their managements greater freedom in decision-making. 7.MRTP Act : The Industrial Policy 1991 restructured the Monopolies and Restrictive Trade Practises Act. Regulations relating to concentration of economic power, pre-entry restrictions for setting up new enterprises, expansion of existing businesses, mergers and acquisitions .etc. have been abolished.

CONCEPT OF PRIVATIZATION

Privatization is closely associated with the phenomena of globalization and liberalization. Privatization is the transfer of control of ownership of economic resources from the public sector to the private sector. It means a decline in the role of the public sector as there is a shift in the property rights from the state to private ownership. The public sector had been experiencing various problems , since planning, such as low efficiency and profitability, mounting losses, excessive political interference, lack of autonomy, labour problems and delays in completion of projects. Hence to remedy this situation with Introduction of NIP'1991 privatization was also initiated into the Indian economy. Another term for privatization is Disinvestment. The objectives of disinvestment were to raise resources through sale of PSUs to be directed towards social welfare expenditures, raising efficiency of PSUs through increased competition, increasing consumer satisfaction with better quality goods and services, upgrading technology and most importantly removing political interference. The main aspects of privatization in India are as follows; 1.Autonomy to Public sector : Greater autonomy was granted to nine PSUs referred to as 'navaratnas' (ONGC, HPCL, BPCL, VSNL, BHEL) to take their own decisions. 2.Dereservation of Public Sector : The number of industries reserved for the public sector were reduced in a phased manner from 17 to 8 and then to only 3 including Railways, Atomic energy, Specified minerals. This has opened more areas of investment for the private sector and increased competition for the public sector forcing greater accountability and efficiency. 3.Disinvestment Policies : Till 1999-2000 disinvestment was done basically through sale of minority shares but since then the government has undertaken strategic sale of it's equity to the private sector handing over complete management control such as in the case of VSNL , BALCO .etc.

CONCEPT OF GLOBALIZATION

Globalization essentially means integration of the national economy with the world economy. It implies a free flow of information, ideas, technology, goods and services, capital and even people across different countries and societies. It increases connectivity between different markets in the form of trade, investments and cultural exchanges. The concept of globalization has been explained by the IMF (International Monetary Fund)

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as ‘the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology.’ The phenomenon of globalization caught momentum in India in 1990s with reforms in all the sectors of the economy. The main elements of globalization were; 1. To open the domestic markets for inflow of foreign goods, India reduced customs duties on imports. The general customs duty on most goods was reduced to only 10% and import licensing has been almost abolished. Tariff barriers have also been slashed significantly to encourage trade volume to rise in keeping with the World trade Organization (WTO) order under (GATT)General Agreement on Tariff and Trade. The amount of foreign capital in a country is a good indicator of globalization and growth. The FDI policy of the GOI encouraged the inflow of fresh foreign capital by allowing 100 % foreign equity in certain projects under the automatic route. NRIs and OCBs (Overseas Corporate Bodies)may invest up to 100 % capital with repatriability in high priority industries. MNCs and TNCs were encouraged to establish themselves in Indian markets and were given a level playing field to compete with Indian enterprises. Foreign Exchange Regulation Act (FERA) was liberalized in 1993 and later Foreign Exchange Management Act (FEMA) 1999 was passed to enable foreign currency transactions. India signed many agreements with the WTO affirming it’s commitment to liberalize trade such as TRIPs (Trade Related Intellectual Property Rights), TRIMs (Trade Related Investment Measures) and AOA (Agreement On Agriculture).

Impact of Globalization:

Advantages of Globalization:

• There is a decline in the number of people living below the poverty line in developing countries due to increased investments, trade and rising employment opportunities. There is an improvement in various economic indicators of the LDCs (Less Developed Countries) such as employment, life expectancy, literacy rates, per capita consumption etc. Free flow of capital and technology enables developing countries to speed up the process of industrialization and lay the path for faster economic progress. Products of superior quality are available in the market due to increased competition, efficiency and productivity of the businesses and this leads to increased consumer satisfaction. Free flow of finance enable the banking and financial institutions in a country to fulfill financial requirements through internet and electronic transfers easily and help businesses to flourish. MNCs bring with them foreign capital, technology, know-how, machines, technical and managerial skills which can be used for the development of the host nation.

Disadvantages of Globalisation:

• Domestic companies are unable to withstand competition from efficient MNCs which have flooded Indian markets since their liberalized entry. It may lead to shut down of

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operations, pink slips and downsizing. Moreover skilled and efficient labour get absorbed by these MNCs that offer higher pay and incentives leaving unskilled labour for employment in the domestic industries. Thus there may be unemployment and underemployment. Payment of dividends, royalties and repatriation has in fact led to a rise in the outflow of foreign capital. With increased dependence on foreign technology, development of indigenous technology has taken a backseat and domestic R and D development has suffered. Globalization poses certain risks for any country in the form of business cycles, fluctuations in international prices, specialization in fewexportables and so on. It increases the disparities in the incomes of the rich and poor, developed nations and LDCs. It leads commercial imperialism as the richer nations tend to exploit the resources of the poor nations. Globalization leads to fusion of cultures and inter-mingling of societies to such an extent that there may be a loss of identities and traditional values. It gives rise to mindless aping of western lifestyles and mannerisms however ill-suited they may be. It leads to overcrowding of cities and puts pressure on the amenities and facilities available in urban areas.

NEW ECONOMIC POLICY

In 1990s the govt. of India in order to come out of the economic crisis decided to devite from its previous economic policies and learn towards Privatization . In July 1991 when thedevaluation of Indian currency took place the govt. started announcing its new economic polices one after another. Though these polices pertained to different aspects of the economic field they had one thing in common. The economic element was to orient the Indian system towards theworld market it is in this context the govt. launched its new economic policy which consisted ofamong other things three important features. Liberalization , Privatization and Globalization .Liberalization of the economy means to free if from direct or physical control imposed by the govt.economic reforms were based on the assumption that marten forces could guide the economy in amore effective manner than govt.

Main Objectives of New –Economic Policy – 1991

The main objectives behind the launching of the new –economic policy (NEP) in 1991 bythe union finance minister Dr. Manmohansingh, could be stated as follows:

- The main objective was to plunge Indian economy in to the arena of ‘Globalization and togive it a new thrust on market orientation.
- The NEP intended to bring down the rate of inflation and to remove imbalances inpayment.
- It intended to move towards higher economic growth rate and to build sufficient foreignexchange reserves.
- It wanted to achieve economic stabilization and to convert the economic in to a market economy by removing all kinds of unnecessary restrictions.

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- It wanted to permit the international flow of goods, services, capital, human resources and technology, without many restrictions.

Beginning with mid-1991, the govt. has made some radical changes in its policies bearingon trade, foreign investment exchange rate, industry, fiscal of fairs etc…The various elements,when put together, constitute an economic policy which marks a big departure from what has gonebefore.

New Economic Policies: Liberalization, Privatization and Globalization

The last quarter of the 20th century has been a wave of economic policy reforms in thedeveloping world, with one country after another taking the Liberalization cure, often imposed bythe international financial institutions. This wave of reform had been preceded by a quarter-centuryof state directed effort at economic development, during which time the goals of economic self reliance and import substitution industrialization were the hallmarks of development strategiesin the less developed countries. These goals seemed particularly justified, given the longexperience of these countries with colonialism and the agricultural nature of their economies.However, all this seemed to be overtaken by the subsequent surge of liberalization.

LIBERALIZATION

The term “liberalization” in this context implies economic liberalization. “economic liberalization” constitutes one of the basic elements of the new Economic policy (NEP) which theIndian Government launched in the middle of the year 1991. The other important aspects of thepolicy are –Privatization of the public sector, Globalization and market friendly state.

The main trust of the New economic policy is “liberalization”. The essence of this policy isthat greater freedom is to be given to the entrepreneur of any industry, trade or business and thatgovernmental control on the same be reduced to the minimum.

The main purpose of the process to economic liberalization is to set business free and to runon commercial lines. The underlying helief is that commerce and business are not matter tocontained to fixed national boundaries; they are global phenomena. Here, artificial govt.restrictions which hinder economic and commercial activities ad flow of goods and services must be removed. The liberalization intends to liberalization commerce and business and trade from the clutches of controls and obstacles.

The Concept of Liberalization:

The recent wave of economic policy reform in the developing world has been seen as anecessary consequence of a changed world economic system. The key feature of the changed world economy is the clement of the heightened economic Globalization which provides new external challenges as well as opportunities for development.

MAIN FEATURES OF THE POLICY OF LIBERA LISATION:

Following are main features of liberalization.

- Lessened Government control and freelance to private Enterprises.
- Capital Markets opened for private Entrepreneurs
- Simplification of Licensing policy
- Opportunity to purchase foreign exchange at market prices
- Right To Take Independent Decisions Regarding The Market
- Better opportunity for completion
- Widened Liberty in the Realm of Business and Trade

Brief Evaluationof Liberalization:

From the Indian point of view, it is very difficult to say at this stage when the process ofeconomic liberalization taken up by the govt. of India in 1990's has realiy brought big economic gains to India gains to India. The process has no doubt brought some benefits through suffers fromsome deficiencies.

The Gains

The liberalization process has helped the free movement of goods and services it has led tobetter industrial performances. Industrial organizations have now become more efficient andmarket responsive. Country's exports are on the increase. Sectors such as information technology and computer soft ware here registered tremendous progress.

The Deficiencies

Liberalization process has its deficiencies also. The economic reforms including liberalization were introduced all on a sudden and proper background was not created to take theirfull advantage and to face their consequences.

LIBERALIZATION IN INDIA

There are at least two striking features of main stream analysis of the economic reforms programme in India since 1991. The first which is evident not only in official govt. publications particularly English language financial press is the generally un-supported far by and large havebeen successful so both in achieving the medium term goals of structural adjustment and in preparing to economy for intake off in the new globalised environment. The important charecteristics of the new policy may be described and explained under thefollowing four heads liberalization; Privatization of the public sector, Globalization and market friendly state. Liberalization is the thrust of the policy is the freedom for the entrepreneur. The newpolicy permits foreign direct investment to a large extent and in a larger number of Industries then before.

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PRIVATIZATION

Privatization is a managerial approach that has attracted the interest of many categories ofpeople academicians, politicians, government employee players of the private sector and public onthe whole. Privatization has an adverse impact on the employee morale and generates fear of dislocation or termination more likely it also adds on to the apprehension pertaining to accountability and quality. Experts both advocate and criticize Privatization making it more or lessprovocative decision that calls for diligent scurrying by the decision makers in assessment of prossand cons attached to the concerned policy.

In India Privatization has been accepted with a lot of resistance and has been dormant initially during the inception period of economic Liberalization in the country. Thearticle intends to analyze the present status of Privatization in India and summarize its advantagesand disadvantages in context with the Indian economy. Privatization is also one of the aspects ofthe new economic policy which came to take shape in the decade 1990. The term “Privatization ” can notes wide range of ideas. But the broad meaning of Privatization is that in the economic fieldmuch broader role is to be agencies and the role of the public sector activities is to be limited.

Privatization refers to any process hat reduces the involvement of the state, public sector ineconomic activities of a nation. The Privatization process in a mixed economy such as of Indiaincludes:

- Decentralization the transfer of the ownership of productive assets to the private sector.
- Entry of private sector industries into the areas exclusive reserved for the state sector orwhich are considered exclusive monopolies of state.
- Limiting the scope of the public sector or no more diversification of existing public sector understandings.

DEFINITION OFPRIVATIZATION:

- Steve H. Hanke refers to Privatization as “the process where by the public operetions aretransferred to the private sector”.
- Barbara Lee and John Nellis define the concept in this manner: “ Privatization is thegeneral process of involving the private sector in the ownership or operation of a stateowned enterprise. Thus the term refers to private purchase of all or part of a company. It cover “contractedly out” and the Privatization of management through management contractsleases or franchise arrangements.”

MAIN OBJECTIVEOF PRIVATIZATION

1. The process of Privatization has been triggered with the main intention of improving industrial efficiency and to facilitate the inflow of foreign investments.

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2. It also wants to make the public sector undertakings strong able efficient companies. It recommends a change in the role of the government from that of the “owner manager”to that of a mere “controller” or “regular”.
3. It also intend to ensure efficient utilization of all types of resources including human resources.
4. Privatization insists on the government to concentrate on the area such as education administration and infrastructure and to give up the responsibility of looking after business and running industries. It is expected to strengthen the capital market by following appropriate trade policies.

PRIVATIZATION IN INDIA

In India the wave of Privatization that was generated during the Eighties (1980s) became more powerful when Rajiv Gandhi assumed office as the Prime minister of India. The issue of Privatization in India has to be understood in the context of – the relative inefficiency of the public sector industries, dearth of financial resources, defective competition system, continuous labour problem and so on.

When India became independent it embarked upon planned economic development.In order to accelerate the economic development it started giving more important to the publicsector on which the Government had its control. The Industrial Policy Resolution of 1956 alsogave importance to the public sector industries. The growth of the public sector assume importance in the Indian economy. It contributed to employment opportunities, capital formation , development of infrastructure, increase in exports over the years, and to many other areas. But itfailed in certain respects. It failed to generate adequate surpluses to support sustained growth. The public sector was also a failure in obtaining consistent profits, fulfilling labour demands and interests, encouraging industrial researches, reducing the cost of the production, achieving technical expertise, and in successfully facing the competition at the hand of the private sector. During the later years of Mrs. Indira Gandhi’s regime a search for the new policy options began. Gradually, a new industrial policy started taking its shape. The essence of this policy is marketed forces must be allowed to play their role in shaping the economy. With the announcement of new economic policy on 24th July 1991 by Dr. Manmohan Singh, the then Union Finance Minister,India opted for a radical change.

ADVANTAGES OF PRIVATIZATION :

Efficiency, Absences of political interference, Quality service, Systematic marketing Use of freedom technology, Accountability, Innovation, Research and development, Infrastructure.

ARGUMENTS IN FAVOUR OF PRIVATIZATION

- Privatization is Necessary to Revitalize the State Owned Enterprises
- Privatization is Necessary to Face Global Competition

- Privatization is Needed to Create More Employment Opportunities in Future
- Helpful for Mobilizing and Investing Resources
- Recognition of Talents and Good Performance of work

ARGUMENT AGAINSTPRIVATIZATION

- Profitability Alone Should Not Become the Sole Yardstick to Measure Efficiency
- Role of Public Sector Undertaking From the socio-Economic Angle Also Cannot beignored
- Protection of the Interests of the Weaker Section
- Price –fixing Policy Here is Not Profit- Oriented
- Argument that the Private Sector Is More Efficient than the Public Sector is Not Right

The experiment of Privatization undertaken in the European countries has been given a lot of publicity in the media. The Privatization programmes implemented in Britain, Mexico and the previously existed East Germany had attained good success. This success has inspired many nations to go in that direction. India is also one among them. Economist differ in their view regarding the relative success or failure of Privatization in the Indian context. It is however, widel yheld that Privatization could achieve notable success only if it is solidly backed by the political authority, effectively implemented by the bureaucracy and implicitly acceptable. Privatization is complicated and its efficient management is a competent task.

GLOBALIZATION

Globalization represent one of the aspects of the new economic policy lunched in the decades of 1980 and 1990s. The new economic policy has also maid the economy out wardly oriented such that its activities are now to be governed both by domestic market and the world market. The general usages of the terms Globalization can be follows ,

- Interaction and interdependence among countries
- Integration of world economy
- Deterritorisation

The tem Globalization was first coined in 1980s . But even before this there were interaction among nations. But in the modern days Globalization has launched all spheres of lifesuch as economy, education, technology , cultural phenomenon , social aspects etc……the termglobal village is also frequently used to high light the significance of the Globalization . " Globalization of production refers to the integration of economic activities by units of private capital on awaked scale ."S.K Misra and V.K

Pury "stated that in simple terms Globalization means integrating economy of a country with the world economy."

In simple words" Globalization is refers to a process of increasing economic integration and growing economic interdependence between countries in the world economy"

The word Globalization is now used to sum contemporary world order. But the influence of the Globalization of directly visible in the economic field and hence the term is very often takento me economic Globalization of market. The Globalization defined as the process whereby there are social, cultural, technological, exchange across the border.

STEPS INGLOBALIZATION

- Need for corporate sector to go global : The Indian corporate sector has to take lead and initiative in bringing about the Globalization of the economy. To go global a corporate must consciously .
- Needs to promote competitiveness of Indian producers : to succeed in global market ,competitiveness of Indian producers has to be improved .
- Need to adopt new strategies; the changes realities of the global environment detect that the Indian firms must in order to survive.
- Need to create favorable environment; world class companies need to undergo a change.
- Need to set up new institutions
- Need for a rules and regulations : if we want make our companies world – class wealso need rule and regulations that are in leave with global corporate and financial norms.

INDIA'S AWAKNINGTO A GLOBALISED WORLD

The origin of globalizations in India need to be the analyses in terms of economic changes brought about in the country in the last decades of 20th century. Thedefinite move towards economic Globalization came in the summer of 1991 when the country found itself in the midst of a series balance of payment crisis and was bailed out by the IMF andthat world bank offered programs of stabilization and structural adjustment which India was hardly in a position to refuse. TheLiberalization and Globalization of the Indian economy are the keycomponents of the package of the reforms adopted and implemented following the 1992 crises.

INDIA'S PERSPECTIVESON GLOBALAISATION

The concept of Globalization to describe a verity of changing economical , political, and cultural process . the development of Globalization is in India as which traditionally had quite adeveloped pre industrial base trade and market , the market and trade relation continue to belocated in local cultural even today . Also , the economic policies of India

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up to the 1980 has beenthat of import substitution and protectionism . The political Globalization in India ends up with the discussion on the survival and weakening of nations state besides the nation state , another issue srelating to Globalization is that of political ethnocentrism.

Advantages of Globalaisation

- Better and faster industrialization: the flow of industrial units from developed countries todeveloping countries gives speed of industries helping global industrialization. Helps over all balanced development.
- Flow of capital: moves from to surplus countries to the needy in globalization. Investors get advantage of better returns for his capital.
- Speed of production facilities throughout the world: the production units give cost competitive and wider availability and manufactured gods.
- Flow of technology : the advanced level of technology flow from developed country to less developed countries .
- Increase in conception: due to technology and the spared up gradation the demand increases formanufactured good
- Attitude: thinking globally in major plus point in globalization

Disadvantages of Globalization

- Globalization discourages domestic industry and business: with sophistication in technologies and large scale production felicities of other countries domestic trade and industries is hit.
- Problem on the labor front: the process of Globalization needs to job lay offs and exploitation of human recourses. This is especially applicable to under developed countries.
- Widening rich and poor divide: the un employment and decline of in income level in lowerstrata of society widen the gap between the rich and poor more and more.
- Transfer of national recourses: the developed countries tend to establish factories in under developed countries may lead to commercial exploitation.

CONCLUSION

Today Globalization is being challenged around the world. In effects of globalization, inIndia, to the path of developmental at a more rapid rate than ever before. It is true that Globalization brings in its wake great enquiry, mass impoverishment and misery. It is almostirreversibly widens the gap between the developed and the developing nations. What we learnfrom this process of Globalization is that it is more harmful for the developing and the under developing countries. The choice for the devolving countries like India lies not in total globalintegration, but less of global integration and more of

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self relines and self sustenance with anemphasis on indigenous and traditional production and knowledge system.

BALANCE OF PAYMENTS

The **balance of payments**, also known as **balance of international payments** and abbreviated **BoP**, of a country is the record of all economic transactions between the residents of the country and the rest of the world in a particular period (over a quarter of a year or more commonly over a year). These transactions are made by individuals, firms and government bodies. Thus the balance of payments includes all external visible and non-visible transactions of a country. It is an important issue to be studied, especially in international financial management field, for a few reasons. First, the balance of payments provides detailed information concerning the demand and supply of a country's currency. For example, if the United States imports more than it exports, then this means that the supply of dollars is likely to exceed the demand in the foreign exchanging market, *ceteris paribus*. One can thus infer that the U.S. dollar would be under pressure to depreciate against other currencies. On the other hand, if the United States exports more than it imports, then the dollar would be likely to appreciate. Second, a country's balance-of-payment data may signal its potential as a business partner for the rest of the world. If a country is grappling with a major balance-of-payment difficulty, it may not be able to expand imports from the outside world. Instead, the country may be tempted to impose measures to restrict imports and discourage capital outflows in order to improve the balance-of-payment situation. On the other hand, a country experiencing a significant balance-of payment surplus would be more likely to expand imports, offering marketing opportunities for foreign enterprises, and less likely to impose foreign exchange restrictions. Third, balance-of-payments data can be used to evaluate the performance of the country in international economic competition. Suppose a country is experiencing trade deficits year after year. This trade data may then signal that the country's domestic industries lack international competitiveness. To interpret balance-of-payments data properly, it is necessary to understand how the balance of payments account is constructed.[1][2] These transactions include payments for the country's exports and imports of goods, services, financial capital, and financial transfers. It is prepared in a single currency, typically the domestic currency for the country concerned. Sources of funds for a nation, such as exports or the receipts of loans and investments, are recorded as positive or surplus items. Uses of funds, such as for imports or to invest in foreign countries, are recorded as negative or deficit items.

When all components of the BoP accounts are included they must sum to zero with no overall surplus or deficit. For example, if a country is importing more than it exports, its trade balance will be in deficit, but the shortfall will have to be counterbalanced in other ways – such as by funds earned from its foreign investments, by running down currency reserves or by receiving loans from other countries.

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While the overall BoP accounts will always balance when all types of payments are included, imbalances are possible on individual elements of the BoP, such as the current account, the capital account excluding the central bank's reserve account, or the sum of the two. Imbalances in the latter sum can result in surplus countries accumulating wealth, while deficit nations become increasingly indebted. The term **balance of payments** often refers to this sum: a country's balance of payments is said to be in surplus (equivalently, the balance of payments is positive) by a specific amount if sources of funds (such as export goods sold and bonds sold) exceed uses of funds (such as paying for imported goods and paying for foreign bonds purchased) by that amount. There is said to be a balance of payments deficit (the balance of payments is said to be negative) if the former are less than the latter. A BoP surplus (or deficit) is accompanied by an accumulation (or decumulation) of foreign exchange reserves by the central bank.

Under a fixed exchange rate system, the central bank accommodates those flows by buying up any net inflow of funds into the country or by providing foreign currency funds to the foreign exchange market to match any international outflow of funds, thus preventing the funds flows from affecting the exchange rate between the country's currency and other currencies. Then the net change per year in the central bank's foreign exchange reserves is sometimes called the balance of payments surplus or deficit. Alternatives to a fixed exchange rate system include a managed float where some changes of exchange rates are allowed, or at the other extreme a purely floating exchange rate (also known as a purely *flexible* exchange rate). With a pure float the central bank does not intervene at all to protect or devalue its currency, allowing the rate to be set by the market, and the central bank's foreign exchange reserves do not change, and the balance of payments is always zero.

The current account shows the net amount a country is earning if it is in surplus, or spending if it is in deficit. It is the sum of the balance of trade (net earnings on exports minus payments for imports), factor income (earnings on foreign investments minus payments made to foreign investors) and cash transfers. It is called the *current* account as it covers transactions in the "here and now" – those that don't give rise to future claims. The capital account records the net change in ownership of foreign assets. It includes the reserve account (the foreign exchange market operations of a nation's central bank), along with loans and investments between the country and the rest of world (but not the future interest payments and dividends that the loans and investments yield; those are earnings and will be recorded in the current account). If a country purchases more foreign assets for cash than the assets it sells for cash to other countries, the capital account is said to be negative or in deficit.

The term "capital account" is also used in the narrower sense that excludes central bank foreign exchange market operations: Sometimes the reserve account is classified as "below the line" and so not reported as part of the capital account.[4]

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Expressed with the broader meaning for the *capital account*, the BoP identity states that any current account surplus will be balanced by a capital account deficit of equal size – or alternatively a current account deficit will be balanced by a corresponding capital account surplus:

The *balancing item*, which may be positive or negative, is simply an amount that accounts for any statistical errors and assures that the current and capital accounts sum to zero. By the principles of double entry accounting, an entry in the current account gives rise to an entry in the capital account, and in aggregate the two accounts automatically balance. A balance isn't always reflected in reported figures for the current and capital accounts, which might, for example, report a surplus for both accounts, but when this happens it always means something has been missed – most commonly, the operations of the country's central bank – and what has been missed is recorded in the statistical discrepancy term (the balancing item).

An actual balance sheet will typically have numerous sub headings under the principal divisions. For example, entries under **Current account** might include:

- *Trade* – buying and selling of goods and services
- *Exports* – a credit entry
- *Imports* – a debit entry
- *Trade balance* – the sum of Exports and Imports
- *Factor income* – repayments and dividends from loans and investments
- *Factor earnings* – a credit entry
- *Factor payments* – a debit entry
- *Factor income balance* – the sum of earnings and payments.

Especially in older balance sheets, a common division was between visible and invisible entries. Visible trade recorded imports and exports of physical goods (entries for trade in physical goods excluding services is now often called the *merchandise balance*). Invisible trade would record international buying and selling of services, and sometimes would be grouped with transfer and factor income as invisible earnings.

The term "balance of payments surplus" (or deficit – a deficit is simply a negative surplus) refers to the sum of the surpluses in the current account and the narrowly defined capital account (excluding changes in central bank reserves). Denoting the balance of payments surplus as BoP surplus, the relevant identity is

BOP surplus = Current account surplus + Narrowly defined capital surplus

BoO is A statement that summarizes an economy's transactions with the rest of the world for a specified time period. The balance of payments, also known as balance of international payments, encompasses all transactions between a country's residents and its nonresidents involving goods, services and income; financial claims on and liabilities to the rest of the world; and transfers such as gifts. The balance of payments classifies these transactions in two accounts – the current account and the capital account. The current account includes transactions in goods, services, investment income and current transfers, while the capital account mainly includes transactions in financial instruments. An economy's balance of payments transactions and international investment position (IIP) together constitute its set of international accounts.

BREAKING DOWN 'Balance of Payments (BOP)'

Despite its name, the "balance of payments" data is not concerned with actual payments made and received by an economy, but rather with transactions. Since many international transactions included in the balance of payments do not involve the payment of money, this figure may differ significantly from net payments made to foreign entities over a period of time.

Does the "balance of payments" actually balance? In theory, a current account deficit would have to be financed by a net inflow in the capital and financial account, while a current account surplus should correspond to an outflow in the capital and financial account for a net figure of zero. In actual practice, however, the fact that data are compiled from multiple sources gives rise to some degree of measurement error.

Balance of payments and international investment position data are critical in formulating national and international economic policy. Certain aspects of the balance of payments data, such as payment imbalances and foreign direct investment, are key issues that a nation's economic policies seek to address.

Economic policies are often targeted at specific objectives that, in turn, impact the balance of payments. For example, a country may adopt policies specifically designed to attract foreign investment in a particular sector. Another nation may attempt to keep its currency at an artificially depressed level to stimulate exports and build up its currency reserves. The impact of these policies is ultimately captured in the balance of payments data.

Definition of 'Balance of Payment'

Definition: According to the RBI, balance of payment is a statistical statement that shows

1. The transaction in goods, services and income between an economy and the rest of the world,

2. Changes of ownership and other changes in that economy's monetary gold, special drawing rights (SDRs), and financial claims on and liabilities to the rest of the world, and
3. Unrequited transfers.

The Transactions in BOP are Categorised In

a) Current account showing export and import of visibles (also called merchandise) and invisibles (also called non-merchandise). Invisibles take into account services, transfers and income.

b) Capital account showing a capital expenditure and income for a country. It gives a summary of the net flow of both private and public investment into an economy. External commercial borrowing (ECB), foreign direct investment, foreign portfolio investment, etc form a part of capital account.

c) Errors and omissions: Sometimes the balance of payment does not balance. This imbalance is shown in the BOP as errors and omissions. BOP is compiled using the double entry book keeping system consisting assets and liabilities.

Emerging Business Environment Trends:

Business can be defined as transformation of Inputs into diverse output in the form of goods and services to meet and satisfy consumer needs and wants.

Investment Environment:

To achieve faster economic growth, the capital market plays an important role. The capital market today is a reality met in any modern economy. It is a market, the necessity of which is unchallengeable, an extremely dynamic and innovative structure, permanently adapting to the economic environment.

Role of Capital Market in Economic Development:

Capital market can be defined as a financial market .for the creation of financial assets. They exist wherever a financial transaction occurs.it is a market where Savings and investments are traded.

Retail and institutional investors are the entity that have the capital and individuals, businesses and the government are one’s those who seek it. Capital market includes the stock market, currency market and foreign exchange market. Increased efficiency in the financial sector is expected to direct financial resources into the sector where the productivity is maximum.

Capital market can channelize the source of finance in the primary segment.to achieve faster economic growth.

Capital Market is further divided into Primary and Secondary market, which contains Equity and Debt.

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CAPITAL MARKET INSTITUTIONS:

(1) The Securities and Exchange Board of India (Sebi)

Established in 1992 under an Act of Parliament (Act 15 of 1992), SEBI regulates Capital markets and promoting their development. Under the act include protection of the interest of investors and regulating the business in stock exchanges and other securities market, regulating the working of stock brokers and intermediaries associated with it. Registering and regulating of FII, Mutual funds and Venture capital funds.

(2) Bombay Stock Exchange (Bse)

Is the first and largest securities market in India .Established in 1875.Under the ownership of Ministry of .Finance, Government of India. There are 7,400 listed companies, out of which only 4000 trade on the stock exchanges at BSE and NSE. Financial transactions are done online through an electronic trading system

(3) National Stock Exchange (Nse)

The NSE was established in 1994,NSE was backed by major financial institutions, led by Industrial Development Bank of India.NSE inspired BSE and other exchanges to adapt computerised systems and reform trading rules and procedures.BSE shifted from an “open outcry” trading system to a Screen based system.

(4) National Securities Depository Limited (Nsdl)

In late 1996, NSDL was inaugurated.NSE began execution of trades through a new clearing corporation.it was established based on a suggestion by national institution responsible for the economic development of India.it Demat accounts hold assets worth $4 trillion.it provides services related to demat of securities, transfer and settlement of securities in Indiansecurities market. Protean e-Gov Technologies ltd.(earlier known as NSDL e-Governance infrastructure ltd)is a separate company.it offers services related to PAN and also acts as record keeping agency of NPS.

(5)Foreign Institutional Investor (FII’S)

FII‘s can be the important sources of capital in developing the Economies. It is an institutional, individual or group entity seeking to invest in the economy.FII directly affects the stock/securities market of the country. And so, exchange rate and inflation too. They choose to invest in developing countries as they provide growth potential ,due to emerging economies.FII’s can include pension funds, investment banks, hedge funds and mutual funds.

STOCK INDICES

A stock market index also known as stock index, it measures the price movement and the performance of the shares that constitute that index. An index is a number that represents the changes in asset of values between a base time period and another time period. Sensex and Nifty are the two major stock indices of India. For BSE and NSE respectively. They are the Benchmark indices. Broader indices are Nifty50 and BSE

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100.Sector specific indices like Nifty FMCG, Nifty Bank Index, CNX IT, and S&P BSE oil and Gas. These are the different types of stock market indices based on the kind of stocks taken into account to create the index.

WHY ARE STOCK MARKET INDICES REQUIRED?

The performance of stock market indices reflects highly accurate information.it is an indicator of the state of the markets and also the reflection of sentiments of investors. It is a lead indicator of the overall performance of economy or a specific sector of economy.it helps the investors to compare with the returns of money invested in stock market against the alternative form of investment such as gold, debt etc.one can observe the actual performance of stocks in investment portfolio during that period.

CLOSER LOOK AT THE TWO BENCHMARK INDICES:

SENSEX MOVEMENT:

Is being taken as a signal of performance of the corporate inthe country. SENSEX is calculated using a "Market Capitalisation-Weighted "methodology .As per the methodology, the level of index at any point of time reflects the total market value of 30 stocks relative to a base period. Market fluctuates depends upon the demand and supply factors.[The market capitalisation of a co.is calculated by multiplying the price of its stock by the number of no.of shares issued by the company]

(1) S &P BSE Sensex:

It was introduced in 1986 and is oldest in India. The BSE Sensex consists of the top 30 largest and most frequently traded stock in BSE.

(2) CNX NIFTY (NIFTY 50)

It was created in 1996, is owned and maintained by India index Services and products limited (IISL) .it is a joint venture between CRISIL (Credit Rating Agency) and NSE.CNX stands for CRISIL & NSE. Also known as the NSE Nifty, this share market index consists of the top 50 largest and most frequently traded stocks within NSE.

DERIVATIVES MARKET

A derivative security can be defined as a security whose value depends on the values of the other underlying Variables. "Derivatives" means Forward, Future or Option contract of pre-determined fixed duration, linked for the purpose of contract fulfillment to the value of specified real or financial asset or to index of securities.

TYPES OF DERIVATIVES

FORWARDS: A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre- agreed price.

FUTURES: A Future contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures Contract are special types

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of forward contracts in the sense that the former are standardized exchange traded contracts.

OPTIONS: An Option is a contract which gives the right, but not an obligation, to buy or sell the underlying at a stated date and a stated price. A buyer of an option pays the premium and buys the right to exercise his option, the writer of an option is the one who receives the option premium and therefore obliged to sell/buy the asset.

STYLES OF OPTIONS:

European Style: The European Style can be exercised only on the specified date, which are generally the expiration date (eg .Index Options).

American Style: The American Style options can be exercised at any time on or before expiration date.(eg. Stock Options)

TYPES OF OPTIONS:

Call Options: The option which gives the buyer a right to buy the underlying asset.

Put Options: The Option which gives the buyer to sell the underlying asset.

The derivative market performs a number of economic functions:

1. Helps in managing Risk.

2. Increases Savings and investment in Long run.

3. It helps in discovery of future prices.

DEBT MARKET IN INDIA

The Debt Market is the market where fixed income securities of various types of features are issued and traded. The securities are issued by Central and state.

In indian securities market, the term 'bond' is used for debt instruments issued by the central and state government and public sector organizations. The term 'debenture' is used for instruments issued by private corporate sectors. The government securities are issued to meet the short term and long term financial needs of the government. As debt market trade both government and corporate debt.they are regulated by both RBI & SEBI.

RBI: Regulates and facilitates the government bonds and other securities on behalf of governments

SEBI: Regulates corporate bonds, both Private sector undertaking (PSU) and private sector.

The Commercial Banks and the Financial Institutions are the most important participants in the debt market of india.Cooperative banks,NBFC, Mutual funds ,big corporate giants are the major players and has widened there base in recent years. FII'S has been permitted to invest 100% of their funds in debt market, the earlier limit was

30%.Bonds as an instrument tool are considered mostly safe. But no investment is without risk. Investors who take greater risks gets greater risk and vice versa. inflation risk, interest rate risk, call risk, re investment risk ,market risk ,default risk are the risk which are associated with debt instruments. Different type of bond risk associated above almost always decrease the value of bondholding. Good market knowledge is essential for bond investments. India ‘s debt market is based on the size of sovereign debt market.indian G-sec is a US $ 1 Trillion sovereign bond market.

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Module - 5

Global Environment

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World Bank -

The **International Bank for Reconstruction and Development** (**IBRD**) (Also known as World Bank) is an international financial institution that offers loans to middle-income developing countries. The IBRD is the first of five member institutions that compose the World Bank Group and is headquartered in Washington, D.C., United States. It was established in 1944 with the mission of financing the reconstruction of European nations devastated by World War II. The IBRD and its concessional lending arm, the International Development Association, are collectively known as the World Bank as they share the same leadership and staff. Following the reconstruction of Europe, the Bank's mandate expanded to advancing worldwide economic development and eradicating poverty. The IBRD provides commercial-grade or concessional financing to sovereign states to fund projects that seek to improve transportation and infrastructure, education, domestic policy, environmental consciousness, energy investments, healthcare, access to food and potable water, and access to improved sanitation.

The IBRD is owned and governed by its member states, but has its own executive leadership and staff which conduct its normal business operations. The Bank's member governments are shareholders which contribute paid-in capital and have the right to vote on its matters. In addition to contributions from its member nations, the IBRD acquires most of its capital by borrowing on international capital markets through bond issues. In 2011, it raised $29 billion USD in capital from bond issues made in 26 different currencies. The Bank offers a number of financial services and products, including flexible loans, grants, risk guarantees, financial derivatives, and catastrophic risk financing. It reported lending commitments of $26.7 billion made to 132 projects in 2011.

The International Bank for Reconstruction and Development was created in 1944 to help Europe rebuild after World War II. Today, IBRD provides loans and other assistance primarily to middle income countries.

IBRD is the original World Bank institution. It works closely with the rest of the World Bank Group to help developing countries reduce poverty, promote economic growth, and build prosperity.

IBRD is owned by the governments of its 189 member countries, which are represented by a 25-member board of 5 appointed and 20 elected Executive Directors.

The institution provides a combination of financial resources, knowledge and technical services, and strategic advice to developing countries, including middle income and credit-worthy lower income countries. Specifically, IBRD:

- Supports long-term human and social development that private creditors do not finance

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- Preserves borrowers' financial strength by providing support in times of crisis, when poor people are most adversely affected
- Promotes key policy and institutional reforms (such as safety net or anti-corruption reforms)
- Creates a favorable investment climate to catalyze the provision of private capital
- Facilitates access to financial markets often at more favorable terms than members can achieve on their own

IBRD's Services

The World Bank Group works with middle income countries simultaneously as clients, shareholders, and global actors. As this partnership evolves, IBRD is providing innovative financial solutions, including financial products (loans, guarantees, and risk management products) and knowledge and advisory services (including on a reimbursable basis) to governments at both the national and subnational levels.

IBRD finances projects across all sectors and provides technical support and expertise at various stages of a project.

IBRD's financial products and services help countries build resilience to shocks by facilitating access to products that mitigate the negative impact of currency, interest rate, and commodity price volatility, natural disasters and extreme weather.

Unlike commercial lending, IBRD's financing not only supplies borrowing countries with needed financing, but also serves as a vehicle for global knowledge transfer and technical assistance.

Advisory services in public debt and asset management help governments, official sector institutions, and development organizations build institutional capacity to protect and expand financial resources.

IBRD supports government efforts to strengthen not only public financial management, but to also improve the investment climate, address service delivery bottlenecks, and other policy and institutional actions.

The Reserve Bank of India (RBI):

The Reserve Bank of India (RBI) is the central bank of India whose primary function is to manage and govern the financial system of the country. It is a statutory body established in the year 1935 under the Reserve Bank of India Act, 1934. The central bank regulates the issue and supply of the Indian rupee. It also looks after the central government's money. The central bank plays the role of the bankers' bank and regulates the banking sector. It also plays an important role in India's development story by supporting the government in its developmental projects and policies.

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The head office of the RBI, in Kolkata when the bank was established, was shifted to Mumbai in 1937. Originally, the bank was privately owned. However, after Independence, it was nationalised in 1949 and is now fully owned by the Government of India.

Major Functions of the RBI:

The preamble of the RBI says... "to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."

Some of the Basic Functions of the RBI are:

1. Issuer of notes: The RBI is the only institution which has the control over printing of currency notes (except the one rupee note, which is printed by the finance ministry).
2. Banker to the government: The RBI performs banking functions for the state and central governments. It advises the government on monetary policy issues and also manages the government's public debt.
3. Banker's bank: The central bank is also known as the banker's bank because it performs functions similar to what commercial banks do for their customers.
4. Credit regulation: The RBI regulates the flow of money in the country's financial system. It controls inflation in the economy and takes necessary policy decisions from time to time to address systemic concerns.
5. Foreign reserves: The central bank buys and sells foreign currencies to keep the foreign exchange rates stable. It takes necessary steps as and when required.
6. Role in development of the country: The RBI performs various functions and takes necessary decisions to support developmental agenda of the government.

The RBI Board

The board of the RBI consists of a Governor, not more than four Deputy Governors and other members who are appointed by the central government. Currently, Shaktikanta Das is the Governor of the Reserve Bank of India. There are three Deputy Governors — B P Kanungo, Mahesh Kumar Jain, and M D Patra.

SEBI – Securities and Exchange Board of India

SEBI is essentially a statutory body of the Indian Government that was established on the 12th of April in 1992. It was introduced to promote transparency in the Indian investment market. Besides its headquarters in Mumbai, the establishment has several regional offices across the country including, New Delhi, Ahmedabad, Kolkata and Chennai. Before SEBI came into existence, Controller of Capital Issues was the regulatory authority; it derived authority from the Capital Issues (Control) Act, 1947. In

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1988, Sebi was constituted as the regulator of capital markets in India. Initially, Sebi was a non-statutory body without any statutory power. Following the passage of the Sebi Act by Parliament in 1992, it was given autonomous and statutory powers.

SEBI is a statutory body and a market regulator, which controls the securities market in India. The basic functions of Sebi is to protect the interests of investors in securities and to promote and regulate the securities market. Sebi is run by its board of members. The board consists of a Chairman and several other whole time and part time members. The chairman is nominated by the union government. The others include two members from the finance ministry, one member from Reserve Bank of India and five other members are also nominated by the Centre. The headquarters of Sebi is situated in Mumbai and the regional offices are located in Ahmedabad, Kolkata, Chennai and Delhi.

It is entrusted with the task to regulate the functioning of the Indian capital market. The regulatory body lays focus on monitoring and regulating the securities market in India to safeguard the interest of investors and aims to inculcate a safe investment environment by implementing several rules and regulations as well as by formulating investment-related guidelines.

The Structural Set Up of SEBI India

SEBI India follows a corporate structure. It has a Board of Directors, senior management, department heads and several crucial departments.

To be precise, it comprises of over 20 departments, all of which are supervised by their respective department heads, who in turn are administered by a hierarchy in general.

The SEBI is managed by its members, which consists of the following:

- The chairman is nominated by the Union Government of India.
- Two members, i.e., Officers from the Union Finance Ministry.
- One member from the Reserve Bank of India.
- The remaining five members are nominated by the Union Government of India, out of them at least three shall be whole-time members.

Securities Appellate Tribunal (SAT)

Sebi also appoints various committees, whenever required to look into the pressing issues of that time. Further, a Securities Appellate Tribunal (SAT) has been constituted to protect the interest of entities that feel aggrieved by Sebi’s decision. SAT consists of a presiding officer and two other members.

Functions and powers of Sebi

Sebi controls activities of stock exchanges, safeguards the rights of shareholders and also guarantees the security of their investment. It also aims to check fraudulence by

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harmonising its statutory regulations and self-regulating business. The regulator also enables a competitive professional market for intermediaries

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental there to".

SEBI has to be responsive to the needs of three groups, which constitute the market:

1. Issuers of securities

2. Investors

3. Market intermediaries

SEBI has three powers rolled into one body: quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three-member tribunal and is currently headed by Justice Tarun Agarwala, former Chief Justice of the Meghalaya High Court. A second appeal lies directly to the Supreme Court. SEBI has taken a very proactive role in streamlining disclosure requirements to international standards.

Apart from the above functions, Sebi provides a marketplace in which the issuers can increase finance properly. It also ensures safety and supply of precise and accurate information from the investors. Sebi analyses the trading of stocks and safes the security market from the malpractices. It controls the stockbrokers and sub- stockbrokers. It provides education regarding the market to the investors to enhance their knowledge.

The Supreme Court of India and the Securities Appellate Tribunal tend to have an upper hand when it comes to the powers and functions of SEBI. All its functions and related decisions have to go through the two apex bodies first.

Powers

For the discharge of its functions efficiently, SEBI has been vested with the following powers:

- To approve by−laws of Securities exchanges.
- to require the Securities exchange to amend their by−laws.
- inspect the books of accounts and call for periodical returns from recognised Securities exchanges.
- inspect the books of accounts of financial intermediaries.

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- compel certain companies to list their shares in one or more Securities exchanges.
- registration of Brokers and sub-brokers.

SEBI Committees

- Technical Advisory Committee
- Committee for review of structure of infrastructure institutions
- Advisory Committee for the SEBI Investor Protection and Education Fund
- Takeover Regulations Advisory Committee
- Primary Market Advisory Committee (PMAC)
- Secondary Market Advisory Committee (SMAC)
- Mutual Fund Advisory Committee
- Corporate Bonds & Securitisation Advisory Committee

There are two types of brokers:

- Discount brokers
- Merchant brokers

Mutual Funds Guidelines by SEBI

The Securities and Exchange Board of India Regulations, 1996 is a set of guidelines that have been formulated to manage mutual funds in India. As per the said guidelines, mutual funds in India must register under the Trusts Act, 1882.

Those mutual funds that deal exclusively with the money market must get registered with the RBI. The Asset Management Companies (AMC), which manages mutual funds must be SEBI approved. The trustees of the AMC must ensure that mutual funds are performing as per the regulations. It is also entrusted with the responsibility of monitoring the overall performance of mutual funds.

SEBI India has further issued several mutual funds regulations that the sponsors, asset management companies and shareholders must abide by. At the end of every calendar year, mutual funds must ensure that they have been in accordance with the guidelines issued by the Securities and Exchange Board of India. It further requires them to make their constituents of the indices public by getting it published in their respective websites.

SEBI regulates Indian financial market through its 20 departments.

- Commodity Derivatives Market Regulation Department (CDMRD)
- Corporation Finance Department (CFD)
- Department of Economic and Policy Analysis (DEPA)

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- Department of Debt and Hybrid Securities (DDHS)
- Enforcement Department – 1 (EFD1)
- Enforcement Department – 2 (EFD2)
- Enquiries and Adjudication Department (EAD)
- General Services Department (GSD)
- Human Resources Department (HRD)
- Information Technology Department (ITD)
- Integrated Surveillance Department (ISD)
- Investigations Department (IVD)
- Investment Management Department (IMD)
- Legal Affairs Department (LAD)
- Market Intermediaries Regulation and Supervision Department (MIRSD)
- Market Regulation Department (MRD)
- Office of International Affairs (OIA)
- Office of Investor Assistance and Education (OIAE)
- Office of the chairman (OCH)
- Regional offices (ROs)

Insurance Regulatory and Development Authority (IRDA)

The Insurance Regulatory and Development Authority of India (IRDAI) is a statutory body under the jurisdiction of Ministry of Finance , Government of India and is tasked with regulating and licensing the insurance and re-insurance industries in India. It was constituted by the Insurance Regulatory and Development Authority Act, 1999, an Act of Parliament passed by the Government of India. The agency's headquarters are in Hyderabad, Telangana, where it moved from Delhi in 2001.

IRDAI is a 10-member body including the chairman, five full-time and four part-time members appointed by the government of India.

In India insurance was mentioned in the writings of many historical documents, which examined the pooling of resources for redistribution after fire, floods, epidemics and famine.[relevant?] The life-insurance business began in 1818 with the establishment of the Oriental Life Insurance Company in Calcutta; the company failed in 1834. In 1829, Madras Equitable began conducting life-insurance business in the Madras Presidency. The British Insurance Act was enacted in 1870, and Bombay Mutual (1871), Oriental

(1874) and Empire of India (1897) were founded in the Bombay Presidency. The era was dominated by British companies.

In 1914, the government of India began publishing insurance-company returns. The Indian Life Assurance Companies Act, 1912 was the first statute regulating life insurance. In 1928 the Indian Insurance Companies Act was enacted to enable the government to collect statistical information about life- and non-life-insurance business conducted in India by Indian and foreign insurers, including provident insurance societies. In 1938 the legislation was consolidated and amended by the Insurance Act, 1938, with comprehensive provisions to control the activities of insurers.

The Insurance Amendment Act of 1950 abolished principal agencies, but the level of competition was high and there were allegations of unfair trade practices. The Government of India decided to nationalise the insurance industry.

An ordinance was issued on 19 January 1956, nationalising the life-insurance sector, and the Life Insurance Corporation was established that year. The LIC absorbed 154 Indian and 16 non-Indian insurers and 75 provident societies. The LIC had a monopoly until the late 1990s, when the insurance industry was reopened to the private sector.

General insurance in India began during the Industrial Revolution in the West and the growth of sea-faring commerce during the 17th century. It arrived as a legacy of British occupation, with its roots in the 1850 establishment of the Triton Insurance Company in Calcutta. In 1907 the Indian Mercantile Insurance was established, the first company to underwrite all classes of general insurance. In 1957 the General Insurance Council (a wing of the Insurance Association of India) was formed, framing a code of conduct for fairness and sound business practice.

Eleven years later, the Insurance Act was amended to regulate investments and set minimum solvency margins and the Tariff Advisory Committee was established. In 1972, with the passage of the General Insurance Business (Nationalisation) Act, the insurance industry was nationalized on 1 January 1973. One hundred seven insurers were amalgamated and grouped into four companies: National Insurance Company, New India Assurance Company, Oriental Insurance Company and United India Insurance Company. The General Insurance Corporation of India was incorporated in 1971, effective on 1 January 1973.

The re-opening of the insurance sector began during the early 1990s. In 1993, the government set up a committee chaired by former Reserve Bank of India governor R. N. Malhotra to propose recommendations for insurance reform complementing those initiated in the financial sector. The committee submitted its report in 1994, recommending that the private sector be permitted to enter the insurance industry. Foreign companies should enter by floating Indian companies, preferably as joint ventures with Indian partners.

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Following the recommendations of the Malhotra Committee, in 1999 the Insurance Regulatory and Development Authority (IRDA) was constituted to regulate and develop the insurance industry and was incorporated in April 2000. Objectives of the IRDA include promoting competition to enhance customer satisfaction with increased consumer choice and lower premiums while ensuring the financial security of the insurance market.

The IRDA opened up the market in August 2000 with an invitation for registration applications; foreign companies were allowed ownership up to 26 percent. The authority, with the power to frame regulations under Section 114A of the Insurance Act, 1938, has framed regulations ranging from company registrations to the protection of policyholder interests since 2000.

In December 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and the GIC was converted into a national re-insurer. Parliament passed a bill de-linking the four subsidiaries from the GIC in July 2002. There are 28 general insurance companies, including the Export Credit Guarantee Corporation of India and the Agriculture Insurance Corporation of India, and 24 life-insurance companies operating in the country. With banking services, insurance services add about seven percent to India’s GDP.

In 2013 the IRDAI attempted to raise the foreign direct investment (FDI) limit in the insurance sector to 49 percent from the existing 26 percent. The FDI limit in the insurance sector has been raised to 74 percent according to the 2021 union budget.

Functions:

The functions of the IRDAI are defined in Section 14 of the IRDAI Act, 1999,[1] and include:

- Issuing, renewing, modifying, withdrawing, suspending or cancelling registrations
- Protecting policyholder interests
- Specifying qualifications, the code of conduct and training for intermediaries and agents
- Specifying the code of conduct for surveyors and loss assessors
- Promoting efficiency in the conduct of insurance businesses
- Promoting and regulating professional organisations connected with the insurance and re-insurance industry
- Leaving fees and other charges
- Inspecting and investigating insurers, intermediaries and other relevant organisations

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- Regulating rates, advantages, terms and conditions which may be offered by insurers not covered by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938)
- Specifying how books should be kept
- Regulating company investment of funds
- Regulating a margin of solvency
- Adjudicating disputes between insurers and intermediaries or insurance intermediaries
- Supervising the Tariff Advisory Committee
- Specifying the percentage of premium income to finance schemes for promoting and regulating professional organisations
- Specifying the percentage of life- and general insurance business undertaken in the rural or social sector
- Specifying the form and the manner in which books of accounts shall be maintained, and statement of accounts shall be rendered by insurers and other insurer intermediaries.

Foreign Direct Investment:

A foreign direct investment (FDI) is an investment in the form of a controlling ownership in a business, in real estate or in productive assets such as factories in one country by an entity based in another country. It is thus distinguished from a foreign portfolio investment or foreign indirect investment by a notion of direct control.

The origin of the investment does not impact the definition, as an FDI: the investment may be made either "inorganically" by buying a company in the target country or "organically" by expanding the operations of an existing business in that country.

Broadly, foreign direct investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations, and intra company loans". In a narrow sense, foreign direct investment refers just to building new facility, and a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. FDI is the sum of equity capital, long-term capital, and short-term capital as shown in the balance of payments. FDI usually involves participation in management, joint-venture, transfer of technology and expertise. Stock of FDI is the net (i.e., outward FDI minus inward FDI) cumulative FDI for any given period. Direct investment excludes investment through purchase of shares (if that purchase results in an investor controlling less than 10% of the shares of the company).

FDI, a subset of international factor movements, is characterized by controlling ownership of a business enterprise in one country by an entity based in another country. Foreign direct investment is distinguished from foreign portfolio investment, a passive investment in the securities of another country such as public stocks and bonds, by the element of "control". According to the Financial Times, "Standard definitions of control use the internationally agreed 10 percent threshold of voting shares, but this is a grey area as often a smaller block of shares will give control in widely held companies. Moreover, control of technology, management, even crucial inputs can confer de facto control."

Before Stephen Hymer's landmark work on FDI in 1960, there was no theory existed that dealt specifically with FDI. However, there are theories that dealt generally with foreign investments. Both Eli Heckscher (1919) and Bertil Ohlin (1933) developed the theory of foreign investments by using neoclassical economics and macroeconomic theory. Based on this principle, the differences in the costs of production of goods between two countries cause specialisation of jobs and trade between countries. Reasons for differences in costs of production can be explained by factor proportions theory. For example, countries with a greater proportion of labour will engage in labor-intensive industries while countries that have a greater proportion of capital will engage in capital-intensive industries. However, such a theory makes the assumption that there is perfect competition, there is no movement of labour across country borders, and the multinational companies assumes risk neutral preferences. In 1967, Weintraub tested this hypothesis by collecting United States data on rate of return and flow of capital. However, the data failed to support this hypothesis. Data from surveys on the motivation of FDI also failed to support this hypothesis.

Intrigued by the motivations behind large foreign investments made by corporations from the United States of America, Hymer developed a framework that went beyond the existing theories, explaining why this phenomenon occurred, since he considered that the previously mentioned theories could not explain foreign investment and its motivations.[citation needed] Facing the challenges of his predecessors, Hymer focused his theory on filling the gaps regarding international investment. The theory proposed by the author approaches international investment from a different and more firm-specific point of view. As opposed to traditional macroeconomics-based theories of investment, Hymer states that there is a difference between mere capital investment, otherwise known as portfolio investment, and direct investment. The difference between the two, which will become the cornerstone of his whole theoretical framework, is the issue of control, meaning that with direct investment firms are able to obtain a greater level of control than with portfolio investment. Furthermore, Hymer proceeds to criticize the neoclassical theories, stating that the theory of capital movements cannot explain international production. Moreover, he clarifies that FDI is not necessarily a movement of funds from a home country to a host country, and that it is concentrated on particular industries within many countries. In contrast, if interest rates were the main motive for international investment, FDI would include many industries within fewer countries.

Another observation made by Hymer went against what was maintained by the neoclassical theories: foreign direct investment is not limited to investment of excess profits abroad. In fact, foreign direct investment can be financed through loans obtained in the host country, payments in exchange for equity (patents, technology, machinery etc.), and other methods.

The main determinants of FDI is side as well as growth prospectus of the economy of the country when FDI is made. Hymer proposed some more determinants of FDI due to criticisms, along with assuming market and imperfections. These are as follows:

- Firm-specific advantages: Once domestic investment was exhausted, a firm could exploit its advantages linked to market imperfections, which could provide the firm with market power and competitive advantage. Further studies attempted to explain how firms could monetize these advantages in the form of licenses.
- Removal of conflicts: conflict arises if a firm is already operating in foreign market or looking to expand its operations within the same market. He proposes that the solution for this hurdle arose in the form of collusion, sharing the market with rivals or attempting to acquire a direct control of production. However, it must be taken into account that a reduction in conflict through acquisition of control of operations will increase the market imperfections.
- Propensity to formulate an internationalization strategy to mitigate risk: According to his position, firms are characterized with 3 levels of decision making: the day to day supervision, management decision coordination and long-term strategy planning and decision making. The extent to which a company can mitigate risk depends on how well a firm can formulate an internationalization strategy taking these levels of decision into account.

Hymer's importance in the field of international business and foreign direct investment stems from him being the first to theorize about the existence of multinational enterprises (MNE) and the reasons behind FDI beyond macroeconomic principles, his influence on later scholars and theories in international business, such as the OLI (ownership, location and internationalization) theory by John Dunning and Christos Pitelis which focuses more on transaction costs. Moreover, "the efficiency-value creation component of FDI and MNE activity was further strengthened by two other major scholarly developments in the 1990s: the resource-based (RBV) and evolutionary theories"[7] In addition, some of his predictions later materialized, for example the power of supranational bodies such as IMF or the World Bank that increases

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inequalities (Dunning & Piletis, 2008). A phenomenon the United Nations Sustainable Development Goal 10 aims to address

Types of FDI

The types of FDI investments can be classified based on the perspective of the investor/source country and host/destination country. On an investor perspective, it can be divided into horizontal FDI, vertical FDI, and conglomerate FDI. In the destination country, the FDI can be divided into import-substituting, export-increasing, and government initiated FDI. Horizontal FDI arises when a multination corporation duplicates its home country industry chain into the destination country to produce similar goods. Vertical FDI takes place when a multinational corporation acquires a company to exploit the natural resources in the destination country (backward vertical FDI) or by acquiring distribution outlets to market its products in the destination country (forward vertical FDI). Conglomerate FDI is the combination between horizontal and vertical FDI.

Platform FDI is the foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.

Methods of FDI

The foreign direct investor may acquire voting power of an enterprise in an economy through any of the following methods:

- by incorporating a wholly owned subsidiary or company anywhere
- by acquiring shares in an associated enterprise
- through a merger or an acquisition of an unrelated enterprise
- participating in an equity joint venture with another investor or enterprise

Foreign Institutional Investors (FIIs) are those institutional investors which invest in the assets belonging to a different country other than that where these organizations are based.

Foreign institutional investors play a very important role in any economy. These are the big companies such as investment banks, mutual funds etc, who invest considerable amount of money in the Indian markets. With the buying of securities by these big players, markets trend to move upward and vice-versa. They exert strong influence on the total inflows coming into the economy.

Market regulator SEBI has over 1450 foreign institutional investors registered with it. The FIIs are considered as both a trigger and a catalyst for the market performance by encouraging investment from all classes of investors which further leads to growth in financial market trends under a self-organized system.

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FIIs can include hedge funds, insurance companies, pension funds, investment banks, and mutual funds. FIIs can be important sources of capital in developing economies, yet many developing nations, such as India, have placed limits on the total value of assets an FII can purchase and the number of equity shares it can buy, particularly in a single company.

This helps limit the influence of FIIs on individual companies and the nation's financial markets, and the potential damage that might occur if FIIs fled en masse during a crisis.

Foreign Institutional Investors (FIIs) in India

Some of the countries with the highest volume of foreign institutional investments are those with developing economies, which generally provide investors with higher growth potential than mature economies. This is one reason FIIs are commonly found in India, which has a high-growth economy and attractive individual corporations to invest in. All FIIs in India must register with the Securities and Exchange Board of India (SEBI) to participate in the market.

General Agreement on Tariffs and Trade (GATT):

The General Agreement on Tariffs and Trade (GATT), signed in 1947 by 23 countries, is a treaty minimizing barriers to international trade by eliminating or reducing quotas, tariffs, and subsidies. It was intended to boost economic recovery after World War II.

GATT was expanded and refined over the years, leading to the creation in 1995 of the World Trade Organization (WTO), which absorbed the organization created to implement GATT. By then, 125 nations were signatories to its agreements, which covered about 90% of global trade.

The Council for Trade in Goods (Goods Council) is now responsible for the GATT and consists of representatives from all WTO member countries. As of September 2022, the chair of the Goods Council is Etienne Oudot de Dainville. The council has 10 committees that address subjects including market access, agriculture, subsidies, and anti-dumping measures.

The GATT was created to form rules to end or restrict the most costly and undesirable features of the prewar protectionist period, namely quantitative trade barriers such as trade controls and quotas. The agreement also provided a system to arbitrate commercial disputes among nations, and the framework enabled a number of multilateral negotiations for the reduction of tariff barriers. The GATT was regarded as a significant success in the postwar years.

One of the key achievements of the GATT was that of trade without discrimination. Every signatory member of the GATT was to be treated as equal to any other. This is known as the most-favored-nation principle, and it has been carried through into the WTO. A practical outcome of this was that once a country had negotiated a tariff cut with some other countries (usually its most important trading partners), this same cut would automatically apply to all GATT signatories. Escape clauses did exist, whereby countries could negotiate exceptions if their domestic producers would be particularly harmed by tariff cuts.

Most nations adopted the most-favored-nation principle in setting tariffs, which largely replaced quotas. Tariffs (preferable to quotas but still a trade barrier) were, in turn, cut steadily in rounds of successive negotiations.

The GATT held eight rounds of meetings—the first beginning in April 1947, the last ending in December 1993. Each of the conferences had significant achievements and outcomes.

The first meeting was in Geneva, Switzerland, and included 23 countries. The focus of this opening conference was on tariffs. The members established tax concessions touching more than US$10 billion of trade around the globe.

The second series of meetings began in April 1949 and were held in Annecy, France. Again, tariffs were the primary topic. Thirteen countries were at the second meeting, and they accomplished an additional 5,000 tax concessions reducing tariffs.

Starting in September 1950, the third series of GATT meetings occurred in Torquay, England. This time 38 countries were involved, and almost 9,000 tariff concessions passed, reducing tax levels by as much as 25%.

Japan became involved in the GATT for the first time in 1956 at the fourth meeting along with 25 other countries.

The meeting was in Geneva, and again the committee reduced worldwide tariffs, this time by US$2.5 billion.

This series of meetings and reduced tariffs would continue, adding new GATT provisions in the process. In 1964, the GATT began to work toward curbing predatory pricing policies. These policies are known as dumping. Then in the 1970s, an arrangement regarding international trade in textiles, known as the Multifibre Arrangement (MFA), came into force. The next big event was the Uruguay Round, which lasted from 1986 to 1993, with the agreements signed in 1994, and created the WTO.

The average tariff rate fell from around 22% when the GATT was first signed in Geneva in 1947 to around 5% by the end of the Uruguay Round. As the years have passed, the countries continued to attack global issues, including addressing agriculture disputes and working to protect intellectual property.

World Trade Organization:

The Uruguay round of GATT (1986-93) gave birth to World Trade Organization. The members of GATT singed on an agreement of Uruguay round in April 1994 in Morocco for establishing a new organization named WTO.

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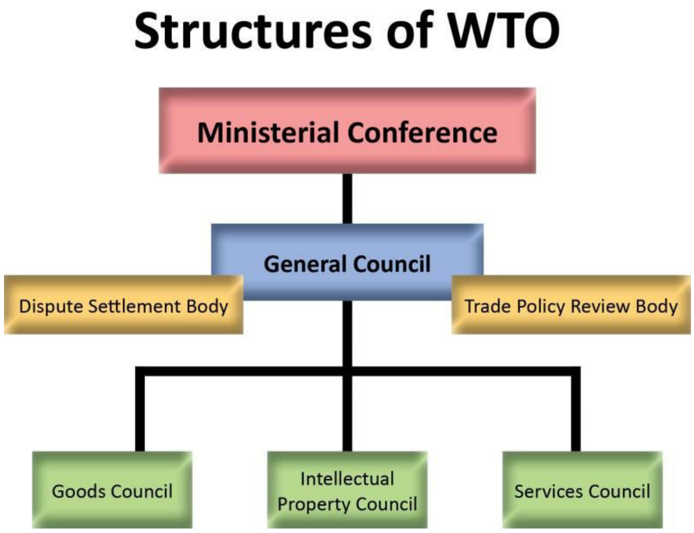
It was officially constituted on January 1, 1995 which took the place of GATT as an effective formal, organization. GATT was an informal organization which regulated world trade since 1948.

Contrary to the temporary nature of GATT, WTO is a permanent organization which has been established on the basis of an international treaty approved by participating countries. It achieved the international status like IMF and IBRD, but it is not an agency of the United Nations Organization (UNO).

Structure of WTO:

The WTO has nearly 153 members accounting for over 97% of world trade. Around 30 others are negotiating membership. Decisions are made by the entire membership. This is typically by consensus.

A majority vote is also possible but it has never been used in the WTO and was extremely rare under the WTO's predecessor, GATT. The WTO's agreements have been ratified in all members' parliaments.



The WTO's top level decision-making body is the Ministerial Conferences which meets at least once in every two years. Below this is the General Council (normally ambassadors and heads of delegation in Geneva, but sometimes officials sent from members' capitals) which meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Disputes Settlement Body.

At the next level, the Goods Council, Services Council and Intellectual Property (TRIPs) Council report to the General Council. Numerous specialized committees, working groups and working parties deal with the individual agreements and other areas such as, the environment, development, membership applications and regional trade agreements.

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Secretariat:

The WTO secretariat, based in Geneva, has around 600 staff and is headed by a Director-General. Its annual budget is roughly 160 million Swiss Francs. It does not have branch offices outside Geneva. Since decisions are taken by the members themselves, the secretariat does not have the decision making the role that other international bureaucracies are given.

The secretariat s main duties to supply technical support for the various councils and committees and the ministerial conferences, to provide technical assistance for developing countries, to analyze world trade and to explain WTO affairs to the public and media. The secretariat also provides some forms of legal assistance in the dispute settlement process and advises governments wishing to become members of the WTO.

Objectives of WTO:

The Important Objectives of WTO are:

1. To improve the standard of living of people in the member countries.
2. To ensure full employment and broad increase in effective demand.
3. To enlarge production and trade of goods.
4. To increase the trade of services.
5. To ensure optimum utilization of world resources.
6. To protect the environment.
7. To accept the concept of sustainable development.

Functions of WTO:

1. To implement rules and provisions related to trade policy review mechanism.
2. To provide a platform to member countries to decide future strategies related to trade and tariff.
3. To provide facilities for implementation, administration and operation of multilateral and bilateral agreements of the world trade.
4. To administer the rules and processes related to dispute settlement.
5. To ensure the optimum use of world resources.
6. To assist international organizations such as, IMF and IBRD for establishing coherence in Universal Economic Policy determination.

WTO Ministerial Conference:

Conference	Year	Place
I	9-13 Dec., 1996	Singapore

II	18-20 May 1998	Geneva (Switzerland)
III	30 Nov.-3 Dec., 1999	Seattle (USA)
IV	9-14 Nov., 2001	Doha (Qatar)
V	10-14 Sep., 2003	Cancun (Mexico)
VI	13-18 Dec.. 2005	Hong Kong
VII	30 Nov-2Dec., 2009	Geneva (Switzerland)

WTO Agreements:

The WTO's rule and the agreements are the result of negotiations between the members. The current sets were the outcome to the 1986-93 Uruguay Round negotiations which included a major revision of the original General Agreement on Tariffs and Trade (GATI).

GATT is now the WTO's principal rule-book for trade in goods. The Uruguay Round also created new rules for dealing with trade in services, relevant aspects of intellectual property, dispute settlement and trade policy reviews.

The complete set runs to some 30,000 pages consisting of about 30 agreements and separate commitments (called schedules) made by individual members in specific areas such as, lower customs duty rates and services market-opening.

Through these agreements, WTO members operate a non-discriminatory trading system that spells out their rights and their obligations. Each country receives guarantees that its exports will be treated fairly and consistently in other countries' markets. Each country promises to do the same for imports into its own market. The system also gives developing countries some flexibility in implementing their commitments.

(a) Goods:

It all began with trade in goods. From 1947 to 1994, GATT was the forum for negotiating lower customs duty rates and other trade barriers; the text of the General Agreement spelt out important, rules, particularly non-discriminations since 1995, the updated GATT has become the WTO s umbrella agreement for trade in goods.

It has annexes dealing with specific sectors such as, agriculture and textiles and with specific issues such as, state trading, product standards, subsidies and action taken against dumping.

(b) Services:

Banks, insurance firms, telecommunication companies, tour operators, hotel chains and transport companies looking to do business abroad can now enjoy the same principles of free and fair that originally only applied to trade in goods.

These principles appear in the new General Agreement on Trade in Services (GATS). WTO members have also made individual commitments under GATS stating which of

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their services sectors, they are willing to open for foreign competition and how open those markets are.

(c) Intellectual Property:

The WTO's intellectual property agreement amounts to rules for trade and investment in ideas and creativity. The rules state how copyrights, patents, trademarks, geographical names used to identify products, industrial designs, integrated circuit layout designs and undisclosed information such as trade secrets "intellectual property" should be protected when trade is involved.

(d) Dispute Settlement:

The WTO's procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and therefore, for ensuring that trade flows smoothly.

Countries bring disputes to the WTO if they think their rights under the agreements are being infringed. Judgments by specially appointed independent experts are based on interpretations of the agreements and individual countries' commitments.

The system encourages countries to settle their differences through consultation. Failing that, they can follow a carefully mapped out, stage-by-stage procedure that includes the possibility of the ruling by a panel of experts and the chance to appeal the ruling on legal grounds.

Confidence in the system is bourne out by the number of cases brought to the WTO, around 300 cases in eight years compared to the 300 disputes dealt with during the entire life of GATT (1947-94).

(e) Policy Review:

The Trade Policy Review Mechanism's purpose is to improve transparency, to create a greater understanding of the policies that countries are adopting and to assess their impact. Many members also see the reviews as constructive feedback on their policies.
All WTO members must undergo periodic scrutiny, each review containing reports by the country concerned and the WTO Secretariat.

International Monetary Fund (IMF)

The origin of the IMF goes back to the days of international chaos of the 1930s. During the Second World War, plans for the construction of an international institution for the establishment of monetary order were taken up. At the Bretton Woods Conference held in July 1944, delegates from 44 non-communist countries negotiated an agreement on the structure and operation of the international monetary system. The Articles of Agreement of the IMF provided the basis of the international monetary system. The IMF commenced financial operations on 1 March 1947, though it came into official existence on 27 December 1945, when 29 countries signed its Articles of Agreement (its

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charter). The IMF has near-global membership of 190 member countries. Virtually, the entire world belongs to the IMF. India is one of the founder- members of the Fund.

Objectives of IMF: Article 1 of the Articles of Agreement (AGA) spell out 6 purposes for which the IMF was set up. These are:

I. To promote international monetary cooperation through a permanent institution which provides the machinery for consolation and collaboration on international monetary problems.

II. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objective of economic policy.

III. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

IV. To assist in the establishment of a multila teral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

V. To give confidence to members by making the general resources of the Fund tempo - rarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments, without resor ting to measures destructive of national or international prosperity.

VI. In accordance with the above, to shorten the duration and lessen the degree of dis - equilibrium in the international balance of payments of members.

All these objectives of the IMF may be summarised: To promote international coope ration; to facilitate the expansion and balanced growth of international trade; to promote exchange stability; to assist in the establishment of a multilateral system of payments; to make its general resources available to its members experiencing balance of payments difficulties under adequate safeguards; and to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

Functions of IMF: The principal function of the IMF is to supervise the international monetary system. Several functions are derived from this. These are: granting of credit to member countries in the midst of temporary balance of payments deficits, surveillance over the monetary and exchange rate policy of member countries, issuing policy recommen - dations. It is to be noted that all these functions of the IMF may be combined into three. These are: Regulatory, Financial, and Consultative functions.

Regulatory Function: The Fund functions as the guardian of a code of rules set by its (AOA— Articles of Agreement).

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Financial Function: It functions as an agency of providing resources to meet short term and medium term BOP disequilibrium faced by the member countries.

Consultative Function: It functions as a center for international cooperation and a source of counsel and technical assistance to its members.

The main function of the IMF is to provide temporary financial support to its members so that 'fundamental' BOP disequilibrium can be corrected. However, such granting of credit is subject to strict conditionality. The conditionality is a direct consequence of the IMF's surveillance function over the exchange rate policies or adjustment process of members. The main conditionality clause is the introduction of structural reforms. Low income countries drew attraction of the IMF in the early years of 1980s when many of them faced terrible BOP difficulties and severe debt repayment problems. Against this backdrop, the Fund took up 'stabilization programme' as well as 'structural adjustment programme'. Stabilisation programme is a demand management issue, while structural programme concentrates on supply management. The IMF insists member countries to implement these programmes to tackle macroeconomic instability.

Its Main Elements Are:

(i) Application of the principles of market economy;

(ii) Opening up of the economy by removing all barriers of trade; and

(iii) Prevention of deflation.

The Fund provides financial assistance. It includes credits and loans to member countries with balance of payments problems to support policies of adjustment and reform. It makes its financial resources available to member countries through a variety of financial facilities. It also provides concessional assistance under its poverty reduction and growth facility and debt relief initiatives. It provides fund to combat money- laundering and terrorism in view of the attack on the World Trade Centre of the USA on 11 September 2001. In addition, technical assistance is also given by the Fund. Technical assistance consists of expertise and support provided by the IMF to its members in several broad areas: the design and implementation of fiscal and monetary policy; institution-building, the handling and accounting of transactions with the IMF; the collection and retirement of statistical data and training of officials. Maintenance of stable exchange rate is another important function of the IMF. It prohibits multiple exchange rates. It is to be remembered that unlike the World Bank, the IMF is not a development agency. Instead of providing development aid, it provides financial support to tide over BOP difficulties to its members.

Organization and Management of the IMF:

Like many international organisations, the IMF is run by a Board of Governors, an Executive Board and an international staff. Every member country delegates a representative (usually heads of central banks or ministers of finance) to the Board of

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Governors—the top link of the chain of command. It meets once a year and takes decision on fundamental matters such as electing new members or changing quotas.

The Executive Board is entrusted to the management of day-to-day policy decisions. The Board comprises 24 executive directors who supervise the implementation of policies set by the member governments through the Board of Governors.

The IMF is headed by the Managing Director who is elected by the Executive Board for a 5 year term of office. Rights and obligations, i.e., the balance of Powers in the Fund is determined by a system of quotas. Quotas are decided by a vote of the Board of Governors. Quotas or subscriptions roughly reflect the importance of members in the world economy. It is the quota on which payment obligation, credit facilities, and voting rights of members are determined.

Financial Structure of the IMF:

The capital or the resources of the Fund come from two sources:
(i) Subscription or quota of the member nations, and

(ii) Borrowings.

Each member country is required to subscribe an amount equivalent to its quota. It is the quota on which payment obligations, credit facilities, and voting right of members are determined. As soon as a country joins the Fund, it is assigned a quota which is expressed in Special Drawing Rights (SDRs). At the time of formation of the IMF, the quota of each member was made up of 25 p.c. in gold or 10 p.c. of its net official holdings of gold and US dollars (whichever was less). Now this has been revised.

The capital subscriptions or quota is now made up of 25 p.c. of its quota in SDRs or widely accepted currencies (such as the US dollar, euro, the yen or the pound sterling) instead of gold and 75 p.c. in country's own currency. The size of the Fund equals the sum of the subscriptions of members. Total quotas at the end-August 2008 were SDR 217.4 billion (about $341 billion).

The Fund is authorized to borrow in special circumstances if its own resources prove to be insufficient. It sells gold to member countries to replenish currency holdings. It is entitled to borrow even from international capital market. Though the Articles of Agreement permit the Fund to borrow from the private capital market, till today no such use has been made by the IMF.

Special Drawing Rights (SDRs):
The Special Drawing Rights (SDRs) as an international reserve asset or reserve money in the international monetary system was established in 1969 with the objective of alleviating the problem of international liquidity. The IMF has two accounts of operation—the General Account and the Special Drawing Account. The former account uses national currencies to conduct all business of the fund, while the second account is

transacted by the SDRs. The SDR is defined as a composite of five currencies—the Dollar, Mark, Franc, Yen and Pound. The SDRs are allocated to the member countries in proportion to their quota subscriptions. Only the IMF members can participate in SDR facility. SDRs being costless, often called paper gold, is just a book entry in the Special Drawing Account of the IMF. Whenever such paper gold is allocated, it gets a credit entry in the name of the participating countries in the said account. It is to be noted that SDRs, once allocated to a member, are owned by it and operated by it to overcome BOP deficits. Since its inception, there have been only four allocation to SDRs—the first in 1970, and the last in 2008-09—mainly to the developing countries.

Instruments of IMF Lending and Loan Conditionality:

The IMF Articles of Agreement clearly state that the resources of the Fund are to be used to give temporary assistance to members in financing BOP deficit on current account. Of course, the financial assistance provided by the Fund is loan. The following technique is employed: If a country calls on the Fund it buys foreign currencies from the IMF in return for the equivalent in the domestic currency.

This, in legal and technical terms, is called a 'drawing' on the Fund. The technique, therefore, suggests that the IMF does not lend, but sells the required currency to the members on certain terms. This unique financial structure of the Fund clearly suggests that the Fund's resources cannot be lent for long time. It is meant to cover short run gaps in BOP.

The IMF's unique financial structure does not allow any member to enjoy financial assistance over a long time period. The total amount that a country is entitled to draw is determined by the amount of its quota. A member is entitled to draw an amount not exceeding 25 p.c. of its quota. The first 25 p.c. called the 'gold tranche' ('tranche' a French Word meaning slice) or 'reserve tranche' can easily be drawn by countries with BOP problems.

This 25 p.c. of the quota is the members' owned reserves and therefore no conditions are attached to such drawings. This may be called 'ordinary, drawing rights; even the Fund cannot deny its use. However, no interest for the first credit tranche is required to be paid though such drawings are subject to repayment within 3-5 years period. The 'credit tranche' of 100 p.c. each equalling 25 p.c. of a member's quota are also available subject to the IMF approval and hence, 'conditional'. Originally, it was possible to borrow equal to 125 p.c. of one's quota. At present, borrowing limit has been raised to 450 p.c. of one's quota which must be redeemed within five years.

Borrowing methods used by the Fund are:

(i) Stand-by Arrangements: This method of borrowing has become the most normal form of assistance by the Fund. Under this form of borro wing, a member state obtains the assurance of the Fund that, usually over 12-18 months, requests for drawings of foreign exchange (i.e., to meet short- term BOP problems) up to a certain amount will be allowed if the country concerned wishes. However, the stand-by arrangements can be extended up to 3 years while repayments are required to be made within 3-5 years of each drawing. The term “stand-by” here means that, subject to conditionality, a member has a right to draw the money made available, if needed. In most cases, the member does, in fact, draw.

(ii) Extended Fund Facility (EFF): Stand-by arrangements to stabilise a member’s BOP run usually for a period of 12-18 months. Developing countries suffer from chronic BOP problems which could not be remedied in the short run. Such protracted BOP difficulties experienced by the LDCs were the result of structural imbalances in production and trade. It then necessitated an adjust ment programme and redemption scheme of longer duration.

In the 1970s, the Fund recognised this idea and built up the EFF in 1974. The EFF is designed to provide assistance to members to meet their BOP deficits for longer period (3-4 years) and in amounts larger in relation to their quotas. Repayment provisions of EFF cover a period of 4-10 years. However, conditions for granting loans are very stringent. Drawings on this account since 2000 stand at over 50 billion dollar in SDRs.

(iii) Compensatory Financing Facility (CFF): Apart from the ordinary drawing rights, there are some ‘special finances’ windows to assist the developing countries to tide over BOP difficulties. CFF, introduced in 1963, is one such special drawing provision. Its name was changed to Compensatory and Contingency Financing Facility (CCFF) in 1980, but the ‘contingency’ was dropped in 2000. Under it, members were allowed to draw up to 25 p.c. of its quota when CFF was introduced. It can now draw up to 45 p.c. Since the mid- 1990s, this has been the least-used facility.

(iv) Structural Adjustment Facility (SAF) and the Enhanced SAF (ESAF): In 1986 a new facility—the SAF—was introduced for the benefit of low income countries. It was increasingly realized that the so-called stringent and inflexible credit arrangements were too inadequate to cope with the growing debt problems of the poorest members of the Fund. In view of this, SAF was introduced which stood quite apart from the monetary character of the Fund.

Under it, credit facilities for economic reform programmes are available at a low interest rate of 0.5 p. c compared to 6 p.c. for most Fund facilities. Loans are for 10 years with a grace period of five and a half years. LDCs facing protracted BOP problems can get assistance under SAF provided they agree to undertake medium-term structural adjustment programmes to foster economic growth and improve BOP conditions. An extended version of SAF—ESAF—was introduced in 1987. The ESAF has been replaced by a new facility, called Poverty Reduction and Growth Facility in 1999.

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What emerges from the structural adjustment facility is that the IMF's loan is now available to member countries in support of policy progra mmes. It now insists on the supply side policy 'as a condition' for assistance, in addition to loans meant for shortterm BOP difficulties.

(v) Poverty Reduction and Growth Facility (PRGF): The PRGF that replaced the ESAF in November 1999 provides concessional lending to help the poorest member countries with the aim of making poverty reduction and economic growth —the central objectives of policy programmes. Under this facility, lowincome member countries are eligible to borrow up to 140 p.c. of its quota for a 3-year period. Rate of interest that is charged is only 0.5 p. c and repayment period covers 5 1/2-10 years, after disbursement of such facility. However, financial assistance under this facility is, of course, 'conditional'.

(vi) Supplemental Reserve Facility (SRF): This instrument provides additional short-term financing to member countries facing exceptional BOP difficulties because of a sudden and disruptive loss of market confidence reflected in capital outflows of countries concerned. Consequent upon the eruption of East Asian financial crisis, the SRF was introduced in 1997. Till date, the top three largest borrowing nations are Greece, Portugal and Ireland from the IMF.

Strings of Conditionality: It is to be remembered here that the IMF lending is conditional. Further, the IMF lending is temporary ranging from 1 year to 3 years. Repayment period varies from country to country and from one facility to another. Repayment under PRGF for low income countries is 10 years with a 5 1/2 year grace period on principal payments.

The IMF may be viewed as both a financing and an adjustment-oriented international institution for the benefit of its members. The distinguishing features of the Fund loans are their cost and certain macroeconomic policy conditions. These conditionality requirements range from rather general commitments to cooperate with the IMF in setting policies to formulating a specific, quantified plan for monetary, trade, and fiscal policies.

The IMF practice of tying loans to conditions reflects the dominant influence of the capitalist world. The strings of conditionality's as well as the policy of sanctions that came to the fore in the early 1960s made this international organization the most controversial institution. This is because of the fact that the conditions set by the Fund cannot constitute a standard solution for deficit countries to the Fund's finances. By attaching conditions to credit facilities, the Fund has assumed the role of a 'neocolonist'. Some say that the IMF has been acting as 'a rubber stamp for the desires of the US administration'.

The conditionality is always intended to restore internal and external balance and price stability. While formulating specific performance criteria (often referred to as 'conditional loans' that is, 'at the point of a gun'), the Fund prepares 'stabilisation' programme and 'adjustment' programme which member states will be required to adopt to tackle macroeconomic instability.

The programme design involves monetary and fiscal policy measures so that structural adjustment (i.e., reforms aimed at changing the structure of both production and consumption) takes place. Stabili sation is generally regarded as a precondition of structural adjustment policies'.

Thus, stabilisation and structural programmes not only includes monetary and fiscal policies but also exchange rate policy (i.e., devaluation), liberalisation or deregulation, privatisation, reforming institutions to carry governments' new role, freeing markets to determine prices, reforming the labour sector. Almost all stabilisation programmes intend to curb effective demand.

Working of the IMF:

There are two phases in the working of the IMF over the last 65 years. The first phase covers the period late 1940s (i.e., 1947) to 1971. This phase is popularly known as the 'Bretton Woods System'. The IMF system or the Bretton Woods System provides for exchange rate stability in the short run but allowed for the possibility of exchange rate adjustment when a country experienced 'fundamental' disequilibrium in its BOP accounts. Thus, the pegged exchange rate was adjusted in accordance with the IMF. Hence the name is 'adjustable peg system'.

As the system was the source of some major problems, it was abandoned in 1971 and more flexibility was introduced in the monetary system. In other words, the demise of the Bretton Woods System made room for the floating exchange rate regime, requiring changes in the role of the IMF. After prolonged negotiations (1973-78), the IMF started its second-leg journey in 1978.

The decade of the 1970s saw massive borrowing by the developing countries. It rose to $600 billion by 1982. Meanwhile, the rise in interest rates in the USA from 1979 and the appreciation of dollar caused tremendous difficulties to the developing countries in servicing their debts. On the other hand, the switch to the floating exchange rate system coincided with the deteriorating economic conditions in the industrialized countries.

Debt crisis that emerged in many developing countries had a dramatic effect. Mexico a Latin American country announced its failure to honour debt obligations. The IMF now played a crucial role to put the international financial system in order. It came in for mobilization of additional financial resources so as to reduce the debt burden. As a result of this and other related measures, many countries regained access to the international banks and creditors and the severity of the debt problem moderated considerably in Latin America in the early 1990s.

With the breakup of the Soviet Union in 1989, a new category of countries, especially the erstwhile communist countries, joined the IMF. The IMF now came forward to assist countries undergoing transition from a centrally planned economy to a marketoriented economy. Privatization is indeed a crucial element of the transition process. That is why the IMF is providing financial assistance and technical support for the development of sound economic management and the privatization of state enterprises.

In 1997, the East Asian financial crisis began when the currencies of the ‘Asian tiger’ economies (South Korea, Singapore, Hong Kong, Taiwan) plummeted, and the stock market crashed. Rescue packages were launched by the IMF under strong authority conditions.

Achievements of IMF:
From this balance sheet of the working of the IMF, we are now in a position to evaluate its performance over the last 65 years or so. First, we state the achievements of the Fund.

The IMF acts both as a financing and an adjustment-oriented international institution for the benefit of its members It has been providing financial assistance to the deficit countries to meet their temporary disequilibrium in BOP.

The Fund aims at promoting exchange rate stability. In its early phase, the Fund made arrangements of avoidance of competitive exchange depreciation.

It has made an attempt to solve the problem of international liquidity. To create international liquidity. Special Drawing Rights (SDRs)—an artificial currency—were created in 1969 as foreign exchange reserves to benefit the developing countries in particular. SDR allocations are made to member countries to finance the BOP deficits.

It is an institution through which consultation in monetary affairs takes place in an ongoing way. It acts as a forum for discussions of the economic, fiscal and financial policies of member countries, keeping the BOP problems in mind. Previously, the poorest developing countries did not receive adequate treatment from the Fund. But from 1980s onwards—when the debt crisis broke out in poor countries—the Fund decided to divert its financial resources to these countries.

In 1980s, centrally planned economies were not hitherto members of the Fund. With the collapse of the Soviet Union in 1989, ex-communist countries became members of the Fund and the Fund is providing assistance to these countries so as to instill, the principles of market economy. It has decided to finance resources to combat terrorism and money-laundering.

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Finally, the IMF has assisted its members in the formulation of appropriate monetary, fiscal, and trade policies.

Failures of IMF:

Despite these achievements, its failures are glaring. In other words, its success is, on the whole, limited. There are some serious charges against this institution that cannot escape attention.

The Fund provides short-term finance to its members to tackle BOP disequilibrium. For this purpose, it adopted an adjustable peg system in the first phase of its life. But it failed to establish a stable exchange rate. Its role in controlling the competitive exchange depreciation policies adopted by the members was subject to serious scrutiny, although it was created to avoid devaluation as a BOP measure as much as possible.

Truly speaking, the IMF is incapable of taking independent policy decisions. It complies with the 'order' of the superpowers. Further, it has minimal influence over the policy decisions of the major industrial powers. In these cases, its mandate to exercise 'firm surveillance' over some influential members or superpowers is virtually meaningless—it has no influence over the US deficits or European interest rates.

Secondly, the Fund imposes conditions on the poor countries while sanctioning loans. Now, it is ignoring its central concern—exchange rate management and the BOP problems. It is now championing the issue of 'market principle'. It suggests poor developing countries to cut expenditure-borrowing-subsidy, raise prices of state enterprises, privatization of state-owned enterprises, etc. If such measures—most popularly known as structural adjustment programmes—are adopted only then the IMF credit would follow. It is said that the third world debt crisis is due to the Fund policies and working.

Thirdly, the Fund has failed to eliminate foreign exchange restrictions imposed by its members that hamper the growth of trade. In view of these, the developing countries are blaming the IMF for their economic malaise. It is said that the IMF has outlived its mission and the time has come for it to go into oblivion. Sixty- five years is long enough.

Role of IMF in Economic Development of LDCs:

Being a central institution of international monetary system, the IMF works for global prosperity by promoting a balanced expansion of world trade. The IMF not only operates as a BOP adjustment institution but also a BOP financing institution.

The IMF system provides for exchange rate stability in the short run but allows for exchange rate adjustment if a country faces 'fundamental' disequilibrium in its BOP accounts. Hence the name 'adjustable peg system' that lasted till 1971 since its birth. Till the mid-60s of the 20th century, some progress had been achieved in the direction of international cooperation and compliance with the Fund's Articles of Agreement.

Continuous drop in its gold reserves and chronic BOP deficits resulting in a crisis of confidence of dollar forced the USA to abandon the convertibility of dollars into gold in 1971. This is called breakdown of the Bretton Woods System that seriously raised questions about the role of the IMF in the provisioning of international finance. Floating exchange rate system thus introduced caused severe hardships to the LDCs. Meanwhile, many LDCs faced serious BOP deficits because of a world recession, the first oil shock in the form of ricocheting fuel prices, and a falling exports of LDCs.

Earlier, that is before 1971, the bulk of the Fund's resources was used to maintain the value of currencies of the developed world. The Fund had been also marginalized by the actions of the G-7 and regional trading blocks. However, with the change in the exchange rate system, the role of the IMF also underwent a change.

It shifted its focus of attention to the developing countries in the late 1970s. In the 1980s, it became more generous in providing resources to the countries in difficulty. Since then, both the IMF and the World Bank have been helping ex-communist countries to build a market economy, though the IMF was created primarily as an institution for the promotion of international monetary stability. The founding fathers of the Fund expected that it would poke its nose in the affairs of the LDCs and, lately, of the former communist countries.

Today, the Fund is being labelled as an 'anti- developmental' institution, as far as structural adjustment lending is concerned. The IMF now serves the needs of global finance instead of the needs of global stability. The use of conditionality and the direct 'surveillance' on macroeconomic policy by the Fund is suggestive of increasing involvement in the LDCs' development process.

Drawings from the EFF, SRF, PRGF, etc., are available if the member countries agree to a stabilisation programme. The IMF focuses mainly on a country's macroeconomic stability as well as structural adjustment programme that influences its macroeconomic performance. Conditionality's are attached when member countries opt for drawings from the above noted sources of the Fund.

Structural adjustment programmes (that includes not only stabilisation programmes associated with monetary and fiscal policy measures, but also trade liberalisation, privatisation, globalisation, freeing markets to determine prices, reforming institutions, to carry government's new role, and so on) are said to be preconditions for securing Bank-Fund loans. Its adverse impacts on the LDCs are varied and numerous.

First, SAP was justified as necessary to the LDC world as it would enable them to repay their debt to banks of advanced countries. By the late 1980s, more than 70 LDCs had to swallow the SAP medicine. But its impact on growth of these countries was negative. As many as 77 p.c. of countries saw the most significant decline in their per capita incomes. In Latin America, during the 1960s and 1970s, income grew by 75 p.c. when these economies were relatively closed, but during the 1980s, income grew by 61 p.c. only. Average incomes in sub-Saharan Africa actually contracted.

Latest research data for 98 countries during 1970-2000 revealed a negative impact of the IMF programmes on the per capita income growth of 1.7 p.c. p.a. Another study (1991) of 40 countries showed negligible growth in GDP, marginal increase in export growth and the BOP situation and a decline in investment. The IMF aims at tackling BOP disequilibrium but does little to learn the root causes of such disequilibrium.

Secondly, the costs of adjusting to greater openness of the LDC economy are shouldered mainly by the poor. The Fund recommends privatization so as to offset government failure. It is said that the government-run enterprises are inefficient. Bureaucracies are corrupt. Thus by 'freeing the markets', competitive efficiency could be improved. But the costs of such adjustment programmes are expensive. Indeed, globalization has triggered both poverty and inequality. Today's world see the "billionaires of capitalists" and the exponential growth of poverty-stricken, malnou rished people. In compliance with the IMF demand, in Argentina during 1976-87, employment in public administration was down by 11.5 p.c. and in State enterprises by 18.9 p.c. In India, during the stabilisation period 1991-99, growth rates in employment in the organized sector declined form 1.44 p.c. to 0.84 p.c. and further to -0.31 p.c. during 1994-2006. The inevitable consequence of this is the rise in the number of unemployed and poor people. "In the eyes of some, the acronym IMF stands for (I)inflation, (M)isery and (F)amine!" (A.P Thirlwall).

Again, the IMF introduced economic shock therapy measures in command economies. All these comprised the introduction of capitalism in Russia and other former Sovietbloc countries and hence a shift from the state-led development to market-led development.

Thirdly, Joseph Stiglitz has accused the IMF of promoting an agenda of 'market fundamen talism' thereby injuring the country's social fabric. The Fund emphasises fiscal discipline—cuts in government expenditures and subsidies—so as to pursue a free market economy philosophy. But because of cuts in government expenditures and various subsidies on basic necessities and a rise in the price of public services, vulnerable people bore the major brunt. Following cuts in subsidies on food products, milk prices in Chile went up by 400 p.c., bread by 367 p.c., potatoes by 850 p.c. and carrot by 1.589 p.c. in 1975—the average rate of inflation there was 340 p.c. Many LDCs saw their indicators of standard of living— infant mortality, life expectancy, adult literacy, primary school enrolment, per capita calorie supply, etc. — falling to an unimaginable proportion. The Fund is unresponsive to "**adjustment with a human face"**.

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Fourthly, structural adjustment conditionality is often criticized for the third world debt crisis. Borrowing-dependent third world countries in the 1970s and 1980s went for private commercial bank loans—thereby causing accumulation of external debt and ballooning of debt service payments. Faced with this crisis, many of the LDC countries approached the IMF for borrowing to avert the risk of default. It then invented the structural adjustment lending, provided conditionality's imposed by the Fund-World Bank are respected by the borrowing nations. This debt burden also caused severe BOP crises in many countries. The Fund- Bank does not find incentives to close exchange gap; rather they decapitalize LDCs.

Finally, the Fund often brings political and social unrest. Many of the policy measures suggested by the Fund (e.g., subsidy cut, labor retrenchment, golden handshake, etc.) caused widespread strikes, riots, etc., in many countries. Actually, finding no other alternatives, these countries had to swallow the bitter painful SAP medicine.

One author has remarked that the Fund has overthrown more governments than the military'! Social unrest consequent upon strict conditionality's brought more chaos, rather than solution. Argentina faced military takeover in 1976, Brazil in 1964, Chile and Uruguary in 1973, Turkey in 1960, 1971, and 1980. Military coups do not deserve the name 'stabilization' and 'structural adjustment'.

BRICS

BRICS is an acronym for the grouping of the world's leading emerging economies, namely Brazil, Russia, India, China and South Africa. The BRICS Leaders' Summit is convened annually.

The BRICS brings together five of the largest developing countries of the world, representing 41% of the global population, 24% of the global GDP and 16% of the global trade.

It's an emerging investment market and global power bloc.

Structure of BRICS

BRICS does not exist in form of organization, but it is an annual summit between the supreme leaders of five nations.

The Chairmanship of the forum is rotated annually among the members, in accordance with the acronym B-R-I-C-S.

BRICS cooperation in the past decade has expanded to include an annual programme of over 100 sectoral meetings.

The acronym "BRICS" was initially formulated in 2001 by economist Jim O'Neill, of Goldman Sachs, in a report on growth prospects for the economies of Brazil, Russia, India and China – which together represented a significant share of the world's production and population.

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In 2006, the four countries initiated a regular informal diplomatic coordination, with annual meetings of Foreign Ministers at the margins of the General Debate of the UN General Assembly (UNGA).

This successful interaction led to the decision that the dialogue was to be carried out at the level of Heads of State and Government in annual Summits.

The first BRIC Summit took place in 2009 in the Russian Federation and focused on issues such as reform of the global financial architecture.

South Africa was invited to join BRIC in December 2010, after which the group adopted the acronym BRICS. South Africa subsequently attended the Third BRICS Summit in Sanya, China, in March 2011.

Main Objectives of BRICS

The BRICS seeks to deepen, broaden and intensify cooperation within the grouping and among the individual countries for more sustainable, equitable and mutually beneficial development.

BRICS takes into consideration each member's growth, development and poverty objectives to ensure relations are built on the respective country's economic strengths and to avoid competition where possible.

BRICS is emerging as a new and promising political-diplomatic entity with diverse objectives, far beyond the original objective of reforming global financial institutions.

Main Areas of Cooperation within BRICS

1. Economic Cooperation

There are rapidly growing trade and investment flows between BRICS countries as well as economic cooperation activities across a range of sectors.

Agreements have been concluded in the areas of Economic and Trade Cooperation; Innovation Cooperation, Customs Cooperation; strategic cooperation between the BRICS Business Council, Contingent Reserve Agreement and the New Development Bank.

These agreements contribute to realisation of the shared objectives of deepening economic cooperation and fostering integrated trade and investment markets.

2. People-To-People Exchange

BRICS members have recognised the need for strengthening People-to-People exchanges and to foster closer cooperation in the areas of culture, sport, education, film and youth.

People-to-People exchanges seek to forge new friendships; deepen relations and mutual understanding between BRICS peoples in the spirit of openness, inclusiveness, diversity and mutual learning.

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Such People to people exchanges include the Young Diplomats Forum, Parliamentarian Forum, Trade Union Forum, Civil BRICS as well as the Media Forum.

3. Political and Security Cooperation

BRICS member political and security cooperation is aimed at achieving peace, security, development and cooperation for a more equitable and fair world.

BRICS provides opportunities for sharing policy advice and exchanges of best practices in terms of domestic and regional challenges as well as advancing the restructuring of the global political architecture so that it is more balanced, resting on the pillar of multilateralism.

BRICS is utilised as a driver for South Africa's foreign policy priorities including the pursuit of the African Agenda and South-South Cooperation.

4. Cooperation Mechanism

Cooperation among members is achieved through:

Track I: Formal diplomatic engagement between the national governments.

Track II: Engagement through government-affiliated institutions, e.g. state-owned enterprises and business councils.

Track III: Civil society and People-to-People engagement.

Impact of BRICS on Global Institutional Reforms

The main reason for co-operation to start among the BRICs nation was the financial crises of 2008. The crises raised doubts over sustainability of the dollar-dominated monetary system.

The BRICs called for the "the reform of multilateral institutions in order that they reflect the structural changes in the world economy and the increasingly central role that emerging markets now play".

BRICs managed to push for institutional reform which led to International Monetary Fund (IMF) quota reform in 2010. Thus the financial crises had momentarily reduced western legitimacy and briefly let the BRICs countries become "agenda setters" in multilateral institutions.

New Development Bank

NDB is headquartered in Shanghai. At the Fourth BRICS Summit in New Delhi (2012) the possibility of setting up a new Development Bank was considered to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies, as well as in developing countries.

During the Sixth BRICS Summit in Fortaleza (2014) the leaders signed the Agreement establishing the New Development Bank (NDB).

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Fortaleza Declaration stressed that the NDB will strengthen cooperation among BRICS and will supplement the efforts of multilateral and regional financial institutions for global development thus contributing to sustainable and balanced growth.

NDB's key areas of operation are clean energy, transport infrastructure, irrigation, sustainable urban development and economic cooperation among the member countries.

The NDB functions on a consultative mechanism among the BRICS members with all the member countries possessing equal rights.

Major Projects funded by NDB in India:

It has committed funding to a number of major infrastructure projects in India, including the Mumbai Metro rail, Delhi-Ghaziabad-Meerut Regional Rapid Transit System and many Renewable Energy projects.

The NDB has so far approved 14 Indian projects for an amount of nearly USD 4.2 billion.

In 2020, India announced a 1 billion USD loan pact with NDB to boost rural employment and infrastructure.

Contingent Reserve Arrangement

Considering the increasing instances of global financial crisis, BRICS nations signed BRICS Contingent Reserve Arrangement (CRA) in 2014 as part of Fortaleza Declaration at Sixth BRICS summit.

The BRICS CRA aims to provide short-term liquidity support to the members through currency swaps to help mitigating BOP crisis situation and further strengthen financial stability.

The initial total committed resources of the CRA shall be one hundred billion dollars of the United States of America (USD 100 billion).

It would also contribute to strengthening the global financial safety net and complement existing international arrangements (IMF).

Challenges Associated with BRICS:

The marked dominance of big three Russia-China-India is challenge for the BRICS as it moves ahead. To become a true representative of large emerging markets across the world, BRICS must become pan-continental. Its membership must include more countries from other regions and continents.

The BRICS will need to expand its agenda for increasing its relevance in the global order. As of now, climate change and development finance, aimed at building infrastructure dominate agenda.

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As BRICS moves forward foundational principles of BRICS i.e. respect for sovereign equality and pluralism in global governance are liable to be tested as the five member countries pursue their own national agendas.

The military standoff between India and China on the Doklam plateau, which has effectively brought to an end the naive notion that a comfortable political relationship is always possible amongst the BRICS members.

China's efforts to co-opt nation states, which are integral to its Belt and Road Initiative, into a broader political arrangement has potential to cause conflict among BRICS members especially China and India.

Heterogeneity: It is claimed by critics that heterogeneity (variable/diverse nature of countries) of the BRICS nations with its diverse interests possess a threat to the viability of the grouping.

China Centric: All the countries in the BRICS group trade with China more than each other, therefore it is blamed as a platform to promote China's interest. Balancing trade deficit with China is a huge challenge for other partner nations.

Not Been Effective: The five-power combine has succeeded, albeit up to a point. However, China's economic rise has created a serious imbalance within BRICS.

Also the group has not done enough to assist the Global South to win their optimal support for their agenda.

Importance of BRICS for India:

Geo-Politics: Present geopolitics has made it difficult for India to carve a middle path for balancing its strategic interests between the U.S and the Russia-China axis.

Therefore, the BRICS platform provides an opportunity for India to balance the Russia-China axis.

Global Economic Order: BRICS countries shared a common objective of reforming the international financial and monetary system, with a strong desire to build a more just, and balanced international order

To this end, the BRICS community plays an important role in the G20, in shaping global economic policies and promoting financial stability.

Terrorism: BRICS also provides a platform for India to galvanize its efforts against terrorism.

Global Grouping: India is actively pursuing its membership for the United Nation Security Council (UNSC) and Nuclear Supplier Group (NSG).

China forms the major roadblock in pursuing such goals.

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Therefore, BRICS provides an opportunity to actively engage with China and resolve the mutual disputes. It also helps in garnering support of other partner countries.

Recent Initiatives of BRICS:

BRICS Media Forum: In March 2022, the BRICS countries (Brazil, Russia, India, China and South Africa) launched a three-month-long training programme for journalists.

The programme was an initiative of the BRICS Media Forum.

BRICS Meeting on Climate Change: In May 2022, the Union Minister of Environment, Forest and Climate Change participated in the BRICS high-level meeting on Climate Change.

In the meeting, India highlighted the relevance of the forum to jointly address climate change, to explore approaches to accelerate low-carbon and resilient transition, and to achieve sustainable recovery and development.

BRICS did well in its first decade to identify issues of common interests and to create platforms to address these issues.

For BRICS to remain relevant over the next decade, each of its members must make a realistic assessment of the initiative's opportunities and inherent limitations.

BRICS nations need to recalibrate their approach and to recommit to their founding ethos. BRICS must reaffirm their commitment to a multi-polar world that allows for sovereign equality and democratic decision making by doing so can they address the asymmetry of power within the group and in global governance generally.

They must build on the success of the NDB and invest in additional BRICS institutions. It will be useful for BRICS to develop an institutional research wing, along the lines of the OECD, offering solutions which are better suited to the developing world.

BRICS should consider a BRICS-led effort to meet their commitments under the Paris Agreement on climate change and the UN's sustainable development goals. This could include e.g. setting up a BRICS energy alliance and an energy policy institution.

NDB in partnership with other development finance institutions could be a potent vehicle to finance progress towards the sustainable development goals amongst the BRICS members.

Idea of setting up a BRICS Credit Rating Agency (BCRA) as proposed by India, opposed to Western agencies like Standard & Poor’s, Moody’s etc can be on BRICS future agenda.

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Module - 6

Case Studies, Question Papers and MCQs.

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Sample Question Papers

Sample Question Paper – 1:

Instructions: 1. Question no.1 is compulsory & carries 20 marks.

2. Attempt any Four Questions from Q.2 to Q.6.(10 Marks each)

1. Case Study:

India is a fast growing economy in the world and has the potential to compete with the other big economies of the world. However, a growing population, increasing inflation, political instability, need for infrastructure development, and many other issues are causes for concern for the Indian economy. In fact, these issues are preventing the growth of the Indian economy to a considerable extent. Out of all these factors, it is the impact of inflation that is felt across all sections.

1. Answer the following questions: (5M * 4Q = 20 M)

a) Impact of inflation on the Indian economy.

b) Reasons for increasing inflation rates in India.

c) Measures taken by the Indian government to control inflation.

d) Role of RBI in managing inflation in India.Explain the general trends in the Indian e-commerce sector.

2. Answer any Two of the following questions:(5M * 2Q = 10 M)

a) What is business environment. Explain the components of it.

b) Write a note on SWOT analysis of any sector in India.

c) Explain the various Macro environmental factors in Business.

3. Answer any Two of the following questions :(5M * 2Q = 10 M)

a) Define Political Environment? Explain the Impact of Political environment in Business.

b) Explain the objective and function of World Bank.

c) Briefly explain the various component of J-A-M in India.

4. Answer any Two of the following questions :(5M * 2Q = 10 M)

a) Define National Income. How to calculate National Income.

b) Explain the objective and functions of EU.

c) What is GDP. Explain the various methods for GDP calculation.

5. Answer any Two of the following questions :(5M * 2Q = 10 M)

a) Briefly explain the different measures taken by Govt. of India to protect Environment.

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b) Briefly explain about the Objectives and Instruments of Monetary policy.

c.) Explain with a diagram the levels of Economic Integration.

7.Write Short Note on any Two of the following.(5M * 2Q = 10 M)
a) Make in India Campaign b)Balance of Payment c) SAARC

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Sample Question Paper - 2:

Instructions: 1. Question no.1 is compulsory & carries 20 marks.

2. Attempt any Four Questions from Q.2 to Q.6. (10 Marks each)

1. **Case Study**:In the highly competitive and rapidly changing world, many countries are finding a need to adapt to a global market. Costa Rica has developed rapidly over the last 30 years. Once a country that relied on agricultural exports, Costa Rica is now heavily influenced by high-tech foreign direct investment. The resulting growth of technology as a major export has given new direction and opportunity to Costa Rica, but it has also presented new challenges to its educational system. In the past few decades, the Costa Rican Ministry of Public Education has charged the educational system with educating students that are technically literate and possess 21st century skills. Furthermore, multinational corporations have invested money and resources at all levels of the educational system in order to better develop students who are prepared for a global economy. Costa Rican schools and their leaders are facing pressure to ensure their students are prepared to be productive citizens by ensuring they have the knowledge and skills necessary to compete in a labor market that demands a new set of skills, which most educational systems around the world are not providing their students. Despite having five national universities, 51 private universities, and a 95% literacy rate amongst its population, there remains a low secondary graduation rate, a low percentage of students pursuing higher education, and even fewer who are pursuing higher education in science or technology. In order to prepare Costa Rican students to be competitive in a high-tech global market, educational shifts are needed to ensure students possess twenty-first century skills. To make these educational shifts, leaders in government, industry, and education all need to play an active role. This case study uses Bolman and Deal's Four Frame Theory to understand what impact globalization and multi-national corporations have had on educational leadership, and it investigates to what extent government policy and investment by multinational corporations have impacted the development of 21st century skills, as defined by Tony Wagner (2010), in Costa Rican students.

Answer the following questions : (5M * 4Q = 20 M)

a) Impact of Globalization in the education sector of a country.

b) Reasons for increasing Educational tie ups in India.

c) Explain the various factors which accelerates globalization in India.

d) Role of Digital media in globalization of business .

2. Answer any Two of the following questions:(5M * 2Q = 10 M)

a) What is business environment. Explain the components of it.

b) Differentiate between Internal and external environment.

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c) Differentiate between monetary policy and fiscal policy.

3. Answer any Two of the following questions :(5M * 2Q = 10 M)

a) Define Technological Environment? Explain the Impact of Technological environment in Business.

b) Explain the objective and function of IBRD.

c) Briefly explain the various component of J-A-M in India.

4. Answer any Two of the following questions :(5M * 2Q = 10 M)

a) Define National Income. How to calculate National Income.

b) Briefly explain the objective and function of IMF..

c) What is GDP. Explain the various methods for GDP calculation.

5. Answer any Two of the following questions :(5M * 2Q = 10 M)

a) Explain the various legal and regulatory factors affecting business.

b) Briefly explain about the Objectives and Instruments of Fiscal policy.

c.) What is monitory policy. Explain the objective and instruments of monitory policy.

6. Write Short Note on any Two of the following. (5M * 2Q = 10 M)

a) Make in India Campaign b) L-P-G c) WTO

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Sample Question Paper – 3:

1. Case Study:
India is one of the fast growing economies in the world and has the potential to compete with the other big economies of the world. However, a growing population, increasing inflation, political clashes, need for infrastructure development, and many other issues are causes for concern for the Indian economy. In fact, these issues are preventing the growth of the Indian economy to a considerable extent. Out of all these factors, it is the impact of inflation that is felt across all sections.

Answer the following questions : (5M * 2Q = 10 M).

a) Measures taken by the Indian government to control inflation in current scenario.

b) Role of RBI in managing inflation in India. What are the measures taken MPC to maintain the inflation rate with 4 % (+/- 2%)

Answer any Four questions : (5M * 4Q = 20 M).

2. Define Political Environment? Explain the Impact of Political environment in Business.

3. Define National Income. What are the various methods to calculate National Income.

4. Explain with a diagram the levels of Economic Integration.

5. What is Globalization? Explain the Advantages and Disadvantages of it.

6. Explain the various Macro environmental factors in Business with example.

Solve the MCQs (30)
1. In which of the following basic categories can business environment be divided?

A. Local and Regional

B. Regional and National.

C. Internal and External.

D. Financial and Nonfinancial.

ANSWER: C

2. ______environment is within the control of the business.

A. Internal.

B. External.

C. Micro.

D. Macro.

ANSWER: A

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3 ____ environment is beyond the control of the business.

A. Internal.

B. External.

C. Micro.

D. Macro.

ANSWER: B

4. Factors that create opportunities and threats to business units is known as_______.

A. internal environment.

B. external environment.

C. micro environment.

D. macro environment.

ANSWER: D

5. Study of human population is called as _____ environment.

A. political.

B. social.

C. demographic.

D. economic

ANSWER: C

6. Culture spreads from one place to another and such transmission is called as ________.

A. difference.

B. reputation.

C. adoption.

D. heritage. ANSWER: A

7. A systematic application of scientific knowledge to practical task is known as________.

A. technology.

B. culture.

C. demograpic.

D. legal.

ANSWER: A

8. The economic system in which business units or factors of production are privately owned and governed is called as______.

A. capitalism.

B. socialism.

C. democratic.

D. republic.

ANSWER: A

9. Fiscal policy is called as ______ policy.

A. monetary.

B. budgetary.

C. industrial.

D. economic.

ANSWER: B

10. Which can be a method of privation?

A. Denationalization.

B. Purchasing shares.

C. Takeover.

D. Merger.

ANSWER: A

11. _______ state can have an elected or hereditary head.

A. Democratic.

B. Autocratic.

C. Socialized.

D. Republic.

ANSWER: A

12. India is good example for ________economy.

A. socialist.

B. mixed .

C. capitalist.

D. communist.

ANSWER: B

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13. ____refers to the system of moral principles and rules of conduct applied to business.

A. Business culture.

B. Business ethics.

C. Business.

D. Society.

ANSWER: B 14. The following statement with respect to culture is false.

A. Culture is enduring.

B. Culture is changing.

C. Culture is evolved among the members of a society.

D. Culture is determined by national boundaries.

ANSWER: D

15. The micro environment consists ______.

A. Technological Environment.

B. Political Environment.

C. Economic Environment.

D. Public, middlemen, consumers & competitors.

ANSWER: D

16. __________ decides on a particular course of action.

A. Legislature.

B. Executive.

C. Judiciary.

D. Public.

ANSWER: A

17. Economic growth can be measured by ___________.

A. the CPI.

B. the CBI.

C. GDP.

D. MPC.

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ANSWER: C 18. The liberalization of the rules relating to FDI permitting _______% equity in wide range of Industries.

A. 50.

B. 51.

C. 52.

D. 53.

ANSWER: B

19. GDP is ____.

A. Gross Domestic Product.

B. Gross Domestic Percentage.

C. Gross Domestic Personnel.

D. Gross Domestic Public

ANSWER: A

20. GNP stands for______________________

A. Gross National Product

B. Gross negative product

C. Gross negotiable product

D. None of the above

ANSWER: A

21. The income level of residents in a country is indicated by _______.

A. gross national income.

B. gross domestic product.

C. per capita gross national income.

D. per capita gross domestic product.

ANSWER: C 22. The European Union is an example of ______.

A. monetary union.

B. free trade area.

C. common market.

D. economic union.

ANSWER: D

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23. The major responsibility of RBI is __________.

A. healthy regulation.

B. monetary regulation.

C. work regulation .

D. industrial regulation.

ANSWER : B

24. BRICS was established in…..

a) 2005

b) 2010

c) 2006

d) 2012

ANSWER : C

25. SAARC is headquartered in …..

a) Dhaka

b) Colombo

c) Delhi

d) Kathmandu

ANSWER : D

26. Which of the following is not an international organization?

a) SAARC

b) ASEAN

c) ADB

d) CBDT

ANSWER : D

27. Who was the predecessor of WTO?

a) GATT

b) ITO

c) GAAT

d) UNCTAD

ANSWER : A

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28. Which is the one not included in national culture?

A. Language.

B. Internet.

C. Belief.

D. Attitude.

ANSWER: B 29. What are the elements of business ethics?

A. Values rights and duties.

B. attitudes pressure and environment.

C. value environment and attitude.

D. Responsibilities. ANSWER: A

30. Fiscal policy is called as ______ policy.

A. monetary.

B. budgetary.

C. industrial.

D. economic.

ANSWER: B

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ABOUT THE BOOK

Every business is affected by the environment in which it operates. The business environment includes all external factors impacting a business, including customers, suppliers, government regulations, and economic conditions. Business Environment refers to the various external micro and macro factors that can potentially impact the success or downfall of any business venture. These factors range from local economic conditions to global political trends.

All businesses must consider their environment to make sound decisions about their strategies, operations and financial performance. By understanding the interaction between different components of the environment, companies can better anticipate how those components will influence their bottom line to remain competitive and profitable. This book provides a comprehensive overview of what constitutes a business environment and some key considerations for businesses when determining how best to manage it. Business establishes, grows or operates and dies in environment. It exchanges resources within environment. It collects inputs i.e. Man money, materials, machines etc. and provides output i.e. Goods and Services in the environment. Environment means surrounding. Business environment defines as a force those effects on organizational performance. It includes internal an eternal factors. It provides opportunities and threats.

Businesses do not operate in a vacuum but rather in a dynamic environment that has a direct influence on how they operate and whether they will achieve their objectives. This external business environment is composed of numerous outside organizations and forces that we can group into seven key sub environments viz. economic, political and legal, demographic, social, competitive, global, and technological. Each of these sectors creates a unique set of challenges and opportunities for businesses.

This book will help readers to understand the basic terms, factors and regularity bodies which affects the business in their decision making process.

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