Business Environment

Nature of Business Environment

Q1 What is Business Environment, what is the importance of Business environment?

Ans: Business is any activity undertaken for the purpose of producing or selling a particular commodity r service and earns a profit. The business has several dimensions such as purchasing the inputs, converting the inputs into the output, selling that output at a profitable price. Every dimension of a business depends upon several factors. Hence a business is influenced by several factors, all them put together are described as Business Environment. A business can grow and prosper in a particular environment just as a plant can grow in a particular soil, climate, water supply etc. Hence the entrepreneur has to pay attention to the environment in which he has to conduct his business activities. If he is able to adapt his business to the environment effectively and efficiently the business can make higher profits. This makes the study of business environment important.

The business environment is studied under different categories and sub-categories.

Business Environment		
Internal	External	
	Micro	Macro
Mission and Objectives	Customers	Demographic
Plans and Policies	Competitors	Economic
Human Resources	Suppliers	Natural Environment
Physical Resources	Channel Intermediaries	Political
Financial Resources	Society (Public)	Cultural
Corporate Image		Legal
Labour Management Relations		International
Research and Development		
Organisational Structure		

Micro Environment

This refers to the factors which influence the prospects of a particular firm; the firm can influence them with certain efforts. They are as follows:

1 – Customers

The type and the nature of the customers influence the rate of growth of any firm if the customers belong to an affluent section of the community; they are very particular about the quality of the commodity. The firm has to be very particular about choosing the inputs and transforming them in to the output. The cost factor is subsidiary if the firm is dealing with such customers.

If the customers are more commoners the quality of the commodity if less important than the cost of production. The customers want the commodity at a lower price so the firm will have to conscious about the cost in purchasing the inputs, in employment of labour, in packing and such other factors influencing the cost.

2 – Competitors

In modern age an absolute monopoly is a very rare thing. Most of the FIRMS have to work in some type of competition such as Monopolistic Competition or Oligopoly. A Firm has to be particular about the intensity of the competition. If the competition is severe the firm will have to be very particular about keeping the costs at the lowest level so that it can sell the commodity at a competitive price.

If the Firm is working in monopolistic competition it has to spend substantial amounts of money on marketing the commodity. The firm has to spend on advertisement, promotions the product through brand ambassadors undertaking sports and cultural programmes etc.
If the firm is working under Oligopoly, There is Inter-Dependence of the firms whatever action is taken by a particular firm gets a reaction from the other firms. Therefore a firm has to think of the possible reactions of competitors before taking any action.

Now a days the non price competition has become more prominent than price competition,. Instead of selling the commodity at a lower price the firms prefer to offer other incentives to the buyers so that they are attracted to the product. The other incentives are in the form of gifts, providing some complementary commodities, a longer period of guarantee home delivery, after sales service etc.

3 – Suppliers

The quality of the commodity and the cost of production are considerably influenced by the supplies of the inputs. If the inputs are supplied at economical prices, are of standard quality and if the supply is uninterrupted and timely the firm can produce a standard quality of a commodity and sell it at reasonable prices. Often the firms employ more than one supplier so as to ensure an uninterrupted supply of inputs. Some firms setup their own firms / units for producing or supplying the inputs required. That is helpful in ensuring an uninterrupted supply of inputs at proper time and at proper prices.

If the supplies of inputs are regular, consistent and reliable there is no need to keep a larger quantity in stock. The working capital required will be less; the interest on working capital will be less. Interest is a part of the cost of production. If the firm economizes on interest payments it can bring down the cost of production and sell the commodity at a lower price

4 – Channel Intermediaries

They refer to the different levels in the chain from the production unit to the final customer. The chain incorporates the stockists, the wholesalers, the distributors, the retailer etc. If there is a high level of efficiency maintained at every part of the chain the commodity can reach the final consumer in good condition and at a reasonable price. So the Firm has to select and maintain efficient intermediaries. The firm has to offer them proper terms

5 – Society

The prospects of a firm depend upon the society in which it has to work and sell its products. In a homogenous society the job of the firm is easy. The people have almost the same habits likes and dislikes, values and ethical norms. In a heterogeneous society the job of the firm is difficult. A particular product may be acceptable to a particular section of the society but not acceptable to some other sections. In a country like India a firm has to into consideration all types of sections of the community such as the religious sections, the caste, the sect, language, region etc.

Conclusion:

All these forces influence the chances available to a firm to survive and develop.

Macro Environment

The macro environment comprises of those forces which influence all business firms operating in an economy. They can be studied under the following categories

1 – The Demographic Environment

The demographic features of an economy are highly influential in determining the prospects of a business firm. The following dimensions of the demographic environment can be particularly mentioned

(a) Size of the population

A large size provides a large market. In a country like India, the producer of any commodity can hope to have an adequately large market.

(b) The financial status of the population

Mere size of population is no guarantee of a market for a commodity except in bare necessaries of life. Even a small but an affluent community can provide a larger market for durable consumer goods like Automobiles, Personal Computers and TV's. The market for these commodities in a small country like france or germany is much larger than in a larger country like India.

The following table shows the demand for certain commodities in India and China

Particulars	India	China
Electricity Con per Capita (kWh)	435	1,379
Air Passengers ('000)	23,797	119,797
PC (per 1000 persons)	12	41
Mobile Subscribers (per 1000 persons)	44	258

(c) Rural Urban Distribution

Normally the demand for most of the costly durable consumer's goods is higher in urban areas. Therefore if the share of the urban population in the total population is larger, the market for costly durable consumer goods is larger.

(d) The rate of Growth

If the population is growing at am faster rate the share of infants and children in the total population would be larger. Consequently the demand for goods required by infants and children will be higher.

If the population is more or less stable the share of the population occupied by senior citizens will grow and that will increase the demand for goods entering in to their consumption eg: Medicines.

(e) Labour Supply

A large size of the population will create a large supply of labour. Consequently the firms will have to use labour intensive technologies as far as possible. If the firms use capital intensive technology the problem of unemployment will be aggravated. The society will have to spend large amounts of money on giving relief to the unemployed persons. The government may be forced to increase taxed which will also put a burden on the higher income groups.

(f) Level of Education and technical training

If the educated class occupies a larger share of the population, the demand for newspapers books and notebooks will be relatively higher. The following table shows the sale of newspapers per 1000 persons in certain countries

Japan	566
UK	326
Sweden	412
India	60
Bangladesh	29

Conclusion

Thus every aspect of the demographic structure of the population provides an opportunity and also a challenge to a Firm. It has to convert the challenge into the opportunity and sell its products.

17th Aug 08

Economic Environment

Economic Environment			
Economic Conditions in the Market		Economic Policies of Govt	Economic System of Country
Demand Factors	Supply Factors		
Levels of Income	Number of Suppliers	Industrial Policy	Free Market Economy
Level of Savings	Extent of Competition	Fiscal Policy	Command Economy
Levels of Spending	Nature of Supply	Monetary Policy	Mixed Economy
		Foreign Trade Policy	
		Foreign Exchange Policy	

Economic Systems

Every country has to address itself to some basic problems; they are

i) Which commodities should be produced?
ii) In which quantities they should be produced?
iii) How they should be distributed?

The countries are classified in to three groups on the grounds of the methods adopted by them for finding answers to these questions.

1) The Free Market Economies
2) Command Economies
3) Mixed Economies

1 – Free Market Economies

Basic Features

i) <u>Private ownership of the productive resources:</u> All productive resources in the form of soil, factories,. Means of transport, shops, theatres, newspapers etc are privately owned by individuals and their groups. A Few productive resources may be owned by the government; but their contribution to total production is very small.

ii) Private Use of the Productive Resources: This is a corollary of the 1st feature. As the ownership of the productive resources is with individuals, their use is also with the individuals. Every farmer decides the commodity to be produced in his land. Every industrialist decides the commodity to be produced.

iii) Profit Motive: All Productive activities are undertaken with the intention of earning a profit that is an income. The concerned person has to produce something which would satisfy the want of the community and thereby would increase social welfare but the primary end of an individual in taking up any productive activity is to earn an Income.

iv) Non interference on the part of the government: The government does not interfere in economic activities. The people are free to take up any productive activity and conduct it in their own way, within the legal framework.

v) Price Mechanism: The production of different goods and services and the allocation of the resources in the production of different goods and services is regulated by the invisible hand of the price mechanism. If the people want larger quantity of a commodity, the demand for that commodity rises. Till the supply rises, the demand exceeds supply with the result that the price of the commodity rises. This is a green signal for the producers. They increase the production of the concerned commodity by diverting productive resources from other commodities to the concerned commodity.

2) Command Economies

Basic Features

i) Collective ownership of resources: All productive resources in the form of land, factories etc are collectively owned by the government which is the representative of the society. Few productive resources may be left in private ownership but their contribution to total production is negligible.

ii) Collective Use of Resources: All productive activities are undertaken by the government as a representative of the community. The use of few resources may be left to individuals.

iii) Welfare Motives: The productive activities are guided by the welfare motive and not by the profit motive. A commodity needed by the community is produced in the required quantity irrespective of the profit or loss made in its production.

iv) Complete Control by the Government: All Activities relating to the production and the distribution of goods and services are completely controlled by the government. The people have no freedom of production and restrictive freedom of occupation and even of consumption.

v) Administered Prices: The prices of different goods and services are fixed by the government under the expert advice of the planning authority. The price may cover / may not cover the cost of production.

3) Mixed Economy

India has adopted mixed economy with the intention of procuring the advantages of both and avoiding their disadvantages. He features of a mixed economy are as follows

i) Distribution of Ownership of Resources between Government and People: Some resources are owned by the government and some other resources by the people.

ii) Distribution of Productive Activities: The productive activities are divided between the government (Public Sector) and the people (Private Sector). Normally the basic industries, the Capital Goods Industries, The Heavy Industries are placed in to the public sector and the light and consumer goods industries in the Private Sector.

iii) Welfare Motive and Profit Motive: The activities of the public sector are guided by the welfare motive whereas the activities of the private sector are guided by profit motive. They balance each other. This ensures earning a profit and also a high level of public welfare.

iv) Government control over Productive Activities: So far as the public sector is concerned, it is completely under the control of the government. The private sector is indirectly controlled by the government.

v) Regulated Prices: The prices of goods produced in the public sector are decided by the government; even the prices of the products of the private sector are regulated by the government to balance the interest of the producers on one hand and of the consumers on the other hand.

Our Choice

After getting political freedom we were confronted with the problem of choosing an appropriate system for us. We rejected total capitalism because we had experiences of exploitation and inequalities. We also rejected socialism because it does not admit freedom which was so dear to us. Hence we adopted a mixed economy model.

The Industrial Policy Resolution, 6th April 1948:

This resolution ushered mixed economy in to India. The economic activities were divided into four categories, but the basic idea was to entrust some of them to be in the care of the public Sector and keep some others open for the private sector. This gave an assurance to the private sector that it would continue to operate in particular fields.

The Industrial Policy Resolution of Sep 1956:

This resolution further strengthened our wish to have a mixed economy led by a strong public sector. The industries were put into three categories:

Schedule A – It consisted of twelve industries. It was decided that those industries which were already in the public sector would continue with the public sector. New Industries would be setup by the public sector but existing industries in the private sector would be continued in the private sector.

Schedule B – It consisted of seventeen industries. It was decided that as far as possible new industrial units in this schedule will be setup in the public sector but if necessary the private sector may be invited to help the public sector in the development of these industries.

Schedule C – All other industries were kept open for the private sector but it was made clear that if any industry in this schedule is not developed properly by the private sector, government may develop it, thus government was not debarred from any industrial activity.

Up to 1990, we operated the mixed economy Model leaning towards public sector. The private sector got a subordinate position in India's industrial setup. Our business units were required to prepare and execute their policies in that atmosphere. Several industries were nationalized the government also introduced very strong controls on setting up and operating the industries with the help of the Industries (Development and Regulation) Act, 1951.

A Change in this policy was made with the economic reforms introduced by the Narasimha Rao government in 1991.

Economic Conditions in the Market	
Demand Factors	Supply Factors
Levels of Income	Number of Suppliers
Level of Savings	Extent of Competition
Levels of Spending	Nature of Supply

23rd Aug 2008

Mixed Economy - A mixed economy as it prevails in India

A mixed economy resembles a capitalist economy with certain modifications. It is not a complete different economic system. The state tries to change the structure of the capitalist economy so as to make it more appropriate for model economy situations.

The prominent features of a mixed economy can be described as follows:

1. Private and state ownership of the means of production

In India almost the entire agricultural sector is under private ownership. In the non agricultural sector, 3/4th of the industries are in the private sector. The wholesale and retail trade is mostly in the private sector and transport is also largely in the private sector except the railways transport. The air transport is being privatized rapidly.

The role of the public sector is supportive. The public sector is expected to build the infrastructure which is sued by the private sector. The public sector also develops the basic and capital goods industries. Their products are used by the private sector but even in this field we are fast moving towards privatization.

2. Decisive Role of Market Mechanism with supportive role of planning

On the whole the economy is regulated by the market mechanism. The prices of goods and services are determined by the operation of forces of demand and supply. If at a particular price demand exceeds supply the price rises, If supply exceeds demand the price falls. The producers are guided by the changes in the prices of different goods. A rise in the price of a commodity is like a green signal for the producer to increase its production. A fall in price is a signal to reduce production. Thus the production of goods and services and the allocation of resources as between the production of the different goods and services are controlled by the invisible hand of the price mechanism.

The technique of production is also regulated by the prices of the factors of production, if labour is cheaper the producers use labour intensive technology. If capital is cheaper then the producers use capital intensive technology. Of course in certain productive activity the technique to be used is determined by the nature of the industry.

The money market and the capital market supply the long and short term capital required by productive activities. They are also controlled by the forces of demand and supply. The level of investment is determined by a balance between the rate of interest and the marginal efficiency of capital. The fluctuations in share prices reflect the performance of the different companies. If the share prices are rising it is a sign of an excellent performance of the company concerned. This is also helpful to the company to raise more capital and undertake expansion of its business.

3. Intervention Role of the State

In a mixed economy the state intervenes in any productive activity with the intention of making it more community friendly. If it s found that the private sector is cornering the stocks of a commodity and exploiting the consumers, the state setup its own units to produce the commodity and augment its supply. This is helpful in arresting the rise in the price of the commodity.

The state intervenes in the forex market also through the Central Bank of the country (RBI in India). If the local currency is depreciating the state enters in to the forex market and starts purchasing it that halts the depreciation. On the other hand if the local currency is appreciating the state enters in to the market and sells it. The supply of the local currency (i.e.: Demand for foreign currency) increases which prevents appreciation of the local currency i.e.: depreciation of the foreign currency. This is necessary for balancing the balance of payments. The state also intervenes in the market for fixing the prices of commodities, if the prices are rising the government starts selling that commodity and protecting the interests of the consumers. If the prices are falling the government fixes minimum prices and purchases the commodity at those prices. This prevents a further fall and protects the interests of the producers.

4. Public Sector Activities guided by Social Benefit

The public sector mainly specialized in the production of public utilities such as local transport, supply of cooking gas, supply of water and such other commodities which enter into the budget of the common man. The government also undertakes purchase and sale of necessaries of life so as to protect the vulnerable sections of the community against an excessive rise in prices.
In a less developed economy which is trying to develop, the public sector is born out of need. It is not a matter of any ideological step like socialism. The private sector is not capable of developing the infrastructure, the basic and heavy industries, the capital goods industries etc because its material and human resources are limited. The state has unlimited powers and can mobilize resources on a very large scale. Therefore the public sector is a dire need of a developing economy particularly in the initial period of development. In India the public sector was born in 1948 to give a big push to the developmental efforts

5. The Supportive role of economic planning.

Planning is an ingredient of a socialist economy but that does not mean that every economy which has planning is a socialist economy. In a developing economy planning is necessary for introducing a system in economic development and an efficient exploration and exploitation of resources. Planning introduces priorities in the use of resources which is a basic need of a developing economy hence the planning in a mixed economy has a different nature than planning in a socialist economy. It is indicative in nature.

Appraisal of a Mixed Economy

Though mixed economy is an inescapable for a developing economy it has drawbacks of its own. The more prominent are as follows:

1. Less Firm

The mixed economy is a very delicate form of economic system. It is prone to all types of political, social and international developments and changes. A mixed economy is characterized by co-existence of the public sector and the private sector but the relative importance of the two sectors changes from country to country and also from time to time. It is easily influenced by political changes in the country. The rise of the UPA government with the support of the leftist parties strengthened the importance of the public sector.

2. Concentration of Economic Power

The goal of a developing economy is to bring about a rapid economic growth. The government takes several steps for accelerating the pace of economic growth but they may give a scope for emergence and growth of big business houses. The economic power is concentrated in the hands of a few big business houses that can exert a strong political influence on the government. The government policies can be turned to the benefit of the big business houses.

Even the money market and capital lean towards the big business houses. They can expand at a fast rate. In India the licensing policy was actually helpful in the growth of big business houses. In 1963-64 there were only 2 monopoly houses namely Tatas and Birlas with assets exceeding Rs: 200 crore each. In 2001 – 02 there were 10 monopoly houses with assets exceeding 5,978 crores each. In 2004 only Reliance Industries was worth Rs: 71,000 crore.

3. Inefficient public sector

The public sector symbolizes state monopoly and incorporates several evils of monopoly. It looses incentive to innovate. It becomes rigid and indifferent towards the buyers. It is often characterized by bribery, corruption and favoritism . Political pressure is used in taking economic decisions. The combined effect is a huge loss on the part of the public sector undertakings. This is borne by the tax payers

4. Sliding back to Capitalism

Though mixed economy is supposed to maintain between the public sector and the private sector, in its operations it slides back to capitalism. India is a glaring example of the mixed economy adopted in 1948 became virtually a free market economy by the year 2000.

Conclusion

Thus a mixed economy is a need of a developing economy in the initial stages. But as the economy develops the private sector rise into prominence and the mixed economy is knowingly or unknowingly transformed in to a market regulated economy.

30th Aug 08

Journey of India's Industrial Policy from 1948 – 1991

Introduction

In a mixed economy the industrial policy of the government reflects the thinking of the community on the spheres earmarked for the public sector and the private sector. There was nothing like an Industrial Policy in India in the pre-independence period. At the outset of independence there was confusion and misconceptions in the minds of the industrialists about the fate of their businesses. It was necessary to remove the confusion and give a clear cut direction to the industries to invest and expand. Hence a conference of industrialists was held in February 1948 and based upon the deliberations in the conference the 1st industrial policy resolution was adopted by the parliament on 6th April 1948.

The main provisions of the IPR April 1948

The industries were divided in to four categories as follows:

1. Exclusive Monopoly of the State :

It included three industries namely the production of arms and ammunitions, production and control of atomic energy and railway transport. The private sector would not get any entry in these three industries.

2. State Initiative

This sector included six industries namely Coal, Iron n Steel, Aircraft Manufacture, Shipbuilding, Manufacture of telephone, Telegraph and wireless apparatus and mineral oil. New units in these six industries would be setup by the state but the existing units would get a life of 10 years after which the government would take final decision in respect of them.

3. Government Control

This category included 18 industries such as Automobiles, Heavy Chemicals, Heavy Machinery, Machine Tools, and Fertilizers etc. These industries would continue to be in the private sector but they will be subject to an extensive control by the government.

Thus a clear cut demarcation line was drawn between the private sector and the public sector. That gave a confidence to the private sector.

2nd Industrial Policy of Sep 1956

After the 1st resolution was passed, two important developments took place

1. The Indian Constitution was passed conferring the right to property on the people.
2. The parliament adopted resolution declaring “Socialistic Pattern of Society “as our goal.

It was necessary to pass the 2nd resolution in the light of these two developments, besides the industries in the 2nd category which were in the private sector were given a lease of ten years from 1948. It was necessary to take a final decision in respect of them before 1958; hence the 2nd IPR was passed in Sep 1956.

The objectives of the 1956 resolution:

1. To accelerate the pace of Industrialization by creating an appropriate atmosphere
2. To develop the heavy industries including machine making industries
3. To expand the public sector in conformity with the goal of the socialistic pattern of society.
4. To reduce inequalities in the distribution of incomes and wealth by providing more employment opportunities.
5. To prevent the growth of monopolies.

Division of Industries

The 1956 IPR divided the industries into three categories:

1. Exclusive Monopoly of the State

This category included 17 industries divided into two sub-categories.

a) Four industries namely production of defence equipments, generation of atomic energy, railway transport and air transport were to be exclusive monopoly of the state.
b) In respect of the remaining 13 industries namely, Iron and Steel, Heavy Machinery, Coal, Heavy Electrical Equipments, Ship Building etc, new units would be setup by the state but the existing units in the private sector would be allowed to be continued in private hands. Besides the government may take the co-operation of the private sector to develop the industries in this sector.

2. State Initiative

This category included 12 industries such as minerals not mentioned in the 1st category, road transport, sea transport, machine tools, drugs, plastics, antibiotics etc. In these industries the state would increasingly establish new units but the state may invite the private sector to supplement its efforts if necessary.

3. Private Sector

All the remaining industries were left in the 3rd category. The private sector was free to develop it but if the private sector failed to develop any of the remaining industries the government may take it up and develop it.

Thus the 1956 resolution strengthened the public sector. Almost 29 industries were now taken over by the public sector in its jurisdiction.

Industries (Development and Regulation) Act of 1961

Aim: The aim of this resolution was to give a complete control to the government over the management and development of industries. The main provisions of the act were as follows

1. No new industrial enterprise could be established without a prior license from the central government
2. No substantial addition to the capacity of an existing industrial unit can be made without prior license of the central government.
3. The government would conduct enquiries in to the working of any licensed industrial unit and may point out the malfunctioning in the working if any.
4. The government is authorized to prescribe the prices of the products, the quantity to be produced, the method of production etc.
5. The government would appoint development councils representing the management and labour for every industrial unit. The council would prepare and implement programs of development.

6. Industries employing less than 100 workers and having fixed capital of less than Rs. Ten lakhs would be exempted from licensing.

The Industrial Policy Resolution of July 1991

The journey of India's industrial policy from 1948 till 1990 was guided by 3 basic principles.

i. A strict control of the government over industries.
ii. Front seat to the public sector in industrial development.
iii. Protection to Indian industries against foreign competition.

The environment created by these three principles gave results for some time but it also developed several evils in course of time. Therefore the industrial policy resolution of 1991 reversed these principles and adopted new principles such as

1. Liberating the industrial sector from government control
2. Giving front seat to the private sector in industrial development.
3. Exposing the Indian industries to global competition.

The clauses of the new industrial policy are to be studied in the light of these principles

a) Abolition of the licensing system

The licensing policy was expected to direct India's industrial development in the desirable sectors but it developed evils like delays and corruption. Hence the licensing system was removed except in case of 18 industries. The list was subsequently reduced to 11 industries which are mainly related to safety, security, public health and morality.

Thus 85 % of the Indian industrial sector was liberated from licensing. Even the licensed industries were given freedom to expand to satisfy market needs without taking prior approval / capacity clearance from the government.

b) Curtailing the size of the public sector

The no of industries in the public sector was reduced to only 8 mainly production of defence equipment, atomic energy, coal and lignite, mineral oils etc.

Subsequently this list was reduced to only 3 industries mainly generation of atomic energy, chemicals required for atomic energy and railway transport. The other industries were thrown open to the private sector.

The industries in the public sector were given greater autonomy. They were permitted to sell a part of their capital to private parties so as to widen the capital base. The government is planning to reduce its equity holdings in public sector banks to 50%.

c) Foreign Investments

A list of 34 high priority, high technology industries was prepared. Foreign equity was allowed upto 51 % in these industries. In some industries even 100 % foreign equity is allowed. A Foreign Investment Promotion Council had been setup to prepare project reports in certain thrust areas. They can be used by foreign capital.

Foreign Investment Implementation Authority has been setup for providing a single point interface between foreign investors and government machinery. Foreign equity holdings in Insurance sector and telecom sector were increased.

d) Removing controls on Monopoly

The Monopolies and Restrictive Trade Practices Act 1956, declared certain companies as MRTP companies and dominant enterprises. In 1986 companies having fixed assets of more than Rs. 100 crores were put into this category. They were not allowed expansion and development without prior permission of the government of India. They were required to obtain permission from the government of India for any type of investment, expansion, amalgamation or appointment of directors.

The 1991 resolution removed these restrictions. No Firm is now declared as a MRTP firm or a dominant enterprise. The MRTP commission continues

e) Removal of locational Restrictions

Earlier permission from the government of India was required for locating a particular industrial unit at a particular place. The new policy removed that provision and incorporated the following simple procedures:

a) An Industrial unit can be setup in a place with a population of less than 1 million without any restrictions.
b) If the population is more than 1 million and the industry is a polluting one the unit can be setup outside a periphery of 25 kms.

6th Sep 08

Monetary Policy

Meaning

Monetary policy refers to policy formulated and implemented for achieving the following objectives:

i. Regulating the supply of money including credit money and adjusting it to the needs of the economy
ii. To control the cost of money by regulating the rates of interest.
iii. Directing the supply of money to the required channels in accordance with the plan of priorities prepared by the planning authority.

Importance of monetary policy

A modern economy is a money economy. All transactions are effected with the help of and through the medium of money. The prices of goods, services and factors are fixed in terms of money. People earn their income in the form of money and spend it in the form of money. So the supply of money creates money income in the hands of the community and expenditure of money generates the demand for different goods and services.

The monetary authority has to maintain a perfect balance between increase in the production of goods and services and increase in the supply of money. If increase in the supply of money exceeds increase in the production of goods and services the result is inflation. On the other hand, if the production of goods and services increases at a fast rate and the supply of money increases at a slow rate the result is recession and maybe depression. Hence the monetary authority has to monitor the growth in production very closely and adjust the money supply to it.

In India the monetary policy is formulated and implemented by the Reserve Bank of India which is an autonomous financial institution. It is expected that the RBI would use professional expertise to control the supply of money to the benefit of the community.

Instruments of monetary Policy

In a modern economy the supply of money consists of two parts:
i. The legal tender money
ii. The bank money which is also called the Credit money

i. The legal tender money :

It consists of coins and paper currency. This is completely controlled by the central bank of the country (RBI in India). The legislature of the country lays down the system of note issue. Since 1952 we have adopted the fixed fiduciary system of note issue. The outline of the system is as follows:

The notes issued constitute a liability on the part of the RBI. The liabilities must be balanced by equivalent assets. These assets are composed of three parts

i. Gold plus Foreign securities worth not less than Rs 200 crores
ii. Out of this the value of gold should not be less than Rs 115 crores.
iii. Government of India securities worth the remaining part of the note issued.

Thus the RBI cannot increase the supply of legal tender money without acquiring the required monetary reserves.

ii. Bank money which is also called the Credit money

The commercial banks accept deposits and use them for advancing loans. The credit instruments issued by them in the form of cheques, drafts etc are also used as medium of exchange. Hence an increase in the loans advanced by commercial banks increases the supply of money. If the monetary authority desires a contraction in money supply it has to create an atmosphere in which the commercial banks reduce loans. On the other hand if the central bank wants to bring about an expansion of money supply it can create an atmosphere in which the commercial banks can expand their loans.

Instruments of Monetary Policy

The instruments used by the central Bank for controlling the supply of bank money are classified into two categories namely General Instruments and Selective Instruments.

The General Instruments

These instruments are called general because they are uniformly applicable to all commercial banks and in respect of loans given for all purposes. The general instruments are as follows:

i. The Bank rate policy: Bank rate is the official rate at which the central bank of the country rediscounts bills offered by the commercial banks. The following example shows how a change in the bank rate can bring about a change in the supply of money.

A Bill is drawn when some goods are sold by a person to another person. A Bill is an order made by the drawer (the seller) on the drawee (buyer) to pay a particular amount of money to him (the seller) on or before a particular date. The bill is accepted by the drawee and then it becomes a negotiable instrument. It is returned to the drawer. He can discount that bill with a commercial bank. The rate at which the bill is discounted by the commercial bank is called the Market Rate. If the bank is itself in need of money it rediscounts the same bill with the Central bank of the country. The rate at which the bill is rediscounted by the central bank is called the Bank Rate. It is normally a little below the market rate. The difference between the MR and BR gives profit margin to the commercial bank.

When the central bank wants to bring about a contraction in bank credit, it raises the bank rate. The effect is that the commercial banks raise the market rate in order to retain their profit margin. Rise in the market rate brings about a contraction in the volume of bills offered by the customers to the commercial banks. If the volume of bills is less, the amount of money going out from the commercial banks to the people is less i.e.: the supply of money is less.

If the central bank wants to bring about an expansion of Bank credit it lowers the bank rate. The commercial banks can lower the market rate due to which the people offer more bills for discounting and the supply of money increases.

13th Sep 08

2 – Open Market Operations

The Central bank enters in to the bond market and purchases or sells government securities for bringing about expansion or contraction of credit. Open Market sales bring about contraction of credit in the following way

RBI sells bonds worth rs: 5 crore. They are purchased by a person A. he gives a cheque for Rs. 5 Crore to the RBI. This cheque is drawn upon some commercial bank (BOB). RBI collects the amount from BOB. The cash in the possession of BOB is reduced by Rs 5 cr. It has to reduce credit to the extent of a multiple of rs : 5 cr. If the ratrio of cash held by the commercial banks to their deposits is 10%, a draining of 5 crore from the cash reserves of the commercial banks can bring about a contraction of credit to the extent of Rs. 50 cr.

When the Central bank wants to bring about expansion of credit, it purchases govt bonds in the open market. It gives cheques drawn upon itself to the sellers of those bonds. They deposit those cheques with the commercial banks in which they have their accounts. The amount of these cheques are collected by the commercial banks from the central bank. The cash reserves held by the commercial banks increase. They are able to expand credit to the multiple of the additional cash reserves.

The ephicacy of the open market operations depends upon the following factors:

a) An adequate volume of government securities in the market

The central bank can purchase a sizeable amount of government securities provided the total volume of government securities in the market is large.

b) The capacity of the central bank to invest in government bonds

The central bank is described as the Lender of the Last Resort. It has to maintain a very high degree of liquidity. The government bonds may be absolutely safe but the central bank may find it difficult to convert them into cash in an emergency.

c) A very big sale of bonds in the market may result into a substantial fall in bond prices that may be harmful to their prices in particular and the entire capital market in general.

As between bank rate and open market operations the OMO are more effective. The central bank takes initiatives in implementing the open market operations. In the bank rate the role of the central bank is a little passive. if the commercial banks have excess liquidity they may not raise the market rate even though the central bank raises the bank rate. In that situation the central bank starts open market sales, takes away excess liquidity from the commercial banks and then raises the bank rate. Now the commercial banks are forced to approach the central bank for accommodation. If the bank rate is increased in that situation, the commercial banks have to pay a higher rate. They are forced to raise their rate of interest. Thus the bank rate and the OMO are often used simultaneously.

3 – Variable Reserve Ratio

Every commercial bank in the country is under a legal obligation to keep a certain proportion of their deposits in the form of cash with the central bank of the country. The ratio of these cash deposits to the total deposits of a commercial bank is called the cash reserve ratio. If the CRR is 10 % and if the total deposits of a bank are rupees Rs.1000 crore, it has to keep Rs.100 crore with the central bank in the form of cash. In India the range within which the CRR can be changed is fixed by Parliament under the RBI act 1935 as amended from time to time. The range is between 5% to 20%. RBI is authorised to change the rate within that margin depending upon the requirements of the time.

In Feb 2001, the CRR was 8.5%. Since then RBI adopted the policy of lowering it because of the recessionary tendencies prevailing in the country. The CRR was lowered from 8.5% progressively to 4.5 % by June 2003. It was almost on the same level till the end of 2004 since when the RBI started raising it. It was raised to 8.25 % upto july 2008. On 5th july 2008 it was increased to 8.5%, on 19th july to 8.75% and on 29th of July to 9%.

When the banks keep more cash with the central bank they are left with less cash for advancing loans. The supply of credit money declines.

4 - Statutory Liquidity Ratio

It is legally obligatory on the part of all commercial banks to invest a certain part of their deposits in govenment bonds. The ratio of the money invested in government bonds to the total deposits is called the statutory liquidity ratio. It serves two purposes

a) it provides the central bank an Instrument of monetary policy.
b) It provides a certain definite amount of money to the government for financing economic development. The parliament has fixed the range of the SLR between 25% and 40%.

The RBI is authorised to fix and change the SLR within this margin. When it wants to bring about a contraction of credit, it increases the SLR. The commercial banks have to invest a larger part of their deposits in government bonds. To that extent they are left with less cash for advancing loans that puts a brake on their capacity to extend credit.

Upto 1991, the SLR was 38.5% which was very near the ceiling. On the recommendations of N Narsimha committee, RBI started lowering the SLR. It was brought to 25% by 2005 and has been maintained at the same level since then. In 2005 parliament authorised RBI to lower it below 25%, but RBI did not use that authority. Now it is not possible that the SLR would be lowered till the inflationary trends are controlled.

5 – Repo Rate

This is the rate at which RBI advances short term funds to the commercial banks. They issue credit instruments called repurchase obligations. These instruments incorporate a specific date on which they would be purchased back by the issuing bank. The repos are purchased by RBI which means, RBI puts that much money at the disposal of the commercial banks. The rate charged on the repos is called the Repo rate.

A rise in the repo rate means that the commercial banks have to pay higher rates of interest to RBI. Consequently they have to charge higher rates of interest to their customers. The cost of money is raised. The demand for money falls and the amount of money flowing from the RBI to the commercial banks and thereafter from the commercial banks to the public is reduced.

In feb 2001 the Repo rate was 10%. It as reduced in the subsequent period which was a period of recession in india. It was lowered to 6.25 % in nov ’05, Since then it has been continuously increased. It was also raised to 8.5 % from 8 % on 5th July ‘08 subsequently it was increased to 9% on 29th July ’08.

Selective Instruments of Credit Control

These instruments of monetary policy can be used in respect of any particular bank or in respect of a loan given against a particular security. Hence they are called selective instruments. The prominent amongst them are as follows:

a) Regulation of credit margin

Whenever a commercial bank gives a loan against a tangible security, it maintains a margin between the value of the security and the amount of the loan given. This is necessary for maintaining safety of the bank. It also provides an instrument to the central bank to control the volume of credit given against a particular security.

Eg. A person tenders gold and applies for a loan. The market value of the gold is Rs; 10 lacs, and the credit margin prescribed by RBI is 20%. The commercial bank will be able to give a maximum amount of 8 lac against that security. If the margin is increased to 30% the commercial bank will have to reduce the loan to 7 lac.

This instrument is especially used for preventing cornering of stocks of essential raw materials.

b) Direct Action

The central bank gives instructions to the commercial banks in respect of their lending policies. If a particular bank ignores the instructions RBI can take disciplinary actions against it. The action consists of charging a penal rate of interest to the offending bank, stopping lending to that bank or rejecting the bills offered by that bank for discounting. In any case the bank has to raise the rate charged to the customers which drives the customers away from that bank. Besides a disciplinary action taken by the central bank against a commercial bank creates an atmosphere in which the people avoid to go to that bank.

c) Moral suasion

The central bank interacts with the commercial banks and urges them to adopt a particular credit policy. The commercial banks accept the policy suggested by the central bank because they have a respect for the central bank.

Moral suasion is better than direct action. It is preventive whereas direct action is curative. A frequent direct action taken by the central bank spoils the atmosphere between the central bank and the commercial banks. Hence as far as possible the central bank relies upon moral suasion.

d) Consumer credit

The commercial banks advance loans to enable their customers to purchase durable costly consumer goods. The central bank can prescribe the rate of interest which they have to charge on these loans. It can also fix the installments in which the loans are to be recovered. If the rate of interest is raised and the number of installments is reduced it is difficult for the people to use them. The demand for the concerned consumer commodity falls.

e) Publicity

The central bank of the country gives a wide publicity to its policy through its publications. The commercial banks accept that policy even when the central bank does not insist upon it. This method is also widely used by the central banks in developing countries.

Conclusion

In a developing country like India, the selective instruments are used more. They produce positive as well as negative effect. They directly bring about the desired change. They can be effective even if the country does not like a well organized money market and capital market.

20th Sep 08

Trade Policy

Meaning

The Trade policy of a country refers to its policy relating to its foreign trade. It has a strong bearing on economic development of the country. It is said that trade is the engine of growth for an economy. Under the policy of globalization and with fast means of transport and communication the international trade is expending in volumes. Every country tries to take maximum benefit from its international trade. The share of total benefit arising out of global trade going to a particular country is mostly influenced by its foreign trade policy together with the global conditions.

Dimensions of Trade policy

The trade policy of a country has two dimensions namely free trade policy and protection. Free trade policy means there are no restrictions on imports and exports especially imports. The goods and services can move freely between different countries as they move between different parts of a country. The government may impose some taxed on imports and exports especially imports but the intention behind imposing these taxed is not to restrict the inflow of goods in to the country but to earn some revenue from foreign trade. These duties are nominal duties. The quantitative restrictions are almost absent under the policy of free trade.

Under policy of protection the government takes steps to restrict imports with the intention of reserving the domestic market for domestic industries. The imports are restricted with the help of tariffs that is heavy import duties or with the help of non tariff barriers. The tariffs are import duties imposed at very high rates. The prices of the imported goods rise to such a level that the people do not purchase them. The people purchase the domestic goods which are substitutes for the imported goods. The domestic industries get a protected market.

If the tariffs are not effective the non tariff barriers are quantitative restrictions are used for preventing foreign goods from entering in to the domestic market. The imports of some commodities are totally banned. The imports of some other commodities are allowed upto a particular level. The other part of the market remains open for the domestic industry. It can use that market and grow. The forms of non tariff barriers are

a) Quota
b) Health Restrictions
c) Social restrictions
d) Import licensing
e) Exchange control
f) Carrier requirements
g) Voluntary restraint

1. Quota

Quota is the maximum quantity of a commodity allowed to be imported in one financial year. The government fixes the quota after taking into consideration the demand for the commodity in the domestic economy minus our own production. The quota is adjusted to suit changes in our requirements or our own production.

The quota is classified into global quota and allocated quota.

Under the global quota a particular quantity is allowed to be imported in one financial year. The people are free to import it from any country they like.

Under the allocated quota the total quantity to be imported is allocated between different countries. A particular quantity must be imported from a particular country.

2. Health Restrictions

The developed countries prevent import of certain commodities on health grounds. The European countries do not import commodities like milk and meat from India on health grounds.

3. Social restrictions

Several commodities are not imported by the developed countries on grounds of use of child labour.

4. Import Licensing

A quota is normally accompanied by import licensing. The prospective importers are given a license to import a particular quantity of a particular commodity in a particular period.

5. Exchange Control

Under exchange control all foreign exchange becoming available to the citizens of a country is pooled together in the hands of the central bank of the country. The pool is distributed between the importers in the light of the importance and priorities of the commodities to be imported. Those commodities which enjoy a higher priority get the required foreign exchange. The less important commodities are denied foreign exchange.

6. Carrier requirements

Some countries lay down a condition that the imported commodity must be carried in their own ships. Then the shipping charges are adjusted in such a way that certain commodities do not get hipping space. Their imports are automatically restricted.

7. Voluntary restraint

A country requests another country to put a voluntary restraint on the exports of a particular commodity. The response of the other country depends upon the relation between the two countries and the influence of the requesting country.

Arguments made in support of the policy of Free Trade

Free Trade is the most natural form of trade between different countries. The WTO is a champion of the policy of free trade. The main arguments made in support of the policy of free trade can be summarized as follows:

1. Maximum Output of all countries of all goods

Different countries have different advantages in the production of different goods depending upon the availability of different factors of production. Under free trade a country specialises in the production of those commodities in which they have a comparative cost advantage. The country imports the other commodities from the other countries easily because there are no restrictions on imports or exports. The production of different goods is maximized when different countries specialize in the production of different goods depending upon their capacity to produce them. So all commodities are produced at the minimum cost from where all countries can get it.

2. Highest Remuneration to the factors

The remuneration which a factor gets depends upon its productivity. Under the policy of free trade the production of all countries is maximized. Naturally all factors get maximum remuneration

3. Maximum benefit to the consumer

A consumer is always interested in getting a commodity at the lowest price. Under free trade all countries produce all commodities at minimum costs of production. They are carried from one country to another country freely and easily so the people of any country can get these commodities at lowest prices.

4. Advantages of competition

Under free trade policy the producers of different commodities have to compete with not only producers working in that country, but producers producing those commodities in other countries also. Competition is taken up from the national level to the international level. Competition is a driving force behind reducing the cost of production, improving the quality of the commodity, introducing innovations and paying more attention to the needs of the customers.

5. Economies of Scale

When different countries specialize in the production of different goods each country produces the chosen commodities on large scale. Consequently all countries get economies of scale in respect of the production of all commodities. The single advantage of the economies of scale is that goods are produced at the minimum cost. That serves the purpose of getting maximum production within the available resources.

6. Helpful to the developing countries

The developing countries require several things such as machinery, oil, technical knowledge, designs of complex commodities, circuits of electronic goods etc. from developed countries. Under free trade they can conveniently export their goods to the developed countries and import the required goods from them.

7. Cordial international political relations

Under free trade system the countries are dependent upon each other for the commodities required by them. Consequently, they have to maintain cordial political relations between them. If political relations between them are cordial they can devote all their attention to their economic problems and economic development.

Arguments against the policy of free trade

Though free trade is regarded as the most natural form of trade conferring maximum benefits on the countries participating in it, there are several arguments made against it. The prominent amongst them are as follows

1. Harmful to the developing countries

A system of free trade gives rise to a competition between different countries of the world. In this competition the developing countries are weaker competitors. They are not able to compete with the developed countries and develop their industries. They always remain backward, agricultural countries

2. Excessive dependence – Undesirable and risky

Free trade required that a country should develop only those industries in which it has advantage. It should import all other commodities from other countries thus a country has to depend upon other countries for several commodities. This is alright in normal period but in a period like war if the other country refuses to supply some important commodities the receiving country may face a very difficult situation.

3. Possibility of non priority imports

Once a country adopts the policy of free trade and removes restrictions on imports, there is a possibility that some people may take undue advantage of the policy and may import those goods which are on a lower order of priority from the point of the country.

4. Possibility of cut throat competition

Under free trade all countries have to compete with each other. It is said that competition is helpful to progress. This is true up to a particular level. If fair competition develops into an unfair and cut throat competition, the developing countries may suffer.

5. Beneficial, if followed uniformly by all countries

It is found that some countries follow the free trade policy sincerely but some other countries try to find loopholes in the policy and take undue advantage of those loopholes. In such a situation the countries following the policy honestly would suffer.

Conclusion

Thus the policy of free trade is no doubt beneficial to all countries in the long run but it can be misused due to which particularly the developing countries may suffer.

Arguments made in support of the policy of protection

Though theoretically the policy of free trade is beneficial to all, some countries have to resort to the policy of protection in certain circumstances. The arguments in favour of protection are conveniently classified into two categories namely the economic arguments and the non economic arguments.

Economic Arguments

1. The infant industry argument

A newly started industry is called an infant industry. It can never compete with a well established industry with matured entrepreneurs, experienced trend and dedicated labour force and well built infrastructure. The developing countries have infant industries. They require some time to develop the infrastructure, train the workers and inculcate the spirit of dedication to work. During this period they require protection against the well established industries of the developed countries.

This argument was made by the german economist Frederic List against the well established british industries in the post industrial revolution period. To give his quotation “Nurse the baby, Protect the child and Free the Adult”.

In practice it is difficult to find out an infant industry with high potentialities.

2. Diversification Argument

Free trade policy results into specialization of different countries in the production of different goods and services. Specialization is desirable but excessive specialization is risky. If the concerned industry faces a difficulty due to global situation or some domestic problem the entire economy of the country may be devastated. Hence it is safe to develop a number of industries even though they may have no advantage at present.

3. Anti Dumping Argument

Some countries resort to dumping. The receiving country has to protect its industries by using tariff and non tariff barriers.

4. Expediting recovery

A country facing a depression has to restrict the imports of goods from other countries. If imports are not restricted the supply of those goods in the receiving country will increase still further and the country will find it almost impossible to recover from recession.

5. Promoting Employment

If a country develops some industries under protection, they may work as catalyst agents and help in the development of several other industries and that may create employment opportunities.

6. Balance of Payments Arguments

If a country if facing a deficit in the BOP, it has to restrict imports by using tariffs or non tariffs barriers to eliminate the deficit in the BOP.

7. Retaliation Argument

If country A imposes restrictions on imports from country B, obviously country B will have to impose restrictions from imports from country A.

8. Pauper Labour Argument

This argument is made by the trade unions operating in developed countries. They maintain that the wages are lower in the developing countries, therefore the cost of production is lower and prices are lower. If the countries follow free trade policy these goods will rush into the developed economies and will increase the supplies there. A rise in supply will result in to a fall in price and fall in wages, so the wages in the developed countries will also decline. The workers will become poor.

This argument is fallacious. The wages in developing countries are low yet the cost of production is high. The quality of the goods is also inferior as compared to the quality of goods in developed countries. The developing countries hence cannot compete and beat the developed countries.

9. The key industries argument

Every country has to develop the key industries whether or not they enjoy economic advantages at present.

Non-Economic Arguments

1. Defence Industries

A country has to develop industries producing defence equipments whether they enjoy economic advantages or not. It is risky to depend upon other countries in respect of defence.

2. The Preservation Argument

Certain industries are associated with some important period in the history of a country. Those industries have got to be protected on grounds of emotions and not on grounds of economic advantage.

Arguments against Protection

In general the arguments made in support of free trade are the same as arguments made against protection but few special arguments can be mentioned here

1. Burden on the consumer

If a country restricts imports with the help of tariff or non tariff barriers the prices of the commodity rise and the consumers are put to a loss.

2. Misuse of protection

It is expected that the protected industry will spend on research, reduce the cost of production, improve the quality of the commodity and be able to compete in the world market without protection in due time. But it is possible that some industries may never try to develop if they become sure of protection for a long time.

3. Possibility of retaliation

If country A restricts the import of goods from country B, country B may pay it back in the same coin. This will result into contraction of global trade with loss of advantages of trade.

Conclusion

In general the policy of free trade is beneficial to all countries but it should be followed honestly by all countries under the supervision of some impartial agency. The WTO is expected to play that role.

27th Sep, 2008

Multinational Corporations

Explain the effects of MNS from the point of view of the developing countries.

Meaning

An MNC is a commercial concern set up in one country having its base in that country (which is called the home country) & has its operations in many other countries (Host countries).

At least 25% of the world production of that concern is raised outside the home country. The MNCs are found in the field of manufacturing commodities, producing services & in the field of trade.

The MNCs confer several benefits on the host countries. The prominent amongst them are as follow:-

1. Raising the level of investment

A developing economy is caught in vicious circle of low level investment. The National income is low, the population is large. The effect is that the per capita income is low besides a part of that income is invested in unproductive assets, such as Gold & silver; therefore the productive investment is low. The rate of economic growth is slow. Addition to national income is low. Thus, the national income shows a tendency to remain at a low level.

The MNCs are helpful in breaking this vicious circle. They inject some capital into the developing economy. This is supplementary to own investment of the developing economies. The level of investment rises, the rate of economic growth rises. Thus, the MNCs are instrumental in expanding economic growth of the developing economies.

2. Carrying modern Technologies to developing economies

In any country the production is largely determined by the technology used. A developing economy has a comparatively backward technology. It is not able to send adequate amount of money on scientific research. The level of technology is also determined by the size of the marked. In less developed countries, the market for the goods excepting necessaries, is relatively small. The turnover is small. Consequently, the producers are not able to spend on research & introduce innovations.

The MNCs have most modern technology at their disposal. They carry that technology to the developing countries. The local producers belonging to the host countries are able to learn modern technology from MNC. They can also improve their technology.

3. Balancing the Balance of Payments

In general, the developing countries are confronted with the problem of a deficit in the Balance of payment. The MNCs are helpful in curing the deficit in BoP in two ways:-

a. MNCs bring in Foreign Direct Investment (FDI) into the developing economy. This is an incoming payment which is helpful in reducing the deficit in the BoP.
b. The MNCs have a high world wide reputation. Their products have a world wide market. A developing country can export them to near by countries & earn foreign exchange. This is also helpful in balancing the BoP.

4. Work discipline

The MNCs maintain a very high level of discipline amongst workers. They take care to maintain a high level of physical fitness & motivation. The workers employed in MNCs units carry that discipline to the local work force.

5. Catalytic Agent

The MNCs set up units mostly in basic & heavy industries. They purchase raw materials in the local markets; this increases the demand for raw materials & provides an incentive to the producers of the raw materials to increase their production. The workers employed in the MNCs spend their income on goods & services; this increases the demand for several goods & services, their production is increased. Many workers are employed in their production. Thus, the total increase in employment is a multiple of the initial addition to employment in the MNC unit.

6. Benefits to consumers

The MNCs are very particular about maintaining the high standard of their products. They bring out high quality goods. They are able to sell those goods at reasonable prices. Because, they produce them on large scale, the consumers belonging to the developing countries get the benefit of high quality goods at affordable price.

Harmful Effects of MNCs on developing countries

Though MNCs confer several benefits on the developing countries, they also create some problems for them. The more prominent amongst them can be described as follow:

1. Disturbing the plan priorities

The MNCs are profit oriented. They show a strong tendency to take up the production of those commodities in which they can earn a high profit margin. They ignore the production of more important commodities if they do not give them the required profit margin. This results into the allocation of resources to the production of low priority goods. The local producers also show a tendency to enter into the low priority industries if they are more profit earning.

2 .Inappropriate technology

The MNCs are accustomed to use a particular type of technology which is suitable for conditions in developed countries. They bring that technology to the developing countries, but that technology is not suitable for the developing countries. There is excessive supply of labor in developing countries. The technology introduced by MNCs is not proper for absorbing labor. It aggravates the problem of unemployment.

3. Excessive profits

Most of the MNCs earn excessive profit by selling their products at very high prices. A large part of the profit is sent by the MNCs to their home countries. The host country has to provide foreign exchange to the MNCs to enable them to remit the profit to the Home country.

4. Discrimination in staff

Often the MNCs give a cordial treatment to their own persons & a step motherly treatment to the staff belonging to the host country. This creates discontent amongst the staff & labor.

5. Over exploitation of resources

The aim of an MNC is to maximize profit in shortest possible period. They do not care for the long run effects of their activities. They use the productive resources at a very fast rate & finish them. They do not care to renew or replace the used resources.

6. Indifference to social cost

The MNCs are not very particular about controlling the social costs like pollution or loss of life in the event of an accident. They are careless in maintaining the required safety measure.

7. Political pressure

The MNCs often use their money power for bringing pressure upon the government & political parties of the host countries. They interfere in the administration of the developing countries.

Conclusion

Balancing the pros & cons of the business of the MNCs, we have to admit that they are beneficial to the host. The possible adverse effects of their working can be controlled by suitable action.

THE POLITICAL ENVIRONMENT

The Political Conditions in the country influence business activities in different ways. They provide opportunities for the business units to achieve heir goals. At the same time the political conditions pose challenges before the business enterprises. They have to adjust themselves to the political environment and use it to their benefit.

The dimensions of political environment

In any country, the political environment is characterized by the following dimensions:

1. The nature of the polity
2. The nature of the constitution of the country
3. The political system
4. The political awareness of the people and of the government
5. The laws passed by the government

1. The nature of the polity

The political systems in the world can be broadly classified into democracies and autocracies. Under democratic policy the govt. is elected by the people and is answerable to the people for every action or failure to take an action.

In a democracy, the govt. has to take the people into confidence before taking any important decision. The experts may be in favor of a particular activity but the govt. may not be able to take up that activity if it is opposed by a large no. of the people. We have the example of, the decision of the west Bengal govt. in respect of Tata motors. The company was required to shift its plants from west Bengal to some other place, suffering a heavy loss in the shifting.

An autocracy is a state in which the govt. does depend upon the support of the people in continuation in office. The autocracy may take the form of the monarchy of the military or some other type of a dictatorship. Under this type of govt., a decision taken by the govt. can be smoothly carried out even in preface of a strong opposition from some people. In China, any economic reform can be effectively carried through, because of the nature of Chinese govt. If the govt. s convinced of th utility and importance of a business enterprises, it can be carries to its logical end even in the face of opposition from certain sections of the community.

a. Single, two and multi party states

In a single party state like China, it is easy to implement any economic reform. If the party is convinced of the importance of a particular project it can be carries through.

In a two party state, the party enjoying support of the majority gets powered. It can easily carry through any economic reform or give patronage to any project or business enterprise.

In a multi party state, there is no guarantee that any single party would enjoy the support of the majority. Often, such a country is ruled by a coalition govt. in which more than one parties come together to form a govt. Sometimes, some parties support the govt. from outside. The parties adopt a common minimum program. Those projects and enterprises which fall into the framework of the common minimum program can be carries though. But those projects which are outside the common minimum program may find it difficult to work.

2. The nature of the constitution of the country

If a country has an unwritten constitution like that of England, every law passed by the parliament is equally important. The parliament is supreme. It can do or undo things. It can help any project which gets its approval.

In a country like India having written constitution, the authority of the parliament is limited to the clauses of the constitution. If a particular law passed by the parliament or a particular order issued by the executive is contradictory to any provision of the constitution, it can not be put into practice. Thus, the authority of the parliament to help business or to stop a particular business is limited by a provision of the constitution.

29 Sep 2008

Unitary or Federal Constitution

Under, unitary constitution or powers are concentrated in the hands for one central govt. There might be other administrative units but they derive their authority from the central govt. They do not have any independent powers.

Under a federal constitution, the powers of the govt. are divided between the central govt. and the state govts. The sources of income including taxes are also divided between the central govt. and the state govts. In India, the income tax on individuals and the corporation tax are with the central govt. whereas the sales tax and the excise duty on alcohol are with the state govt.

India has a federal constitution. It is possible that a particular project may be approved by the central govt. but they may not be implemented if it has an objection from the state govt. concerned. The business enterprises have also to take into consideration the tax structure of different states while selecting their location in a particular state. Different states may try to attract business activities to them by providing different incentives; this is beneficial to business enterprises because they can get maximum advantages because of the competition amongst the state govt. for attracting business units to them.

The India Constitution guarantees justiciable and non-justiciable rights to the people. The fundamental rights are justiciable whereas the rights incorporated in chapter 4 are non-justiciable. Any citizen can establish his fundamental rights by taking the help of the court of justice.

1. The Political System

India has a representative democracy based on adult franchise. All individuals who have completed the age of 18 years have a right to vote irrespective of their educational standards, income, possession of wealth, occupation etc. The govt. ahs to take into consideration the type of political system while taking any decision. A decision which may appear to be economically sound may not be taken if it has a strong opposition from the people. The population is divided into different groups on grounds of religion, sects, caste etc. Certain decisions may be opposed on religious grounds.

2. The political awareness of the people and the govt.

If the people have a high sense of awareness, the govt. is more responsive to the wishes of the people. n the other hand if the people are passive and indifferent, the govt. looses its democratic character. People having personality cult and a blind faith in certain things are not able to bring into practice the spirit of democracy. The people should be aware of their rights and also of their duties in the smooth functioning of a democracy.

3. The laws passed by the govt.

In any modern state, the will of the people is expressed in the form of laws passed by the legislature. The executive is bound by the laws and individuals are an d institutions can be penalized only under the provisions of a law.

The constitution of the country is described as the law of laws. Any law which is contradictory to the constitution can be repealed.

In India, several laws have been passed for regulating business enterprises. Some prominent amongst them are the companies act which regulates the formation and management of joint stock companies and gives protection to the investors. The factories act regulates the working conditions in the factories. The workers remuneration is regulated by several acts such as the minimum wages act and the payment of bonus act. The industrial disputes act sets up machinery for resolving the disputes between management and workers. The competition act 2002 tries to protect and foster competition which is helpful to progress. The monopolies and restrictive trade practices act tries to control the growth of monopolies and prevent the use of restrictive trade practices. The foreign exchange management act regulates the buying and selling and possession of foreign exchange by individuals and foreign exchange dealers. Any business enterprise has to work within the legal framework set up by the state.

4th Oct 08

Responsibilities of business towards the government

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

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

1. To obey Laws

The laws reflect the wishes of the community, they show what the community wants the member to do and what the community wants the member to avoid. The laws control the behavior of the individuals with each other and with the community.

If business obeys laws the society can function smoothly and business can prosper only when the society is functioning smoothly but if laws are oppressive or obstructing the path of business, they can be opposed in constitutional manner. The business can take the help of constitution or the judiciary to oppose the laws and get them repealed. The maharashtra government banned the sale of gutkha in maharashtra state. The producers of gutkha approached the court which repealed the order of the government of maharashtra on the ground that tobacco is in the jurisdiction of the central government.

2. Payment of taxes

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

3. Social responsibility

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

4. Providing inputs to the government

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

5. Government Contracts

The government has to take up several works such as construction of roads, bridges, flyovers, airports etc. Sometimes these works are undertaken by the government departments but a more common method of undertaking that work is to invite tenders and give contracts to business. It is the responsibility of the business to complete the work in time and maintain a high level of quality of the work. A huge project like the sewi – nhava seva sealink can be conveniently undertaken with the help of business.

6. Government Services

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

7. Active participation in politics

Sometimes the businessmen try to participate actively in politics. A member of the TATA family contested election to the lok sabha. Sometimes the leaders of the business are nominated to the Rajya Sabha so that the government gets the benefit of their practical experience of that field, but often the businessmen try to keep themselves away from active politics.

Government Responsibility towards Business

As the business has to discharge certain responsibilities towards the government, similarly the government has to discharge several responsibilities towards the business. Government is the most powerful and sovereign authority in the country. It can do or undo anything. The government can use that power to regulate and to stimulate business.

In particular the responsibilities of the government towards business can be described as follows:

1. To pass and execute proper laws

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

In India the government has passed several laws such as Companies Regulation Act, The factory Act, The labour Laws, the social security laws, the foreign exchange management act etc.

Though passing of proper laws is important, an efficient implementation of the law is more important. If a good law is implemented in a bad way it produces harmful effects. It encourages dishonesty on the part of the people.

2. Maintenance of law and order

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

3. Providing Money and Credit

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

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

4. Building Infrastructure

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

5. Basic Research

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

A: Basic research is not profit oriented, hence it is the responsibility of the government to conduct it and provide foundation for the commercial research.

B: Commercial research is profit oriented; the business undertakes commercial research by using the basic research as the foundation. The government can give incentive to commercial research by providing fiscal concessions and monetary incentives.

6. Providing information

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

7. Controlling the growth of monopolies and preserving competition

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

8. Reservation of fields of production

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

9. Awarding patent rights and copy rights

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

10. Protections

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

Conclusion

The success and progress of business depend upon perfect understanding and co-operation between government and business.

11th Oct 08

Budget

Meaning

Budget is a financial statement incorporating the income and expenditure of a public authority for one financial year. In India the central government, state government, local self governments and even autonomous institutions like universities prepare and present their own budgets.

The procedure for passing the budget

Budget is prepared by the finance department and is presented to the legislature by the finance minister. It is discussed and passed by the legislature.

The budget contains two parts:
Part A – Speech of the finance minister giving economic survey of the country, which serves as a background against which the budget is presented.

Part B – Tax proposals. The taxes are of two types; Direct & Indirect taxes.

The finance bill which is attached to the budget contains tax proposals. Government is empowered to impose and collect a tax only after the finance bill is passed by the parliament, but that does not allow the government to use that money. The money collected through taxed is credited in to the Consolidated Fund of India. The government has to introduce another bill called the appropriation bill in parliament. Government is authorised to withdraw money from the consolidated fund of India and use it only when the appropriation bill is passed by Parliament.

Importance of the budget

Though budget is a financial statement incorporating the income and expenditure of the government, it has wide effects on the economy of the country. The budget is an instrument which can be used for controlling production of goods and services, distribution of income and wealth amongst different sections of the community, controlling internal and foreign trade, giving protection to the domestic industries and accelerating the rate of economic development. The budget is like a weapon which can be used for removing the obstacles in the path of economic development and expediting the pace of economic development. Hence a modern budget is regarded as reflection of the mind of the government in respect of the economic and social problems confronting the country and the possible solutions to them.

Parts of the Budget

A budget is divided in to two parts namely income and expenditure. Both of them are further classified into two categories:

Receipts

1. Revenue Receipts

They refer to the money collected through taxes, profits of public undertakings, gifts and donations to the government, fines and special assessments. The peculiar feature of the revenue receipts is that they are not refundable to the payers so they do not create any liability on the part of the government.

2. Capital Receipts

They refer to money collected by the government through public borrowings, money deposited by the public with the government, post office saving deposits, small savings of the people, provident funds collected from the salaries of the employees etc. the peculiar feature of these receipts is that they are refundable. They create a liability on the part of the government.

Expenditure

1. Revenue Expenditure

This refers to expenditure on civil and military administration, salaries paid to the employees, stationery movement of government employees, maintenance of the members of the government, conducting elections etc. The peculiar feature of this expenditure is that it does not create any productive assets i.e. it does not help directly in increasing the productivity of the economy.

2. Capital expenditure

This refers to expenditure incurred on construction of roads, railways, bridges, dams, power houses etc. this expenditure builds productive assets which are helpful in increasing the production of goods and services in the future.

The government of India also divides expenditure in to plan expenditure and non plan expenditure, so we have four categories of expenditure namely Plan revenue Expenditure, Plan capital expenditure, Non Plan revenue expenditure and non plan capital expenditure.

The revenue expenditure is also called non productive and the capital expenditure is also called productive expenditure.

Types of Budget Deficits

A budget deficit is a situation in which the expenditure of the government is in excess of the income. The deficits are further classified into four categories

1. Revenue Deficit

This is the excess of revenue expenditure over revenue receipts. It is shown by the following formula:

RD = RE-RR

Where RD = revenue deficit, RE = revenue expenditure and RR = revenue receipts.

The revenue deficit is covered by the government by transferring some amount from capital receipts to revenue receipts.

2. Budget Deficits

This is the excess of total expenditure of the government (revenue expenditure + capital expenditure) over total receipts (revenue receipts + capital receipts). This is shown by the following equation

B D = Total Expenditure – Total Receipts

= (Revenue Expenditure + Capital Expenditure) – (Revenue Receipts + Capital Receipts)

The budget deficit is covered by the government by resorting to deficit financing i.e. additional paper currency through the Reserve Bank of India. Deficit financing causes inflation hence budget deficit is to be avoided as far as possible.

3. Fiscal Deficit

This refers to the excess of total expenditure of the government over total receipts excepting public borrowings in that year. It is shown in the following equation.

Fiscal Deficit = Total Expenditure – Total Receipts excepting borrowings.

FD = (Rev Exp + Cap Exp) – {Rev Rec + (Cap Rec – public borrowings)}

If the public borrowings are added to the capital receipts, the fiscal deficit will become NIL. Therefore the fiscal deficit is equal to public borrowings.

4. Primary Deficit

This is arrived at by deducting the interest payments on government loans from the fiscal deficit. This is given by the following formula:

Primary Deficit = Fiscal Deficit – Interest Payments

Conclusion

In normal circumstances a budget deficit is something to be avoided. A marginal deficit is manageable but excessive and persistent deficits are harmful, hence the parliament has passed the Fiscal Responsibility and Budget Management (FRBM) Act in 2003.