# GENERAL ECONOMICS –II

***COMPLEMENTARY COURSE***

BA HISTORY/BA POLITICAL SCIENCE

III SEMESTER

(2011 Admission)

## UNIVERSITY OF CALICUT

### SCHOOL OF DISTANCE EDUCATION

Calicut University P.O. Malappuram, Kerala, India 673 635

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## SCHOOL OF DISTANCE EDUCATION

## GENERAL ECONOMICS-II

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| CONTENTS | PAGE |
|---|---|
| MODULE I | 5 |
| MODULE II | 19 |
| MODULE III | 27 |
| MODULE IV | 44 |
| MODULE V | 52 |
| MODULE VI | 71 |
| MODULE VII | 91 |
| MODULE VIII | 104 |

# Module I
# MONEY

Definition and functions of money, demand for and supply of money, Fischer's Quantity Theory of money, Inflation and deflation

## Introduction

The word 'money' is derived from the Latin word 'Moneta' which was the surname of the Roman Goddess of Juno in whose temple at Rome, money was coined. The origin of money is lost in antiquity. Even the primitive man had some sort of money. The type of money in every age depended on the nature of its livelihood. In a hunting society, the skins of wild animals were used as money. The pastoral society used livestock, whereas the agricultural society used grains and foodstuffs as money. The Greeks used coins as money.

## Stages in the evolution of money

The evolution of money has passed through the following five stages depending upon the progress of human civilization at different times and places.

### 1. Commodity money

Various types of commodities have been used as money from the beginning of human civilization. Stones, spears, skins, bows and arrows, and axes were used as money in the hunting society. The pastoral society used cattle as money. The agricultural society used grains as money. The Romans used cattle and salt as money at different times. The Mongolians used squirrel skins as money. Precious stones, tobacco, tea shells, fishhooks and many other commodities served as money depending upon time, place and economic standard of the society.

The use of commodities as money had the following defects.

- All the commodities were not uniform in quality, such as cattle, grains, etc. Thus lack of standardization made pricing difficult.
- It is difficult to store and prevent loss of value in the case of perishable commodities.
- Supplies of such commodities were uncertain.
- They lacked in portability and hence were difficult to transfer from one place to another.
- There was the problem of indivisibility in the case of such commodities as cattle.

### 2. Metallic money

With the spread of civilization and trade relations by land and sea, metallic money took the place of commodity money. Many nations started using silver, gold, copper, tin, etc. as money. But metal was an inconvenient thing to accept, weigh, divide and assess in quality. Accordingly, metal was made into coins of predetermined weight. This innovation is attributed to King Midas of Lydia in the eighth century B C. But gold coins were used in India many centuries earlier than in Lydia. Thus coins came to be accepted as convenient method of exchange.

As the price of gold began to rise, gold coins were melted in order to earn more by selling them as metal. This led governments to mix copper or silver in gold coins since their intrinsic value might be more than their face value. As gold became dearer and scarce, silver coins were used, first in their pure form and later on mixed with alloy or some other metal.

But metallic money had the following limitations.

(i) It was not possible to change its supply according to the requirements of the nation both for internal and external use.
(ii) Being heavy, it was not possible to carry large sums of money in the form of coins from one place to another by merchants.
(iii) It was unsafe and inconvenient to carry precious metals for trade purposes over long distances.
(iv) Metallic money was very expensive because the use of coins led to their debasement and their minting and exchange at the mint cost a lot to the government.

**3.Paper money**

The development of paper money started with goldsmiths who kept strong safes to store their gold. As goldsmiths were thought to be honest merchants, people started keeping their gold with them for safe custody. In return, the goldsmiths gave the depositors a receipt promising to return the gold on demand. These receipts of the goldsmiths were given to the sellers of commodities by the buyers. Thus receipts of the goldsmith were a substitute for money. Such paper money was backed by gold and was convertible on demand into gold. This ultimately led to the development of bank notes.

The bank notes are issued by the central bank of the country. As the demand for gold and silver increased with the rise in their prices, the convertibility of bank notes into gold and silver was gradually given up during the beginning and after the First World War in all the countries of the world. Since then the bank money has ceased to be representative money and is simply 'fiat money' which is inconvertible and is accepted as money because it is backed by law.

**4. Credit money**

Another stage in the evolution of money in the modern world is the use of the cheque as money. The cheque is like a bank note in that it performs the same function. It is a means of transferring money or obligations from one person to another. But a cheque is different from a bank note. A cheque is made for a specific sum, and it expires with a single transaction. A cheque is not money. It is simply a written order to transfer money. However, large transactions are made through cheques these days and bank notes are used only for small transactions.

**5. Near money**

The final stage in the evolution of money has been the use of bills of exchange, treasury bills, bonds, debentures, savings certificates, etc. They are known as 'near money'. They are close substitutes for money and are liquid assets. Thus, in the final stage of its evolution money became intangible. Its' ownership in now transferable simply by book entry.

**Definition of Money**

It is very difficult to give a precise definition of money. Various authors have given different definition of money. According to Crowther, "Money can be defined as anything that is generally acceptable as a means of exchange and that at the same time acts as a measure and a store of value". Professor D H Robertson defines money as "anything which is widely accepted in payment for goods or in discharge of other kinds of business obligations.

From the above two definitions of money two important things about money can be noted. Firstly, money has been defined in terms of the functions it performs. That is why some economists defined money as "money is what money does". It implies that money is anything which performs the functions of money. Secondly, an essential requirement of any kind of money

is that it must be generally acceptable to every member of the society. Money has a value for ‘A’ only when he thinks that ‘B’ will accept it in exchange for the goods. And money is useful for ‘B’ only when he is confident that ‘C’ will accept it in settlement of debts. But the general acceptability is not the physical quality possessed by the good. General acceptability is a social phenomenon and is conferred upon a good when the society by law or convention adopts it as a medium of exchange.

## Functions of Money

The major functions of money can be classified into three. They are: The primary functions, secondary functions and contingent functions.

### I. Primary functions of money

The primary functions of money are;

- Medium of exchange and
- Measure of value

#### (i) Medium of exchange

The most important function of money is that it serves as a medium of exchange. In the barter economy commodities were exchanged for commodities. But it had experienced many difficulties with regard to the exchange of goods and services. To undertake exchange, barter economy required ‘double coincidence of wants’. Money has removed this problem. Now a person A can sell his goods to B for money and then he can use that money to buy the goods he wants from others who have these goods. As long as money is generally acceptable, there will be no difficulty in the process of exchange. By serving a very convenient medium of exchange money has made possible the complex division of labour or specialization in the modern economic organization.

#### (ii) Measure of value

Another important function of money is that the money serves as a common measure of value or a unit of account. Under barter system there was no common measure of value and the value of different goods were measured and compared with each other. Money has solved this difficulty and serves as a yardstick for measuring the value of goods and services. As the value of all goods and services are measured in terms of money, their relative values can be easily compared.

### II. Secondary functions

The secondary functions of money are;

#### (i) Standard of deferred payments

Another important function of money is that it serves as a standard for deferred payments. Deferred payments are those payments which are to be made in future. If a loan is taken today, it would be paid back after a period of time. The amount of loan is measured in terms of money and it is paid back in money. A large amount of credit transactions involving huge future payments are made daily. Money performs this function of standard of deferred payments because its value remains more or less stable. When the price changes the value of money also changes. For instance, when the prices are falling, value of money will rise. As a result, the creditors will gain in real terms and the debtors will lose. Conversely, when the prices are rising (or, value of money is falling) creditors will be the losers. Thus if the money is to serve as a fair and correct standard of deferred payments, its value must remain stable. Thus when there is severe inflation or deflation, money ceases to serve as a standard of deferred payments.

**(ii) Store of value**

Money acts as a store of value. Money being the most liquid of all assets is a convenient form in which to store wealth. Thus money is used to store wealth without causing deterioration or wastage. In the past gold was popular as a money material. Gold could be kept safely without deterioration.

Of course, there are other assets like houses, factories, bonds, shares, etc., in which wealth can be stored. But money performs as a different thing to store the value. Money being the most liquid of all assets has the advantage that an individual or a firm can buy with it anything at any time. But this is not the case with other assets. Other assets like buildings, shares, etc., have to be sold first and converted into money and only then they can be used to buy other things. Money would perform the store of value function properly if it remains stable in value.

In short, money has removed the difficulties of barter system, namely, lack of double coincidence of wants, lack of division and lack of measure and store of value and lack of a standard of deferred payment. It has facilitated trade and has made possible the complex division of labour and specialization of the modern economic system.

**III. Contingent functions**

The important contingent functions of money are;

**(i) Basis of credit**

It is with the development of money market the credit market began to flourish.

**(ii) Distribution of national income**

Being a common measure of value, money serves as the best medium to distribute the national income among the four factors of production.

**(iii) Transfer of value**

Money helps to transfer value from one place to another.

**(iv) Medium of compensations**

Accidents and carelessness cause damage to the property and life. Compensation can be paid to such damages in terms of money.

**(v) Liquidity**

Liquidity means the ready purchasing power or convertibility of money in to any commodity. Money is the most liquid form of all assets.

**(vi) Money guide in production and consumption.**

Utility of goods and services can be expressed in terms of money. Similarly, marginal productivity is measured in terms of prices of goods and factors. Thus money become the base of measurement and which directs the production and consumption.

**(vii) Guarantor of solvency**

Solvency refers to the ability to pay off debt. Persons and firms have to be solvent while doing the business. The deposits of money serves as the best guarantor of solvency.

## Forms of money

### Money of account

Money of account is the monetary unit in terms of which the accounts of a country are kept and transactions settled, ie., in which general purchasing power, debts and prices are expressed. The rupee is, for instance, our money of account. sterling is the money of account if Great Britain and

mark that of Germany. Money of account need not, however, be actually circulating in the country. During 1922-24 the mark in Germany depreciated in such an extent that it ceased to be the money of account.

**Limited and unlimited legal tender**

*Money which has legal sanction is called legal tender money*. So its acceptance is compulsory. It is an offence to refuse to accept payment in legal tender money. Thus a legal tender currency is one in terms of which debts can be legally paid. *A currency is unlimited legal tender when debts upon any amount can be paid through it. It is limited legal tender when payments only up to a given limit can be made by means of it*. For example, rupee coins and rupee notes are unlimited legal tender in India. Any amount of transaction can be made by using them. But coins of lower amounts like 25 or 50 paisa are only limited legal tender (up to Rs.25/-). One can refuse to receive beyond this amount.

When a coin is worn out and become light beyond a certain limit, then it ceases to be a legal tender. When one rupee and half-rupee coins are more than 20% below the standard weight they are no longer legal tender.

**Standard money**

Standard money is one in which the value of goods as well as all other forms of money are measured. In India prices of all goods are measured in terms of rupees. Moreover, the other forms of money such as half-rupee notes, one rupee notes, two rupee notes, five rupee notes etc. are expressed in terms of rupees. Thus rupee is the standard money of India.

Standard money is always made the unlimited legal tender money. In old days the standard money was a ***full-bodied money***. That is its face value is equal to its intrinsic value (metal value). But now-a-days in almost all countries of the world, even the standard money is only a ***token money***. That is, the real worth of the material contained in it is very much less than the face value written in it.

**Token money**

Token money is a form of money in which the metallic value of which is much less than its real value (or face value). Rupees and all other coins in India are all token money.

**Bank money**

Demand deposits of banks are usually called bank money. Bank deposits are created when somebody deposits money with them. Banks also creates deposits when they advance loans to the businessmen and traders. These demand deposits are the important constituent of the money supply in the country.

It is important to note that bank deposits are generally divided into two categories: demand deposits and time deposits. Demand deposits are those deposits which are payable on demand through cheques and without any serving prior notice to the banks. On the other hand, time deposits are those deposits which have a fixed term of maturity and are not withdrawable on demand and also cheques cannot be drawn on them. Clearly, it is only demand deposits which serve as a medium of exchange, for they can be transferred from one person to another through drawing a cheque on them as and when desired by them. However, since time or fixed deposits can be withdrawn by forgoing some interest and can be used for making payments, they are included in the concept of broad money, generally called M3.

## Demand for money

Why people have demand for money to hold is an important issue in macroeconomics. The level of demand for money not only determines the rate of interest but also the level of prices and national income of the economy. The demand for money arises from two important functions of money. The first is that money acts as a medium of exchange and the second is that it is a store of value. Thus individuals and businesses wish to hold money partly in cash and partly in the form of assets.

What determines the changes in demand for money is a major issue. There are two views. The first is the 'scale' view which is related to the impact of the income or wealth levels upon the demand for money. The demand for money is directly related to the income level. The higher the income level, the greater will be the demand for money.

The second is the 'substitution' view which is related to relative attractiveness of assets that can be substituted for money. According to this view, when alternative assets like bonds become unattractive due to fall in interest rates, people prefer to keep their assets in cash, and the demand for money increases, and vice versa. The scale and substitution view combined together have been used to explain the nature of the demand for money which has been split into the transactions demand, the precautionary demand and the speculative demand.

Classical economists considered money as simply a means of payment or medium of exchange. In the classical model, people, therefore, demand money in order to make payments for their purchases of goods and services. In other words, they want to keep money for transaction purposes.

On the other hand J M Keynes also laid stress on the store of value function of money. According to him, money is an asset and people want to hold it so as to take advantage of changes in the price of this asset, that is, the rate of interest. Therefore Keynes emphasized another motive for holding money which he called speculative motive. Under speculative motive, people demand to hold money balances to take advantage from the future changes in the rate of interest or what means the same thing from the future changes in bond prices.

An essential point to be noted about people's demand for money is that what people want is not 'nominal money' holdings, but 'real money balances'. This means that people are interested in the purchasing power of their money balances, that is, the value of money balances In terms of goods and services which they could buy. Thus people would not be interested in merely nominal money holdings irrespective of the price level, that is, the number of rupee notes and the bank deposits. If with the doubling of price level, nominal money holdings are also doubled, their real money balances would remain the same. If people are merely concerned with nominal money holdings irrespective of price level, they are said to suffer from 'money illusion'.

The demand for money has been a subject of lively debate in economics because of the fact that monetary demand plays an important role in the determination of the price level, interest and income. Till recently, there were three approaches to demand for money, namely, transaction approach of Fisher, cash balance approach of Cambridge economics, Marshall and Pigou and Keynes theory of demand for money. However, in recent years, Baumol, Tobin and Friedman have put forward new theories of demand for money.

## The Supply of Money

The supply of money is a stock at a particular point of time, though it conveys the idea of a flow over time. The supply of money at any moment is the total amount of money in the economy.

There are three alternative views regarding the definitions or measures of money supply. The most common view is associated with the traditional and Keynesian thinking which stresses the medium of exchange function of money. According to this view, money supply is defined as currency with the public and demand deposits with the commercial banks. Demand deposits are savings and current accounts of depositors in a commercial bank. They are the liquid form of money because depositors can draw cheques for any amount lying in their accounts and the bank has to make immediate payment on demand. Demand deposits with the commercial bank plus currency with the public are together denoted as $M_1$ , the money supply. This is regarded as the narrower definition of the money supply.

The second definition is broader and is associated with the modern quantity theorists headed by Friedman. Prof. Friedman defines the money supply at any moment of time as "literally the number of dollars people are carrying around in their pockets, the number of dollars they have to their credit at banks or dollars they have to their credit at banks in the form of demand deposits, and also commercial bank time deposits". Time deposits are fixed deposits of customers in a commercial bank. Such deposits earn a fixed rate of interest varying with the time period for which the amount is deposited. Money can be withdrawn before the expiry of that period by paying a penal rate of interest to the bank. So time deposits posse liquidity and are included in the money supply by Friedman. Thus the definition includes $M_1$ plus time deposits of commercial banks in the supply of money. This wider definition is termed as $M_2$ in America and $M_3$ in Britain and India. It stresses the store of value function of money.

The third function is the broadest and is associated with Gurley and Shaw. They include in the money supply, $M_2$ plus deposits of saving banks, building societies, loan associations, and deposits of other credit and financial institutions.

**Measures of Money Supply in India**

There are four measures of money supply in India which are denoted by $M_1$, $M_2$, $M_3$, and $M_4$. This classification was introduced by Reserve Bank of India (RBI) in April, 1977. Prior to this till March, 1968, the RBI published only one measure of money supply, M or $M_1$ which is defined as currency and demand deposits with the public. This was in keeping with the traditional and Keynesian views of the narrow measure of money supply.

From April, 1968 the RBI also started publishing another measure of the money supply which is called Aggregate Monetary Resources (AMR). This included $M_1$ plus time deposits of banks held by the public. This was a broad measure of money supply which was in line with Friedman's view.

Since April, 1977, the RBI has been publishing data on four measures of the money supply which are cited below;

1) **$M_1$** – The first measure of money supply $M_1$ consists of:
    - Currency with the public which includes notes and coins of all denominations in circulation excluding cash in hand with banks;
    - Demand deposits with commercial and co-operative banks, excluding inter-bank deposits; and
    - 'Other deposits' with RBI which include current deposits of foreign central banks, financial institutions and quasi-financial institutions such as IDBI, IFCI, etc. RBI characterizes $M_1$ as narrow money.

2) **$M_2$** – The second measure of money supply $M_2$ consists of $M_1$ plus post office savings bank deposits. Since savings bank deposits commercial and co-operative banks are included in the money supply, it is essential to include post office saving bank deposits. The majority of people in rural and urban have preference or post office deposits from the safety viewpoint than bank deposits.
3) **$M_3$** – The third measure of money supply in India $M_3$ consists of $M_1$ plus time deposits with commercial and cooperative banks, excluding interbank time deposits. The RBI calls $M_3$ as broad money.
4) **$M_4$** – The fourth measure of money supply $M_4$ consists of $M_3$ plus total post office deposits comprising time deposits and demand deposits as well. This is the broadest measure of money supply.

   Of the four inter-related money supply for which the RBI publishes data, it is M3 which is of special significance. It is $M_3$ which is taken into account in formulating macroeconomic objectives of the economy every year.

**FISHER'S QUANTITY THEORY OF MONEY: THE CASH TRANSACTIONS APPROACH**

The Quantity Theory of Money states that the quantity of money is the main determinant of the price level or the value of money. Any change in the quantity of money produces an exactly proportionate change in the price level. According to Fisher, "other things remaining the same, as the quantity of money in circulation increases, the price level also increases in direct proportion and the value of money decreases and vice versa". If the quantity of money doubled, the price level also double and the value of money will be one half. On the other hand, if the quantity of money is reduced by one half, the price level will also be reduced by one half and the value of money will be twice.

Fisher has explained his theory in terms of his equation of exchange:

$$MV = PT$$

Where, M=the quantity of money in circulation

V = transactions velocity of circulation

P = average price level.

T = the total number of transactions.

According to Fisher, the nominal quantity of money M is fixed by the Central Bank of the country and is therefore treated as an exogenous variable which is assumed to be given quantity in a particular period of time. Further, the number of transactions in a period is a function of national income; the greater the national income, the larger the number of transactions required to be made. Since Fisher assumed full-employment of resources prevailed in the economy, the volume of transactions T is fixed in the short run.

Fischer extended the equation by including the credit money. That is;

$$PT = MV + M^I V^I$$

Where, $M^I$ = total quantity of credit money

$V^I$ = the velocity of circulation of credit money

This equation equates the demand for money (PT) to the supply of money ($MV + M^I V^I$). The total volume transactions multiplied by the price level represents the demand for money. According to Fischer, PT = ∑PQ. In other words, price level (P) multiplied by quantity bought (Q) by the community (∑) gives the total demand for money. This equals the total supply of money in the community consisting of the quantity of total money M and its velocity of circulation V plus the quantity of credit money $M^I$ and its velocity of circulation $V^I$. Thus total value of purchases (PT) in a year is measured by $MV + M^I V^I$. Thus equation of exchange is $PT = MV + M^I V^I$. In order to find out the effect of the quantity of money on the price level, or the value of money, we write the equation as;

$$P = \frac{MV + MIVI}{T}$$

Fisher points out that the price level (P) varies directly with the quantity of money ($M+M^I$), provided the volume of trade (T) and velocity of circulation ($V, V^I$) remain unchanged. This implies that if M and $M^I$ doubled, while V, $V^I$ and T remain constant, P is also doubled, but the value of money (1/P) is reduced to half.

**Criticisms of the theory**

Fischer's quantity theory of money has been subjected to the following criticisms.

1. **Truism.** According to Keynes, "the quantity theory of money is a truism". Because, it states that the total quantity of money paid for goods and services ($MV + M^I V^I$) must equals their value (PT). But it cannot be accepted today that a certain percentage change in the quantity of money leads to the same percentage change in the price level.
2. **Other things not equal.** The assumption of 'other things remaining the same' is not real. In real life, V, $V^I$ and T are not constant. Moreover, they are not independent of M, $M^I$ and P.
3. **Constants relate to different time.** Prof. Halm criticizes Fisher for multiplying M and V because M relates to a point of time and V to a period of time. The former is a static concept ant the latter is a dynamic concept. Therefore, it is technically inconsistent to multiply these two non-comparable factors.
4. **Fails to measure value of money.** Fisher's equation does not measure the purchasing power of money but only cash transactions, that is, the volume of business transactions of all kinds or what Fisher calls the volume of trade in the community during a year. But value of money relates to transactions for the purchase of goods and services for consumption. Thus the theory fails to measure the value of money.
5. **Weak theory.** According to Crowther, the quantity theory is weak in many respects. First, it cannot explain 'why' there are fluctuations in the price level in the short run. Second, it gives undue importance to the price level as if changes in prices were the most critical and important phenomenon of the economic system. Third, it places a misleading emphasis on the quantity of money as the principal cause of changes in the price level during the trade cycle. Prices may not rise despite increase in the quantity of money during depression; and they may not decline with reduction in the quantity of money during boom. Further, low prices during depression are not caused by shortage of quantity of money, and high prices during prosperity are not caused by abundance of quantity of money.
6. **Neglects interest rate.** One of the main weaknesses of Fisher's quantity theory on money is that it neglects the role of the rate of interest as one of the causative factors between money

and prices. Fisher's equation of exchange is related to an equilibrium situation in which rate of interest is independent of the quantity of money.

## INFLATION AND DEFLATION

### I. Meaning of Inflation

Inflation is a highly controversial term. By inflation we mean a general rise in prices. More precisely, inflation is a persistent rise in the general price level rather than a once-for-all rise in it. It was first defined by neo-classical economists. They meant by it a galloping rise in prices as a result of the excessive increase in the quantity of money.

To the neo-classical and their followers at the University of Chicago, inflation is fundamentally a monetary phenomenon. In the words of Friedman, "*Inflation is always and everywhere a monetary phenomenon and can be produced only by a morse rapid increase in the quantity of money than output*". Coulborn defines inflation as "too much money chasing too few goods." But many economists do not agree that money supply alone is the cause of inflation. As pointed out by Hicks, 'Our present troubles are not of a monetary character'. Economists, therefore, define inflation in terms of a continuous rise in prices. Johnson defines "inflation as a sustained rise in prices". Brooman defines it as "a continuing increase in the general price level". According to Crowther, inflation is a "state in which the value of money is falling, ie. the prices are rising."

### Types of Inflation

Inflation is of various types. We can discuss some of its important types.

**1. Creeping Inflation.**

When the rise in prices is very slow like that of a snail or creeper, it is called creeping inflation. In terms of speed, a sustained rise in prices of annual increase of less than 3 percent per annum is characterized as creeping inflation. Such an increase in prices is regarded as safe and essential for growth.

**2. Walking or Trotting Inflation**

When prices rise moderately and the annual inflation rate is a single digit such an inflation is called walking inflation. In other words, the rate of rise in prices is in the intermediate range of 3 to 6 per cent per annum or less than 10 per cent. Inflation at this rate is a warning signal for the government to control it before it turns into running inflation.

**3. Running Inflation**

When prices rise rapidly like the running of a horse at a rate or speed of 10 to 20 per cent per annum, it is called running inflation. Such an inflation affects the poor and middle classes adversely. Its control requires strong monetary and fiscal measures, otherwise, it leads to hyper-inflation.

**4. Hyper Inflation**

When prices rise very fast at double or triple digit rates from more than 20 to 100 per cent per annum or more, it is usually called 'runway or galloping inflation. It is also characterized as hyperinflation. In reality, hyperinflation is a situation when the rate of inflation becomes immeasurable and absolutely uncontrollable. Prices rise many times every day. Such a situation

brings a total collapse of the monetary system because of the continuous fall in the purchasing power of money.

**5. Semi-inflation**

According to Keynes, so long as there is unemployed resources the general price level would not rise as output increases. But a large increase in aggregate expenditure will face shortages of supplies of some factors which may not be substitutable. This may lead to increase in costs, and prices starts rising. This is known as semi-inflation or bottleneck inflation because of the bottlenecks in the supplies of some factors.

**6. True inflation**

According to Keynes, when the economy reaches the level of full employment, any increase in aggregate expenditure will lead to rise in the price level in the same proportion. This is because it is not possible to increase the supply of factors of production and hence of output after the level of full employment. This is called true inflation.

**7. Open inflation**

Inflation is open when 'markets for goods or factors of production are allowed to function freely, setting prices of goods and factors without normal interference by the authorities.' Thus open inflation is as a result of uninterrupted operation of the market mechanism. There are no controls on the distribution of commodities by the government. Unchecked open inflation may leads to hyper inflation.

**8. Suppressed inflation**

When the government imposes physical and monetary controls to check inflation, it is known as suppressed or repressed inflation. The market mechanism is not allowed to function normally by the use of licensing, price controls and rationing in order to suppress the expensive rise in prices. So long as such controls exist, the present demand is postponed and there is diversion of demand from controlled to uncontrolled commodities.

9. **Stagflation**

Stagflation is a new term which has been added to economic literature in the 1970s. It is a paradoxical phenomenon where the economy experiences stagnation as well as inflation. The word stagflation is the combination of 'stag' plus 'flation' taking 'stag' from stagnation and 'flation' from inflation. Stagflation is a situation when recession is accompanied by a high rate of inflation. It is, therefore, also called inflationary recession. The principal cause of this phenomenon has been excessive demand in the commodity markets thereby causing prices to rise, and at the same time the demand for labour is deficient thereby creating unemployment in the economy.

Three factors responsible for the existence of stagflation in the advanced countries since, 1970 are;

a. rise in oil prices and other commodity prices along with adverse changes in the terms of trade;
b. the steady and sustained growth of the labour force; and c) rigidities in the wage structure due to strong trade unions.

10. **Mark-up inflation**

The concept of mark-up inflation is closely related to the price-push problem. Modern labour organizations possess substantial monopoly power. They, therefore, set prices and wages on the basis of mark up over costs and relative incomes. Firms possessing monopoly power have control over the prices charged by them. So they have administered prices which increase their profit margin. This leads to an inflationary rise in prices.

11. **Ratchet inflation**

A ratchet is a toothed wheel provided with a catch that prevents the ratchet wheel from moving backward. The same is the case under ratchet inflation when despite downward pressures in the economy, prices do not fall. In an economy when aggregate demand falls below full employment level due to the deficiency of demand in some sectors of the economy the price level do not fall. It is because the wage, cost and price structure are inflexible downward. Large business firms and labour organizations possess monopoly power. Consequently, the fall in the demand may not lower prices significantly. In such a situation prices will have an upward ratchet effect and this is termed as "ratchet inflation".

12. **Sectoral inflation**

Sectoral inflation arises when there is excess demand in certain sectors. It leads to a rise in prices in other sectors also.

13. **Reflation**

It is a situation when prices are raised deliberately in order to encourage economic activity. When the economy phases depression the monetary authority adopts measures to put more money in circulation. This leads to rise in prices which is called as 'reflation'

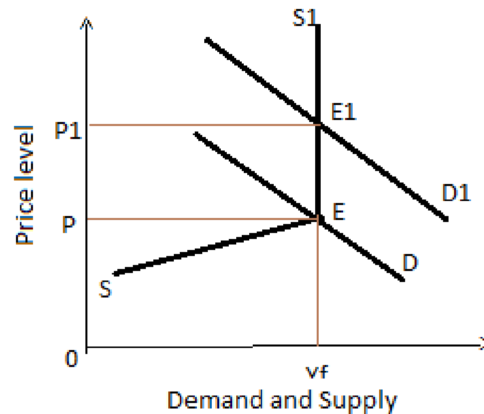
Inflation can also be classified into two broad categories: demand-pull inflation and cost push inflation.

## 1. DEMAND PULL INFLATION

Demand pull inflation is a situation where price rises due to the excess demand in the economy. In this sense, inflation is defined as "too much money chasing too few goods". In other words, an excess of aggregate demand over aggregate supply causes inflationary rise in prices in the economy. This can be explained easily with the quantity theory of money. The theory states that prices rise in proportion to the increase in money supply. Given the full employment level of output, doubling the money supply will double the price level. So inflation proceeds at the same rate at which the money supply expands. In this analysis the aggregate supply is assumed to be fixed and there is always full employment in the economy.

Modern quantity theorists led by Friedman hold that "inflation is always and everywhere a monetary phenomenon." The higher the growth rate of the nominal money supply, the higher is the rate of inflation. When the money supply increases, people spend more in relation to the available supply of goods and services. This bids prices up. Modern quantity theorists neither assume full employment as a normal situation nor a stable velocity of money. Still they regard inflation as a result of increase in the money supply.

The demand pull inflation is illustrated in the following figure.




Suppose the economy is initially in full employment equilibrium at the point E. At this point equilibrium price is determined by the intersection of demand and supply curves D and SS1 respectively. Now with the increase in the quantity of money, the aggregate demand increases. As a result the demand curve shifts to the right to D1.Since the aggregate supply is fixed which is shown by the vertical portion of the supply curve SS1, the demand curve D1 intersects it at the point E1. This raises the price level to OP1.

The Keynesian theory on demand-pull inflation is based on the argument that, so long as there are unemployed resources in the economy, an increase in investment expenditure will lead to increase in employment, income and output. Once full employment is reached and bottlenecks appear, further increase in expenditure will lead to excess demand because output ceases to rise, thereby leading to inflation.

## 2. COST PUSH INFLATION

Cost push inflation is caused by rise in the cost of production – that is, rise in wages, price of raw materials or profits.

### a) Rise in wages

The basic cause of cost-push inflation is the rise in the money wages more rapidly than the productivity of labour. In advanced countries, the trade unions are very powerful. They press the employers to raise the wages. This leads to increase in cost of production of commodities. Employers, in turn, raise the prices of their products. Higher wages enable the workers to buy as much as before, in spite of higher prices. On the other hand, the increase in prices induces trade unions to demand still higher wages. In this way, the wage-cost spiral continues, thereby leading to cost-push or wage-push inflation.

### b) Sectoral rise in prices

A few sectors of the economy may be affected by money wage increases and prices of their products may be rising. In many cases, these products may be used as inputs by other sectors. As a result, production costs of other sectors will rise and thereby pushes the prices of their products.

Thus wage-push inflation in a few sectors of the economy may soon lead to inflationary rise in prices in the entire economy.

**c) Rise in prices of imported raw materials**

An increase in the prices of imported raw materials may lead to cost-push inflation. Since raw materials are used as inputs by the manufactures of the finished goods, they enter into the cost of production of the latter. Thus a continuous rise in the prices of raw materials tends to sets off a cost-push inflation.

**d) Profit-push inflation**

Monopolist and Oligopolist firms raise the prices of their products to offset the rise in labour and production costs so as to earn higher profits. Profit-pull inflation is, therefore, also called administered price theory of inflation or price-push inflation or sellers' inflation or market-power inflation.

## Module II

# Banking

Role and functions of Commercial Banks and Central Bank-Monetary policy and its' instruments (cheque, drafts, etc.)

## CREDIT AND COMMERCIAL BANKING

With the introduction and use of money credit also came into existence. Credit is created when one party (a person, a firm or an institution) lends money to another party, the borrower. The act of lending and borrowing creates both credit and debit. Whereas debt means the obligation to pay the finance borrowed, credit means the claim to receive this money payment from the other party.

The act of borrowing and lending and thereby creation of credit is a special type of exchange transaction which involves future payment of the principal sum borrowed as well as the rate of interest on it. In the modern times there are a variety of institutions which specialize in borrowing and lending of money. The bank credit is only one form of credit. Money lenders, indigenous bankers, credit co-operative societies, commercial and co-operative banks, industrial financial institutions, LIC, export finance houses, etc. are all credit institutions and do the borrowing and lending money.

A bank is an institution which accepts deposits from the public and in turn advances loans by creating credit. It is different from other financial institutions in that they cannot create credit though they may be accepting deposits and making advances.

A commercial bank is a business organization which deals money; it borrows and lends money. In this process of borrowing and lending of money it makes profit. The distinction between money lender and a commercial bank may be noted. Whereas a money lender only lends money to others and that too from his own sources, a commercial bank does both the lending and borrowing business. A commercial bank raises its resources through borrowing from the public in the form of deposits and lends them to the businessmen. Its lending rate of interest is greater than that it pays to its depositors. It is because of this difference in lending and borrowing rates of interest that it is able to make profit.

### Functions of Commercial Banks

Commercial banks perform a variety of functions. They can be categorized as accepting deposits, advancing loans, credit creation, agency functions and miscellaneous functions.

1. **Accepting deposits**

The banks borrow in the form of deposits. This function is important because banks mainly depend on the funds deposited with them by the public. The deposits received by the banks can be of three types;

a)Demand or current account deposits: In this type of deposits the depositor can withdraw the money in part or in full at any time he likes without notice. These accounts are generally kept by the businessmen whose requirements of making business payments are quite uncertain. Usually, no interest is paid on them, because the bank cannot utilize these short term deposits and must keep almost cent percent reserve against them. But in return for these current account deposits, the banks offer some facilities or concession to the account holders. The most important is the cheque facility made available to them. Further, on behalf of the current account deposits, bank collects cheques, drafts, dividend warrants, postal orders, etc.

b)Fixed deposits or time deposits: These deposits are made for a fixed period of time, which varies from fifteen days to a few years. These deposits cannot, therefore, be withdrawn before the expiry of that period. However, a loan can be taken from the bank against the security of this deposit within that period. A higher rate of interest is paid on the fixed deposits based on the period of the deposits.

c) Saving bank deposits: In this case the depositor can withdraw money usually once a week. These deposits are generally made by the people of small means, usually people with fixed salaries, for holding short-term savings. Like the current account deposits, the saving bank deposits are payable on demand and also they can be drawn upon through cheques. But in order to discourage people to use the saving bank deposits very frequently, there are some restrictions on the number of times withdrawals can be made from these accounts. The saving deposits carry lower rate of interest than the fixed deposits.

2. **Advancing loans**

One of the primary functions of the commercial bank is to advance loans to its customers. A bank lends a certain percentage of the cash lying in deposits on a higher interest rate than it pays on such deposits. Thus the bank earns profits and carries on its business.

The bank advances loans in the following ways:

a) Cash credit : The bank advances loan to businessmen against certain specified securities. The amount of loan is credited to the current account of the borrower. In the case of a new customer a loan account for the sum is opened. The borrower can withdraw money through cheques according to his requirements but pays interest on the full amount.

b) Call loans : These are very short-term loans advanced to the bill brokers for not more than fifteen days. They are advanced against first class bill or securities. Such loans can be recalled at a very short notice. In normal times they can also be renewed.

c) Overdraft: A bank often permits a businessmen to draw cheques for a sum greater than the balance lying in his current account. This is done by providing the overdraft facility up to a specific amount to the businessmen. But he is charged interest only on the amount by which his current account is actually overdrawn and not by the full amount of the overdraft sanctioned to him by the bank.

d) Discounting bills of exchange: If a creditor holding a bill of exchange wants money immediately, the bank provides money by discounting the bill of exchange. It deposits the amount of the bill in the current account of the bill holder after deducting the rate of interest for the period of the loan which is not more than 90 days. When the bill of exchange matures, the bank gets its payment from the banker of the debtor who accepted the bill.

**3. Credit creation**

Credit creation is one of the most important functions of the commercial banks. Like other financial institutions, they aim at earning profits. For this purpose, they accept deposits and advance loans by keeping a small amount of cash as reserve for day-to-day transactions. When a bank advances a loan, it opens an account in the name of customer and does not pay him in cash but allows him to draw the money by cheque according to his needs. By granting a loan, the bank creates credit or deposit.

**3.Financing Foreign Trade**

A commercial bank finances foreign trade of its customers by accepting foreign bills of exchange and collecting them from foreign banks. It also transacts other foreign exchange business and sells foreign currency.

**4. Investment**

It is obligatory for commercial banks to invest a part of their funds in approved securities. Other optional avenues of investments are also available. Investments in government securities are useful in two ways. One is that, the commercial banks can get income from their surplus funds. The other is that the liquidity, that is, encashability of securities is higher than that of loans.

**5.Agency Services**

Commercial bands act as an agent of its customers in collecting and paying cheques, bills of exchange, drafts, dividends, etc. It also buys and sells shares, securities, debentures, etc. for its customers. Further, it pays subscriptions, insurance premium, rent, electric and water bills, and other similar charges on behalf of its clients. It also acts as a trustee and executor of the property and will of its customers. Moreover, the bank acts as an income tax consultant to its clients. For some of these service, the bank charges a nominal fee while it renders others free of charge.

**6.Miscellaneous Services**

Besides the above noted services, the commercial bank performs a number of other services. It acts as a custodian of the valuables of its customers by providing them lockers where they can keep their jewellery and valuable documents. it issues various forms of credit instruments, such as cheques, drafts, travellers' cheques, etc. which facilitate transactions. The bank also issues letters of credit and acts as a referee to its clients. It underwrites shares and debentures of companies and helps in the collection of funds from the public. ATM stands for Automated Teller Machine. It is also depicted as Any Time Money as it provides the customers to withdraw money 24 hours subject to certain restrictions.

## CENTRAL BANK

In the monetary system of all countries, the central bank occupies an important place. The central bank is the apex bank in a country. It is called by different names in different countries. It is the Reserve Bank of India in India (set up in 1935), the Bank of England in England, the Federal Reserve System in America, the Bank of France in France, etc.

### Functions of a Central Bank

The following are the major functions of a central bank.

**1. Note Issuing Agency**

The central bank of the country has the monopoly of issuing notes or paper currency to the public. Therefore, the central bank of the country exercises control over the supply of currency in the country. In India with the exception of one rupee notes which are issued by the Ministry of Finance of the Government of India, the entire note is done by the Reserve Bank of India.

Central banks have been following different methods of note issue in different countries. The central bank is required by law to keep a certain amount of gold and foreign securities against the issue of notes. In some countries, the amount of gold and foreign securities bears a fixed proportion, between 25 to 40 per cent of the total notes issued. In other countries, a minimum fixed amount of gold and foreign currencies is required to be kept against note issue by the central bank. This system is operative in India whereby the Reserve Bank of India is required to keep Rs.115

crores in gold and Rs. 85 crores in foreign securities. There is no limit to issue of notes after keeping this minimum amount of Rs 200 crores in gold and foreign securities.

2. **Banker to the Government**

The central bank acts as a banker, agent and adviser to the government. It keeps the banking accounts of the government. All the balances of the government are kept with the central bank. But it pays no interest on these balances. Further, the central bank has to manage the public debt and also to arrange for the issue of new loans on behalf of the government. The central bank also provides short-term loans to the government. Thus it manages the public debt and advises the government on banking and financial matters.

3. **Control of credit**

The chief objective of the central bank is to maintain price and economic stability. For controlling inflationary and deflationary pressures in the economy the central bank adopts quantitative and qualitative measures of credit control. Quantitative methods aim at controlling the cost and quantity of credit by adopting bank rate policy, open market operations, and by variations in reserve ratios of commercial banks. Qualitative methods control the use and direction of credit. These involve selective credit controls and direct action.

4. **Bankers' bank**

The central bank acts as a bankers' bank in three capacities:

(a) as the custodian of the cash reserves of the commercial banks;
(b) as the lender of the last resort; and
(c) as bank of central clearance, settlement and transfers.

All other banks in the country are found by law to keep a fixed portion of their total deposits as reserves with the central bank. These reserves help the central bank to control the issue of credit by commercial banks. They in return can depend up on the central bank for support at the time of emergency. This help may be in the form of a loan on the strength of approved securities or through rediscounting of bills of exchange. Thus the central bank is the lender of last resort for other banks in difficult times.

In India, scheduled banks have to keep deposits with the Reserve Bank not less than 5% of their current demand deposits and 2% of their fixed deposits as reserves. In return they enjoy the privilege of rediscounting their bills with the Reserve Bank as well as securing loans against approved securities when needed.

Clearing function is also performed by the central bank for the banks. Since banks keep cash reserves with the central bank, settlement between them may be easily effected by means of debts and credits in the books of the central bank. If clearing go heavily against some bank, its cash reserves with the central bank will fall below the prescribed limit and therefore the bank concerned will have to make up the deficiency.

5. **Lender of the last resort**

The central bank helps the commercial banks when they face any difficulty. Even a well managed commercial bank can run into difficulty if there is a great rush of demand for cash by the depositors. During such occasions it will not be able to meet a sudden and large demand for cash. The central bank must therefore come to their rescue at such times. Thus the central bank is the last source of supply of credit.

6. **Custody and Management of Foreign Exchange Reserves**

The central bank keeps and manages the foreign exchange reserves of the country. An important function of a central bank is to maintain the exchange rate of the national currency. For example, the Reserve Bank of India has the responsibility of maintaining the exchange value of the rupee. When a country has adopted flexible exchange rate system under which value of a currency is determined by the demand for and supply of a currency, the value of a currency, that is, its exchange rate with other currencies is subject to large fluctuations which are harmful for the economy. Under these circumstances, it is the duty of the central bank to prevent undue depreciation or appreciation of the national currency. Since 1991 when the rupee has been floated, the value of Indian rupee, that is, its exchange rate with US dollar and other foreign currencies has been left to be determined by market forces. RBI has been taking several steps from time to time to stabilize the exchange rate of rupee, especially, in terms of US dollar.

There are several ways by which RBI can manage or maintain the exchange rate of the rupee.

(i) If due to speculative activities of foreign exchange operators, the rupee starts depreciating fastly, RBI can intervene in the market. It can use its reserves of dollars and supply dollars in the market from its own reserves. With the increase in the supply of dollars, the rupee will be prevented from depreciation. It may however be noted that the success of this step depends on the amounts of dollar reserves with RBI.

(ii) Another method by which RBI can manage the exchange rate of rupee is adopting measures which will reduce the demand for dollars. Some importers, foreign investors, foreign exchange operators try to avail of cheap credit facilities of banks and borrow rupee funds from the banks and try to convert them into dollars. This raises the demand for dollars and leads to the depreciation of the Indian rupee. Such a situation occurred in July-September, 1998. RBI intervened and raised the Cash Reserve Ratio (CRR) and increased its repurchase rates. This succeeded in mopping up the excess liquidity with the banks and reduced their lending capacity. This led to the reduction in the demand for dollars and helped in preventing the rupee from depreciating.

## MONETARY POLICY

Monetary policy is an important instrument of economic policy to achieve multiple objectives. *Monetary policy is concerned with the measures taken to regulate the supply of money, the cost and availability of credit in the economy*. It also deals with the distribution of credit between uses and users and also with both the lending and borrowing rates of interest of the banks. In developed countries the monetary policy has been used for overcoming depression and inflation as an anti-cyclical policy. However, in developing countries it has to play a significant role in promoting economic growth.

It is important to understand the distinction between goals, targets and instruments of monetary policy. Whereas goals of monetary policy refer to the objectives such as price stability, full employment or economic growth, targets refer to the variables such as supply of money or bank credit, interest rates which are sought to be changed through the instruments of monetary policy so as to attain these objectives. The various instruments of monetary policy are changes in the supply of currency, variations in bank rates and other interest rates, open market operations, selective credit controls and variations in reserve requirements.

## Instruments of Monetary Policy

The various instruments of monetary policy are;

1. Bank rate policy
2. Open market operations
3. Variable reserve ratio
4. Selective credit controls

### 1. Bank Rate Policy

Bank rate or rediscount rate is the rate fixed by the central bank at which it rediscounts the first class bills of exchange and government securities held by the commercial banks. The bank rate is the interest rate charged by the central bank at which it provides rediscount to banks. The central bank controls credit by making variations in the bank rate. When the economy needs to expand credit (during the periods of deficient demand), the central bank lowers the bank rate. Then borrowing from central bank becomes cheap. So the commercial banks will borrow more. They will, in turn, advance loans to customers at a lower rate. The market rate of interest will be reduced. This encourages business activity. The opposite happens when credit to be contracted in the economy. The central bank raises the bank rate when the economy phases excess demand which makes borrowing costly from it. So the banks borrow less. They, in turn, raise their lending rates to customers. The market rate of interest also rises because of the tight money market. This discourages fresh loans. This leads to contraction of credit which depresses the rise in prices. Thus lowering the bank rate offsets deflationary tendencies and raising the bank rate controls inflation.

### 2. Open Market Operation

Open market operations are another quantitative method of credit control. This method refers to the sale and purchase of securities, bills and bonds of government and private financial institutions by the central bank.

There are two principal of open market operations. One, it influence the reserves of commercial banks in order to control their power of credit creation. Two, to affect the market rates of interest so as to control the commercial bank credit. In this method of credit control, when the central bank of a country wants to control expansion of credit by commercial banks for the purpose of controlling inflationary pressures within the country, it sells government securities in the money market. The purchasing power in the economy is reduced to the extent the commercial banks and individuals purchase government securities.

On the other hand, when the central bank aims at an expansionary policy during a recessionary period, it purchases government securities from the commercial banks and institutions dealing with such securities. The central bank pays the sellers of its cheques drawn against itself which are deposited into their accounts with the commercial banks. The reserves of the latter increase with the central bank which are just like cash. As a result the supply of bank money increases.

Another impact of the open market policy is that when the supply of money changes as a result of open market operations, the market rates of interest also change. A decrease in the supply of bank money through the sale of securities will have the effect of raising the market interest rates. Similarly, an increase in the supply of bank money through purchase of securities will reduce the market interest rates. Thus open market operations have a direct influence on the market rates of interest also.

3. **Variable Reserve Ratio**

Variable reserve ratio (or required reserve ratio or legal minimum requirements) as a method of credit control was first suggested by Keynes in his Treatise on Money(1930) and was adopted by the Federal Reserve System of the United States in 1935.

Every commercial bank is required by law to maintain a minimum percentage of its deposits with the central bank. It may be either a percentage of its time and demand deposits separately or of total deposits. Whenever the amount of money remains with the commercial banks over and above these minimum reserves is known as the 'excess reserves.' It is on the basis of these excess reserves that the commercial bank is able to create credit. The larger the size of excess reserves, the greater is the power of a bank to create credit. and vice versa.

Changes in cash reserve ratio is a powerful method for influencing not only the volume of excess reserves with the commercial banks but also the credit multiplier of the banking system. A change in reserve requirements affect the money supply in two ways: (a) it changes the level of excess reserves; and (b) it changes the credit multiplier

Suppose the commercial bank keep 10% of their central bank. This means Rs.10 of reserves would be required to support Rs.100 of deposit and the credit multiplier is 10 (ie. 1/10% = 10). To check inflation, the central bank raises the cash reserve ratio from 10% to 12%. As a result, the commercial banks will have to maintain a greater cash reserve of Rs.12 instead of Rs.10 for every deposit of Rs.100 and they will now decrease their lending by 2%. The credit multiplier will fall from 10 to 8.3 (ie. 1/12% = 8.3). On the other hand, to check deflation, the central bank may reduce the cash reserve ratio from 10% to 8% and thus make available 2% excess reserve to commercial banks which they utilize to expand credit. The credit multiplier will then rise from 10 to 12.5 (ie. 1/8% = 12.5).

4. **Selective Credit Controls**

Selective or qualitative methods of credit control are meant to regulate and control the supply of credit among its possible users and uses. They are different from quantitative or general methods which aim at controlling the cost and quantity of credit. The aim of selective credit control is to channelize the flow of bank credit from speculative and other undesirable purposes to socially desirable and economically useful uses. They also restrict the demand for money by lying down certain conditions for borrowers. The main types of selective credit controls generally used by the central banks in different countries are cited below:

a) **Regulation of Margin Requirements**

This method is employed to prevent excessive use of credit to purchase or carry securities by speculators. The central bank fixes minimum margin requirements on loans for purchasing or carrying securities. Control over margin requirements means control over down payments that must be made in buying securities on credit. The margin requirement is the difference between the market value of the security and its maximum loan value. If a security has a market value of Rs.100 and if the marginal requirement is 60% the maximum loan that can be advanced for the purchase of security Rs.40. Similarly, a marginal requirement of 80% would allow borrowing of only 20% of the price of the security and a marginal requirement of 100% means that the purchasers of securities must pay the whole price in cash. Thus an increase in marginal requirements will reduce the amount that can be borrowed for the purchase of a security.

b) **Regulation of Consumer Credit**

Under the consumer credit system, a certain percentage of the price of the durable goods is paid by the consumer in cash. The balance is financed through the bank credit which is repayable by the consumer in installments. The central bank can control the consumer credit by (a)changing the amount that can be borrowed for the purchase of the consumer durables and (b)changing the maximum period over which the installments can be extended.

c) **Rationing of Credit**

Rationing of credit may assume two forms: (i) the central bank may fix its rediscounting facilities for any particular bank; (ii) the central bank may fix the minimum ratio regarding the capital of a commercial bank to its total assets. In other words, credit rationing aims at (1) limiting the maximum loans and advances to the commercial banks, and (2) fixing ceiling for specific categories of loans and advances.

d) **Moral Suasion**

Moral suasion means advising, requesting and persuading the commercial banks to cooperate with the central bank in implementing with its monetary policy. Through this method, the central bank merely uses its moral influence to make the commercial bank to follow its policies. For instance, the central bank may request the commercial banks not to grant loans for speculative purposes. Similarly, the central bank may persuade the commercial banks not to approach it for financial accommodation. This method is a psychological method and its effectiveness depends upon the immediate and favourable response from the commercial banks.

e) **Publicity**

The central banks also use publicity as a method of credit control. Through publicity, the central bank seeks : (i) to influence the credit policies of the commercial banks; (ii) to educate people regarding the economic and monetary condition of the country; and (iii) to influence the public opinion in favour of its monetary policy.

f) **Direct Action**

The method of direct action is most extensively used by the central bank to enforce both quantitative as well as qualitative credit controls. This method is not use in isolation; it is often used to supplement other methods of credit controls. Direct action refers to the directions issued by the central bank to the commercial banks regarding their lending and investment policies. It may take different forms: (i) the central bank may refuse to discounts the bills of exchange of the commercial banks whose credit policy is not in line with the general monetary policy of the central bank. (ii) the central bank may charge a penal rate of interest, over and above the bank rate, on the money demanded by the bank beyond the pres cribed limit (c) the central bank may refuse to grant more credit to the banks whose borrowings are found to be in excess of their capital and reserves.

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# Module 3
# PUBLIC FINANCE

| Public revenue and its sources- Public expenditure- Public debt- Deficit financing- fiscal policy-Budget- Finance commission. |
|---|

## Introduction

Public finance deals with the finances of public bodies – national, State or Local – for the performance of their functions. The performance of these functions leads to expenditure. The expenditure is incurred from funds raised through taxes, Fees, Sale of goods and services and loans. The different sources constitute the revenue of the public authorities. Public finance studies the manner in which revenue is raised; the expenditure is incurred upon different items etc… Thus public finance deals with the income and expenditure of public authorities and principles, problems and policies relating to these matters.

## Definitions

"For all States – whether crude or highly developed – some provisions of the kind are necessary and there for supply and application of state resources constitute the subject matter of a study which is best entitled in English as Public Finance" – Charles F. Bastable ("Public Finance – 1892)

"One of those subjects which lie on the border line between Economics and Politics. It is concerned with the income and expenditure of public authorities and with the adjustment of one to the other" – Prof. Hugh – Dalton – ("Principles of Public Finance- 1922). The term 'Public authorities' refers to the Government or State – all levels –National, State and Local.

"A field of enquiry that treats the income and out goes of governments –federal, state and local"- Harold Groves. This definition outlines the types of governments whose finances are studied in Public finance.

"Public Finance is the fiscal science, its policies are fiscal policies, its problems are fiscal problems" –Taylor. According to him public finance studies the manner in which the state through its organ, the government, raises and spends the resources required. Public Finance is thus concerned with the operation and policies of the fisc - The State treasury.

"The main content of Public Finance consists of the examination and appraisal of the methods by which governing bodies provide for the collective satisfaction of wants and secure the necessary funds to carry out this purpose" – Mrs. Ursula Hicks. This definition of Public Finance highlights the satisfaction of collective wants which in turn leads to the need to secure necessary resources.

"The discipline of Public Finance describes and analyses the government services, subsides and welfare payments and methods by which the expenditure to these ends are covered through taxation, borrowing, foreign aid and creation of new money" –CS Shoup. This definition enlarges the scope of Public Finance for modern governments to include different types of expenditure and different sources of revenue.

All the definitions started above illustrate the scope of Public Finance. From these definitions, we can conclude that Public Fiancé is and enquiry into the facts, techniques, principles,

theories, rules and policies which shape, direct, influence and govern the use of scarce resources, with alternative uses, of the governments.

The subject matters of Public Finance can be broadly classifieds in to five categories –

a) Public revenue b) Public expenditure c) Public debt d) Financial administration e) Economic stabilization and f) Federal Finance.

**Public Revenue**;

The income of the states is referred to as Public Revenue in this branch, we study the various ways of raising revenue by the public bodies. We also study the principles and effects of taxation and how the burden of taxation is shared among the various classes of society.

**Public Expenditure**

It deals with the principles and problems relating to the allocation of public spending. We study the fundamental principles governing the flow of public funds in to different channels, classification and justification of Public Expenditure; expenditure policies of governments and the measures adopted for welfare state.

**Public Debts;**

The governments borrow when its revenue falls shot of its expenditure Public debts is a study of various principles and methods of raising debts and their economic effects. It also deals with the methods of repayments and managements of public debts.

**Financial Administration;**

In deals with the methods of Budget preparation, various types of Budgets, war Finance, Development Finance etc… thus, Financial administration refers to the mechanism by which the financial functions are carried on. In other words, financial administration studies the organizing and disbursing of the finances of the State.

**Economic stabilization and Growth**

The use of Public revenue and Public expenditure to secure stability in levels of prices by controlling inflationary as well as deflationary pressures is studied. Similarly the income and expenditure policies adopted by the government so as to attain full employment, Optimum use of resources, equitable distribution of income etc.. are also studied.

## Public Finance and Private Finance

The understanding and the study of public finance is facilitated by a comparison of the public or government finance with private or individual finance. Such a comparison will help us to know how the aims and objectives and methods of public Finance operation are similar or differed from the financial operations of the individual.

**Similarities**

1. Both the State as well as individual aim at the satisfaction of human wants through their financial operations. The individuals spend their income to satisfy their personal wants where as the state spends for the satisfaction of communal or social wants.
2. Both the States and Individual at times have to depend on borrowing , When their expenditures are greater than incomes

3. Both Public Finance and Private Finance have income and expenditure. The ultimate aim of both is to balance their income and expenditure.
4. Both kinds of Finances, the guiding principle is rationality. Rationality in the sense that maximization of personal benefits and social benefits through corresponding expenditure.
5. Both are concerned with the problem of economic choice, that is, they right to satisfy unlimited ends with scarce resources having alternative uses.

**Dissimilarities**

1. The private individual has to adjust his expenditure to his income. ie, his expenditure is being determined by his income. But on the other hand the government first deter minds its expenditure and the devices ways and means to raise the necessary revenue to meat the expenditure.

2. The government has large sources of revenue than private individuals. Thus at the time of financial difficulties the state can raise internal loans from its citizens as well as external loans form foreign countries. In the case of private individual, all borrowings are external in nature.

3. The state, when hard pressed, can resort to printing of currency, as an additional source of revenue. In fact, during emergencies like war, it meats its increased financial obligations by printing new currency. But an individual cannot raise income by creating money.

4. The state prep ears its budget or estimate its income and expenditure annually. But there is no such limitation for an individual. It may be for weekly, monthly, or annually.

5. A surplus budget is always good for a private individual. But surplus budgets may not be good for the government. It implies two things.

a) The government is levying more taxes on the people than is necessary and The government is not spending as much as the welfare of the people as it should.

6. The individual and state also differ in their motives regarding expenditure. The individuals hanker after profit. Their business operations are guided by private profit motive. But the states expenditure is guided by the welfare motive.

7. The private individual spends his income on various items in such a manner as to secure equi – marginal utilities from them. The government on the contrary does not give as much importance to this law as a private individual does. Modern government some times incur cretin types of expenditure from which their do not derive any advantage but they do inker this expenditure to satisfy cretin sections of the community.

8. Individuals always seek quick returns they save only a small amount for future and spend more to satisfy their current needs. Individual tent to think more or present as they are dead in the long run similarly they seldom spend if it does not yield any money income. On the other hand, State has a long term perspective of its expenditure. It does not care only for immediate benefit. State spends on projects having long gestation period. The burden of taxation is borne by the present generation in the interest of long run welfare of the community. Similarly some times government may have to spend on schemes which may not yield any money income at all ( e.g. Public Health)

9. An individual’s spending policy has very little impact on the society as a whole. But the state can change the nature of an economy through its fiscal policies.

10. The pattern of expenditure in the case of private finance is often influence by customs, habits social status etc… The pattern of government expenditures is guided by the general economic policy followed by the government.

11. Private Finance is always a secret affair. Individual need not reveal their financial transactions to any one except for filing tax returns. But Public Finance is an open affair. Government budget is widely discussed in the parliament and out sides. Public accountability is an important future of public finance.

12. Individuals can plan to postpone their private expenditure. But the state cannot afford to put off vital expenditure like defense , famine relief etc… Findlay Shiraz says that compulsory character is an important future of public finance.

## THE PRINCIPLE OF MAXIMUM SOCIAL ADVANTAGE

One of the important principles of public finance is the so – call principle of maximum social advantage explain by Professor Hugh Dalton. Just like an individual seeks to maximize his satisfaction or welfare by the use of his resources, the state ought to maximize social advantage or benefit from the resources at its command.

The principles of maximum social advantage are applied to determine whether the tax or the expenditure has proved to be of the optimum benefit. Hence, the principle is called the principle of public finance. According to Dalton, "This (Principle) lies at the very root of public finance"

He again says "The best system of public Finance is that which secures the maximum social advantage from the operations which it conducts". t may all so called the principle of maximum social benefit . A.C. Pigou has called it the principle of maximum aggregate welfare.

Public expenditure creates utility for those people on whom the amount is spent. When the volume of expenditure is small with a slighter increase in it, the additional utility is very high. As the total public expenditure goes on increasing in course of time, the law of diminishing marginal utility operates. People derive less of satisfaction from additional unit of public expenditure as the government spends more and more. I.e. after a stage, every increase in public expenditure creates less and less benefit for the people. Taxation, on the other hand, imposes burden on the people. So, when the volume of taxation becomes high , every further increase in taxation increases the burden of it more and more . People under go greater scarifies for every additional unit of taxation. The best policy of the government is to balance both sides of fiscal operations by comparing "the burden of tax" and "the benefits of public expenditure" The State should balance the social burden of taxation and social benefits of Public expenditure there would be maximum social advantage.

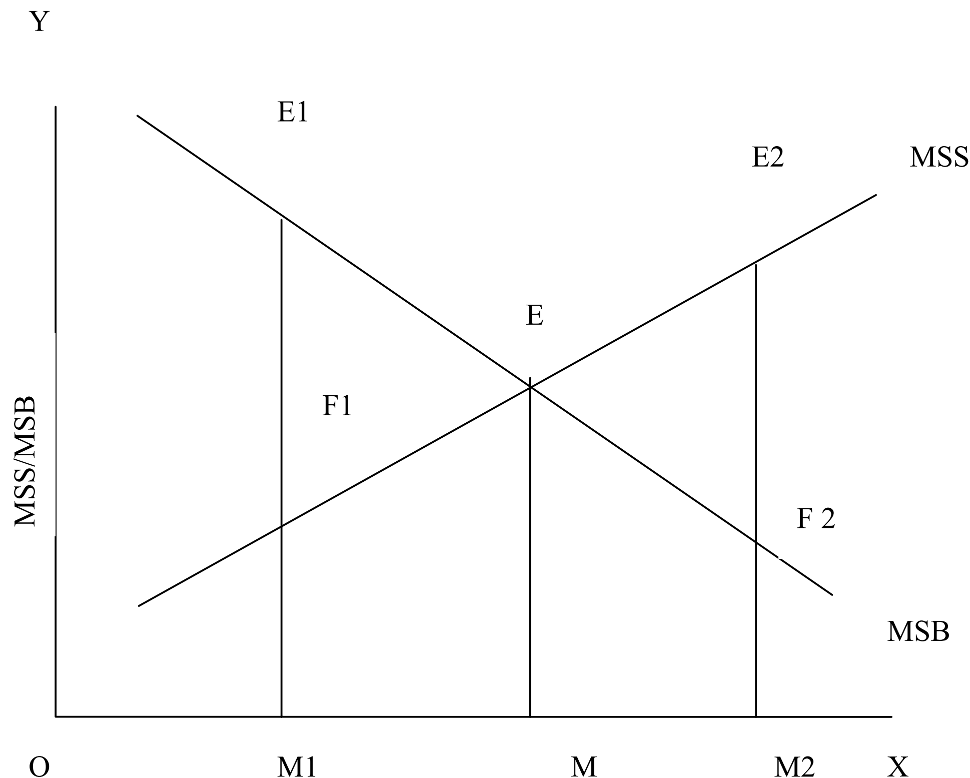
Attainment of maximum social advantage requires that;

a) Both public expenditure and taxation should be carried out up to certain limits and no more.

b) Public expenditure should be utilized among the various uses in an optimum manner, and

c) The different sources of taxation should be so tapped that the aggregate scarifies entailed is the minimum

Diagrammatic Representation




**TAX AND EXPENDITURE**

The curves MSS and MSB show the marginal social scarifies of taxation and marginal social benefit of public expenditure respectively. MSS curve slopes up words since taxation increases marginal social sacrifices. MSB curves slopes down wards showing that public benefit goes on declining with every increase in public expenditure. The ideal point of financial operations is where the governments collect OM taxation from the society and uses it for public expenditure. At this point , MSS is exactly equal to MSB (Point E) at OM 1 , MSS is M1 F1 which is less than MSB (M1 , E1) the depicting a loss of welfare to the society (E1 F1). Similarly is the government is collecting OM 2 taxation to finance larger public expenditure, The MSS is higher than MSB by E2 F2. So the ideal level of taxation and expenditure is at OM. According to Dalton "Public expenditure in every direction, should be carried just so far that the advantage to the community of a further small increase in any direction is just counter balanced by the disadvantage of a corresponding increase in taxation or in receipts from any other source of public income. This gives the ideal public expenditure and income".

## PUBLIC REVENUE

The income of government through all sources is known as public revenue or public income. Prof. Dalton defined public revenue in two senses –

a) Narrow sense and be a broader sense. In the narrow sense, it includes income from taxes prices of goods and services supplied by public sector under takings, revenue from administrative activities, such as fees fine etc. In the wider sense, it includes all the incomes of the

governments during a given period of time, including public borrowing from individuals and banks and income from public enterprise it is known as public receipts.

## SOURCES OF PUBLIC REVENUE

The sources of public revenue can be broadly classified in to two – Tax source and non tax source.

**Taxes:** Taxes are imposed by the government on the people and it is compulsory on the part of the citizens to pay taxes, without expecting a return.

Some definitions:

a) by Prof. Seligman: "Tax is compulsory contribution from a person to the government to defray the expenses incurred in the common interests of all without reference to special benefits conferred".

b) By Prof. Taylor "Taxes are compulsory payments to the governments without expectation of direct return to or benefit to the tax payer"

c) By Prof. Bastable"Tax is compulsory contribution of the wealth of a person for the service of public power".

d) By Prof. Taussig " The essence of a tax , as distinguished from other charges by government , is the absence of a direct quid pro quo between the tax payer and the public authority"

The revenue from taxes came from three main sources. viz; a) Taxes on income b) Taxes on wealth and property and c) Taxes on commodities

### Characteristics of a Tax

1. It is compulsory payments to the government from the citizen
2. It is imposes a personal obligation. it means that it is duty of tax payer to pay it and he should in no case think to evade it.
3. Absence of direct benefit or quid pro quo between the State and people.
4. It is payments for meeting the expenses in the common interest of all citizens.
5. Certain taxes are imposed on specific objectives for example, tax on petrol to reduce consumption and tax on luxuries so as to divert resources for the production of essential commodities.
6. There is no tax without representation.

### Non - Tax Revenue

a) Commercial Revenue. (Income from public property and enterprises)
b) Administrative Revenue ( Fee, Fine, Special assessment )
c) Gifts and grants and
d) Others

### Commercial Revenue:

Income earned by public enterprises by selling their goods and services. For example, Payments for postage, tolls, interest on borrowed funds etc.. They are also known as prices because they come in the form of prices and goods and services provided by government.

**Administrative Revenue**

The receipts of incomes accrued on account of performing administrative functions by the government are called administrative revenue. The important items of administrative revenue are listed below.

**Fees**: "Fee is a payments to defray the cost of each recurring service under taken by the government in the public interest" – Prof. Seligman. Fees are a payment imposed by the government. For Example, Court Fee, License Fee, Passport, Fee etc.

**Fines and Penalties** – Fines penalties are imposed on persons as a punishment for infringement of laws. They are imposed to prevent crime. Fines and penalties are arbitrarily determined.

**Special assessments:** - according to Prof. Seligman "A special assessment is a compulsory contribution levied in proportion to the special benefit derived to defray the cost of specific improvement to property under taken in the public interest". For example, when the government constructs a highway, the prices of plots on either side of it will naturally go up. There for, the land owners may be required to bear a part of expenses incurred by the government. Such charges are called as special assessments.

**Gifts and grants:** - In general gifts and grants are the payments maid by one government to another for some specific functions for example, central grant to state government. Gifts are voluntary contribution maid by the people to the government for some special purposes.

**Other sources of Revenue:** - other sources of revenue are Forfeitures, Escheat, Issues of currency and Borrowings

**Forfeitures**: - it is penalty imposed by the court for failure of individual to appear in the court to complete certain contract as stipulated.

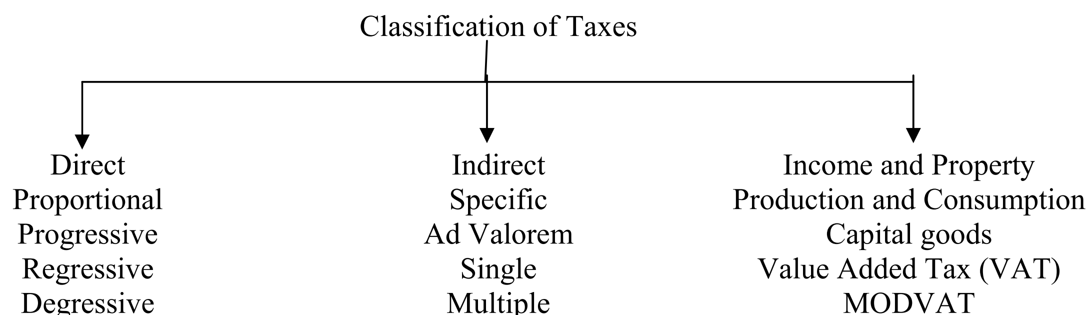
**Escheat:** - Properties having no legal heirs or without will, that go to government are called Escheats.

**Issue of Currency**: - The printing of proper money yields income to the government it is mean to create extra resources by the printing of paper money. It is normally avoided because if once this method of financing is started it becomes difficult to stop it. This further leads to inflation.

**Borrowings**: - This is another source of public revenue. That is through borrowings from the public in the shape of deposits bonds etc. It also includes

**Classification Taxation**

Taxes are classified on different bases. Different bases adopted by the economists to classified taxes are the forms, nature, aims and methods of taxation. The various taxes may be classified under following major heads.



**Direct Taxes and Indirect Taxes**

According to **Dalton** ' a direct Tax is really paid by a person on whom it is legally imposed, while an indirect tax is imposed on one person, but paid partially or wholly by another, owing to consequential change in the terms of some contract or bargaining between them.' According to **J S Mill**, 'A direct tax is one, demanded from the very person who is intended or desired should pay it. Indirect taxes are those which are demanded from the one person in the expectation and intention that we shall identify him at the expenses of another'.

From the above we can reach in a conclusion that direct taxes are those which are paid by persons on whom these are imposed and the real burden is also borne by them. Indirect taxes are imposed on one person but are paid either partly or wholly by another. Examples of direct taxes are income tax, wealth tax, corporation tax, gift tax etc. Indirect taxes: Sales tax, excise duty, VAT etc.

**Public Expenditure**

The expenses incurred by the govt. for its own maintenance, preservation and welfare of the economy as a whole is referred to as public expenditure. In other words, it referred to the expenses of public authorities-central, state and local govt. in a federation-for the satisfaction of collective needs of the citizens or for promotion of economic and social welfare. The development functions include education, public health, social security, irrigation, canal, drainage, roads, buildings, etc. The major cause of increase in the public expenditure is nothing but, these developmental functions. Hence, the study of public expenditure has become very significant in the study of public finance.

The two major reasons for the same are: a) the economic activities of the state has increased manifold and b) nature and volume of public expenditure have greatly affected the economic life of the country in a different manner. ie, it has affected production and distribution and general level of economic activities.

In the laissez-faire era the state was assigned a very limited role to play. The functions assigned to the state where based on the principle of least interference or 'that govt is the best which spends the least.' According to the classicals lead by Adam Smith restricted the functions of the state to 'Justice, Police and Arms.' They considered govt. expenditure wasteful and that money could be used much better by private persons than by the govt. Adam Smith in his magnum opus 'The Wealth of Nations' published in 1776 observed that the sovereign has three main duties to perform as a) to protect the society from violence and invasion of other independent societies b) to protect against injustice and c) erecting and maintaining certain public works.

According to David Ricardo, 'if you want a peaceful govt. you must reduce the budget'. JB Say opined that 'the very system of all plans of finance is to spend little and the best of all taxes is that which is least in amount.

In recent time, public expenditure has been increased enormously. The main reason is the functions of govt. have increased manifold. The modern states are no more police states but welfare states. Adolph Wagner, a German economist presented his famous 'Law of Increase of State Activities' he states that 'comprehensive comparison of different countries and different times show that among progressive people with which alone we are concerned, an increase regularly takes place in the activity of both central and local govts.' This increase is both intensive and extensive. The central and local govts. Constantly undertake new functions, while they perform both, old and new functions more efficiently and completely. In this way the economic needs of the people, to an increasing extent and in a satisfactory fashion are satisfied by the central and local

govts. Prof. RA Musgrave, the twentieth century economist, advocated public expenditure since a govt. is forced to do many activities such as 1) activities to secure a reallocation of resources 2) redistribution activities, 3) stabilizing activities and 4) commercial activities.

**Causes for the Increase in Public Expenditure:**

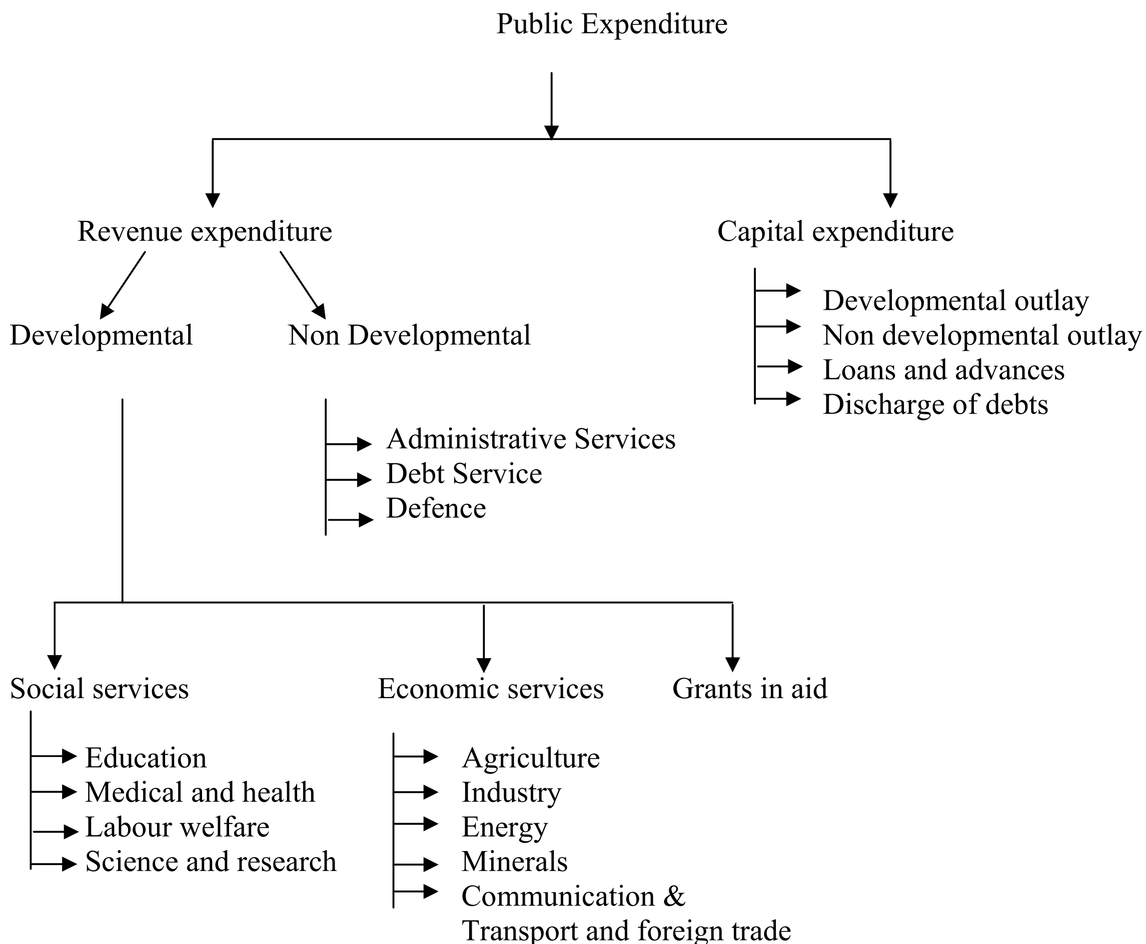
One of the most important features of the present century is the phenomenal growth of public expenditure. Some of the important reasons for the growth of public expenditure are the following.

1) Welfare state: Modern states are no more police states. They have to look in to the welfare of the masses for which the state has to perform a no. of functions. They have to create and undertake employment opportunities, social security measures and other welfare activities. All these require enormous expenditure.
2) Defence expenditure: Modern warfare is very expensive. Wars and possibilities of wars have forced the nation to be always equipped with arms. This causes great amount of public expenditure.
3) Growth of democracy: the form of democratic govt. is highly expensive. The conduct of elections, maintenance of democratic institutions like legislatures cause great expenditure.
4) Growth of population: tremendous growth of population necessitates enormous spending on the part of the modern govts. For meeting the needs of the growing population more educational institutions, food materials, hospitals, roads and other amenities of life are to be provided.
5) Rise in price level: Rises in prices have considerably enhanced public expenditure in recent years. Higher prices mean higher spending on the part of the govt. on items like payment of salaries, purchase of goods and services and so on.
6) Expansion public sector: Counties aiming at socialistic pattern of society have to give more importance to public sector. Consequent development of public sector enhances public expenditure.
7) Development expenditure: for implementing developmental programs like Five Year Plans, Modern govts are incurring huge expenditure.
8) Public debt: Along with debt rises the problem like payment of interest and repayment of the principal amount. This results in an increase in public expenditure.
9) Grants and loans to state govts and UTs: It is an important feature of public expenditure of the central govt of India. The govt provides assistance in the forms of grants-in-aid and loans to the states and to the UTs ;
10) Poverty alleviation programs: as poverty ratio is high, huge amount of expenditure is required for implementing allegation programs.

**Classification of public expenditure:**

Public expenditure has been classified in to a) Revenue expenditure and b) Capital expenditure. Revenue expenditure is current expenditure. For example, administrative and maintenance. This expenditure is of a recurring type. Capital expenditure of capital nature and is incurred once for all. It is non-recurring expenditure. For example, expenditure in building, multi-

purpose projects or on setting up big factories like steel plants, money spent on land, machinery and equipment. This can be explained as follows:




**Theories of growth of public expenditure.**

As we know in modern times all the countries of the world have witnessed an enormous increase in public expenditure. The three important theories of the growth public expenditure are the following:

1) Adolph Wagner's hypothesis
2) Wiseman – Peacock hypothesis and
3) Colin Clark's Critical limit hypothesis.

**Adolph Wagner's Hypothesis:** Adolph Wagner believed that there was a cause-effect relationship between economic growth and public expenditure. His hypothesis of Law of Increasing State Activity lays that as a percapita income and output increase in industrialized counties, the public expenditure of those counties necessarily grows as a proportion to total economic activity. He explained that 'comprehensive comparisons of different countries and different times shows that among progressive people, with which alone we are concerned, an increase regularly takes place in the activity of both central and local govts. The increasing both extensive and intensive, the central and local govts. Constantly undertake new functions, while they perform both old and new functions more effectively and completely.'

Conclusions:-

1) As the national income increases in amount, the percentage of outlay for govt. supplied goods is greater.
2) Increased public expenditure was the natural result of economic growth and continued pressure for social progress.

**Wiseman – Peacock hypothesis:** According to Wiseman and Peacock Public Expenditure does not increase in a smooth and continuous manner. The increasing public expenditure over time has occurred in step-like manner. The general approach to the hypothesis refers to the three related concepts.

1) Displacement effect 2) Inspection effect and 3) concentration effect.

The movement from older level of expenditure and taxation to a new and higher level is called the displacement effect.

War and other social disturbances force the people and govts. to find solutions of important problems, which had been neglected earlier. This is called the inspection effect. That is, new obligations imposed on state, in the form of increased debt interest and war pensions etc.

The concentration effect refers to the apparent tendency for the central govt. economic activities to become an increasing proportion of the total public sector economic activity when the society is experiencing economic growth.

**Critical Limit Hypothesis: (Colin Clark):** The hypothesis was developed by Colin Clark immediately after the Second World War. It is concerned with the tolerance level of taxation. By maximum limit of the tolerance level is 25% of GNP. When the share of govt. expenditure exceeds 25% in the GNP, inflation occurs even in balanced budget.

## Public Debt

Among the non-tax sources, the major source of revenue of the government is public debt. That is, borrowing. It may either be internal or external debts. When the government raises revenue by borrowing from within the country, it is called internal debt. Similarly, if the government is borrowing from the rest of the world, it is a case of external debt. According to Philip E. Taylor, "The debt is the form of promises by the treasury to pay to the holders of these promises a principal sum and in most instances interest on the principal. Borrowing is resorted to provide funds for financing a current deficit."

### Causes for Public Debt

Till the beginning of the 20th century, state performed only limited functions-maintenance of law and order, protection of the country from external attack etc. Therefore, the state had to collect only small revenue and little. Recently, in almost all countries of the world there has been a great increase in the magnitude and variety of governmental activities. The acceptance of the principle of the welfare state increases the role of state participation in economic activity. This has necessitated the need to find out additional sources of finance. Hence, modern governments have come to rely on public borrowings.

**Objectives of public debt**:

The objectives of public debt are the following.

1)To bridge the budget deficit (Deficit Financing)
2) To fight against depression.

3) To check inflation.
4) To finance economic development.
5) To meet unforeseen contingencies.
6) An alternate source of income when taxable capacity is reached.
7) To finance wars.
8) To finance public enterprises.
9) To carry out welfare programmes.
10) To create infrastructure.
11) For creation of productive assets.
12) For creation of essential non-income yielding assets( provision of public goods) etc.

**Important Sources of Public Debt**

Every government has two major sources of borrowing—internal and external. Internally the government can borrow from individuals, financial institutions, commercial banks and the central bank. Externally, the governments borrow from individuals and banks, international institutions and foreign governments. They can be briefly summarized as follows.

1) Borrowing from individuals.
2) Borrowing from Non-Banking Financial Institutions.( Insurance companies, investment trusts, mutual funds etc,)
3) Borrowing from commercial banks.
4) Borrowing from central banks.
5) Borrowing from External sources( IMF,IBRD,ADB, Foreign Governments| countries)

**Classification of Public Debt**

1) Voluntary and compulsory (On the basis of legal enhancement): Voluntary debt is the debt which is paid any legal enforcement. Where as compulsory debt is legally forced in nature. Here people have no option but repay the debt.
2) Funded and unfunded debt (Provision for repayment): funded debt is long term or 'definite period' debt. A proper agreement and terms and conditions of repayment with the percentage of interest payable is declared. They are used for creation of permanent assets. Un funded debt is for a short term and for indefinite period. It is paid through the income received from other sources. These are used for meeting current needs.
3) Internal and external debt: When the government raises revenue by borrowing from with in the country, it is call internal debt. Where as if the government is borrowing from the rest of the world, it is case of external debt.
4) Productive and unproductive (Purpose of loans) Loans on Projects yielding income (Construction of plants, railways, power schemes etc.) are called productive debt. Loans on loan non income yielding projects are called unproductive loans (war, famine relief etc)
5) Redeemable and irredeemable loans (Promise to repay) Redeemable debts refers to the loan which the government promises to pay off at some future date. (principal plus interest) Irredeemable debts are those, principal amount of which are never returned by the government but payees interest regularly.
6) Shot / Medium/ Long term loans (Time duration): Short term loans are usually incurred for a period varying from three months to one year. Usually governments get such loans from the central bank by using treasury bills. These loans are calls 'ways and means advances'

Medium Term loans are those which are obtain for more than one year but less than ten years.

Long term loans are those which are obtain for more than tern years. These are used to finance developmental activities.

## Deficit Financing

Mc. Graw Hill dictionary of modern economics define deficit financing "as a practice by government of spending more than what receives in revenue. Those a government is said to be practicing deficit Financing when it spends in excess of its current revenue".

According to the Planning Commission of India "Deficit Financing is used to denote the direct addition to Gross National Expenditure through budget deficit whether the deficit are on the revenue account or capital account. The essence of such a policy lies there for in government spending in excess of the revenue it receipts in the shape of taxes earning of state enterprises, loan from public deposits and funds and other miscellaneous sources. The government may cover the deficit either by running down its accumulated balances or by borrowing from the banking system".

In Indian context deficit financing takes place; when a budgetary deficit financed by using any one of the following methods.

a) The government may with draw its cash balances from the central bank or
b) Government may borrow fund from the central bank or
c) Government may resort to printing of additional currency

**Advantage of deficit financing**

1. Best use of resources.
2. Helpful to developing countries difficult to create resources through taxation .
3. Additional purchasing power.
4. Helpful despite inflationary nature.

**Limitations**

1. Raise in prices
2. Increase in money supply
3. Speculative activities
4. Adverse effect on savings.
5. Less investment.
6. Unequal distribution of income and wealth.

## Fiscal Policy

According to Arthur Smithies Fiscal policies is "A policy under which the government uses its expenditure and revenue programes to produce desirable effect and avoid undesirable effect on the national income, production and employment".

Fiscal policy is

a) Budgetary policy of the government;
b) It uses public expenditure and taxation as instruments ; and
c) Its objectives is to influence production and employment favorably

The significance of fiscal policy was first emphasized by J.M. Keynes, in mid 1930 s in his "General Theory of Employment, Interest and Money" published in 1936.

Fiscal policy refers to the policy of government with relation to taxation, public expenditure and management of public debt. In other words fiscal policy refers to the financial activities under taken to correct either inflation or deflation.

**The classical concept of fiscal policy**

The classical believed in laissez – Faire, Say's law of market, full employment, optimum allocation of resources etc. According to them full employment is a common phenomenon and is supposed to reach automatically. There is no necessity of any governmental interference. The concept of fiscal policy held by the classical is known as 'Principal of sound finance" according to them "That government is the best which spends the least and imposes lowest amount of taxes".

**Modern concept of fiscal policy**

The modern concept of fiscal policy is called "Functional Finance". This was first stated by J.M.Keynes and was developed by Abba P. Lerner. According to the policy of functional Finance "Government has to play a positive roll so as to regulate and control the economy by means of taxes and expenditure".

**Objectives of fiscal policy in developed countries**

1. Full employment
2. Price stability
3. High and stable rate of growth

**Objectives of fiscal policy in less developed centuries**

1. Full employment
2. Price stability
3. Accelerated rate of economic development
4. Optimum allocation of resources
5. Equitable distribution income and wealth
6. Economics stability and
7. Capital formation and growth

## BUDGET

The term budget has been derived from a French word 'bougette' which means a leather bag or purse. As per *Article 112 of Indian Constitution* the Govt. has to present in the Parliament an annual financial statement showing estimates of revenue and expenditure. This is called the Annual Financial Statement or Budget. Hence, government budget is a schedule of all revenues and expenditures that the Govt. expects to receive and plan to spend during the following year. A Budget includes a) financial actions of the previous year b) budget and revised estimates of the current year and c) the budget estimates for the following year. The budget is presented in the parliament by the Union Finance Minister. Similarly the State Govts. have also to present the budget in the State Legislatures as per *Article 202 of the Indian Constitution.*

**Government Accounts**

1) Consolidated Fund:- All sums of money. All revenues of the govt,the loans raised by it, receipts by way of repayment of loans. All expenditures are also incurred out of this fund. No amount can be withdrawn from this fund without the sanction of the parliament.

2) The Contingency fund:- The fund is placed at disposal of the President to enable the government to meet the unforeseen emergencies. Prior sanction of the parliament is not required to spend from the fund.

3)Public Account:- certain transaction are not included in the contingency fund. The include transactions relating to provident funds, small savings collections, other deposits etc. The money thus received is kept in public account. This money does not belong to the government. It has to paid back to the persons and authorities who have deposited it. Hence, parliamentary approval is not required for payments.

**Features of Budget**

1) It is a statement of expected revenue and proposed expenditure.

2)It is sanctioned by some authority.

3) It is periodicity, generally annual and

4) It prescribes the manner in which revenue is collected and expenditure is incurred.

**Objectives of a Budget**

1) Re-allocation of resources
2) Re-distribution of resources
3) Stabilization of resources
4) Sources of information to the public of the past, present and future activities, plans and programmes of the relevant governments.
5) Tool of government policy
6) To estimate income and expenditure
7) An instrument of fiscal policies
8) Basis of public welfare
9) To ensure financial and legal accountability
10) To serve as a tool of management for controlling administrative efficiency.

**Components of a Budget**

The government budget is divided into Revenue Budget and Capital Budget.

Revenue Budget or Revenue Account is related to current financial transactions of the government which are of recurring in nature. Revenue Budget consists of the revenue receipts of the government and the expenditure met from this revenues.

The Capital Account is related to the acquisition and disposal of capital assets.

Revenue Receipts include receipts from taxation, profits of enterprise, other non-tax receipts like administrative revenue (fees, fines, special assessment etc.), gifts grants etc. Revenue expenditure includes interest-payments, defence expenditure, major subsidies, pensions etc.

Capital budget is a statement of estimated capital receipts and payments of the government over fiscal year. It consists of capital receipts and capital expenditure.

Capital Receipts include

a) Borrowings b) Recovery of loans and advances
c) Disinvestments and d) Small savings.
Capital Expenditure includes a) Developmental Outlay b) Non-developmental outlay
b) Loans and advances and d) Discharge of debts.

## Types of Budgets

Based on the balancing of revenue and expenditure, budgets are divided into Balanced Budget and Unbalanced Budget.

Balanced Budget:- A balanced budget is that over a period of time, revenue does not fall short of expenditure. i.e., revenue is equal to expenditure. (Revenue= Expenditure).

The Budget imbalance may be due to an excess of expenditure over income or an excess of income over expenditure. In other words, budget may either be surplus or deficit. A budget is said to be surplus when public revenue exceeds public outlay. (R>E).

A deficit budget means a budget when expenditure exceeds revenue. (R<E).

## Finance Commission

Under the provisions of the constitution, the president is required under Article 280 (1) to constitute within two years from the commencement of the constitution and there after the expiration of every fifth year or at such early year time as he may consider necessary. The commission is charged with the tremendous responsibilities of making requisite recommendation to the president of India. The Finance Commission consists of a chairman and four members to be appointed by the president.

### Functions of Finance Commission

There are two important functions – Suggestive functions and making recommendations – to be performed by the Finance Commission.

### Suggestive Functions

1. To suggest the criteria of distribution between union and States of net proceeds which are to be or may be divided between them.
2. It deter minds the allocation of net proceeds between different states according to their respective shares of proceeds.
3. Any modification continuance of the term of any agreement entered in to by the union government with the government of any State in part B of the First schedule under clause (v) of Article 178 or Article 306
4. The principal which should govern the grants – in –aid of the revenue of defence state out of the consolidated fund of India.
5. Any other matter refers to the commission by the President of India.

### Making Recommendations

1. The percentage of net proceeds of the Taxes which may be divided between center and State.
2. The allocation of Shares of the proceeds of such taxes in percentages between different States.
3. To deter mind the principal to govern the grants – in aid of the revenue out of the consolidated fund of government of India between States.
4. The modification of continuances of the term of agreement regarding the levy of International customs and duties with part B States.
5. Grants in aids in tribal areas and
6. Special grants for any particular state.

**Finance Commission in India.**

| FC | Year | Chairman | Report Submission |
|---|---|---|---|
| 1. | Nov. 1951 | K.C. Neogi | December 1952 |
| 2. | June 1956 | K. Santhanam | September 1957 |
| 3. | December 1960 | A.K. Chanda | December 1961 |
| 4. | May 64 | Dr. P.V. Rajmannar | August 1965 |
| 5. | February 1968 | Mahavir Tyagi | July 1969 |
| 6. | June 1972 | Brahmananda Reddy | November 1973 |
| 7. | June 1977 | J.M. Shelat | October 1978 |
| 8. | June 1982 | Y.B. Chavan | November 1983 |
| 9. | June 1987 | N.K.P. Salve | March 1990 |
| 10. | June 1992 | K.C. Pant | November 1994 |
| 11. | July 1998 | Prof. A.M. Khusro | June 2000 |
| 12. | July 2002 | C. Rangarajan | November 2004 |
| 13. | October 2009 | Vijay Khelkar | |

# Module IV
# TRADE

Internal and External Trade; Why international trade?; balance of trade and balance of payment; foreign exchange rate; devaluation; revaluation; depreciation; appreciation.

## Internal and External trade

Internal or domestic trade can be defined as exchange of goods and services amoung the residents of the same country. It refers to the trade within the geographical territory of a country. It is the trade between different regions within the same country or the domestic exchanges which takes place within the country

On the other hand, external or international trade may be defined as exchange of goods and services between the residents of a given country and those of the rest of the world. Thus, international trade takes place between the two countries. The main differences between the internal and international trade are as follows

### 1) Factor Mobility

The factors of production, notably labour and capital resources, are more mobile within the country. If the internal mobility were perfect there would not exist interregional differences in factor prices. The factors would move away from the regions where their prices are relatively lower towards the regions where their prices are relatively higher, until the factor price differences are completely wiped off. It is on account of greater mobility of labour and capital within the country that there is a tendency for the equalisation of wage rates and interest rates.

However, in the international setting, the factor mobility is neither free nor perfect. There are restrictive immigration laws which prevent free mobility of labour form one country to another. In respect of capital, there are restrictions on the inflow and outflow of capital and investment across national frontiers. In addition to these legal barriers, there are several other barriers like differences in language, climate, social customs and practices, political and educational systems etc which create additional barriers to factor mobility between countries. Thus, due to comparatively less mobility of labour and capital, the production costs of the same commodity become different in two countries. It is on account of the differences in production costs that international trade takes place.

### 2) Product Mobility

Within the country, the movement of goods and services from one region to another is free. The only internal barriers to free movement of goods and services are the distance and cost of transportation (natural barriers). As against this, there are formidable man-made and natural barriers on trade between two countries. Besides import and export tariffs, exchange controls and other non-tariff barriers put obstacles to the free movement of goods and services between one country and the other. From this point, international trade is quite different from internal trade in goods and services.

### 3) Economic Environment

Within the country, the economic environment is more or less same in all regions of the country. The government policy with regard to interest rates, taxes, wages or prices are the same within the country. Similarly, market structures and consumer taste patterns and preferences are more or less

the same throughout the country. But between countries they could all differ very significantly. This would make the character of international trade significantly different for that of international trade.

**4) Monetary Units**

Usually a single currency unit is used throughout the entire country. There is only one currency is used as a medium of exchange or a measure of value which would make the exchange very smooth as far as internal trade is concerned. But there are different currencies in different countries. The differences with the currency systems prevailing in different countries considerably hamper the smooth flow of goods and services between countries. Thus a number of foreign exchange difficulties arise in international trade.

**5) Natural Advantages**

There can be differences in natural resources and the geographical conditions of different countries. Availability of certain natural resources, geographical and climatic conditions etc give natural advantages to some countries. These advantages lead to territorial division of labour and localization of industries. These advantages cannot be transferred from one country to another.

**Why international trade?**

Since the publication of *Wealth of Nations,* economists have sought answers to a number of questions concerning international trade theory such as why do countries trade with one another? .For more than two hundred years economist have tried to convince the public and policy makers that countries trade for the same reason individuals trade. Countries like individuals are not equally capable of producing every good or service they want and need to consume. All countries like individuals can benefit if each country specialises in producing those goods it can produce best and satisfy their other wants and needs by trading with other countries. Specialization and trade makes total world output of goods and services larger than it would be without trade. In international trade all countries gain and are better-off than the alternative, that is buying and selling goods restricted to their domestic markets. In the words of Horn and Gomez "international trade benefit to all participating nations and injury to none"

Historically, trade has been an important mainspring of growth of countries at different stages of development. In the 19th century the countries that were industrializing has access to food and raw materials in the primary producing countries which allowed the more developed countries to reap the gains from international specialization. In turn, the developing countries were assisted in their development by the demand for raw materials. But today most trade takes place in industrial commodities in which many poor countries find it difficult to compete and demand for developing country's traditional export is slack relative to demand for industrial goods. Except for a very few commodity booms, trade does not seem to work to the equal advantage of both sets of countries. The problem facing developing countries is not so much *whether to trade* but *in what commodities* to trade and to ensure that the terms on which they trade with developed countries are favorable.

During the 19th century, most of the world's industrial production was concentrated in England. Large increase in industrial production and population in resource-poor England led to rapidly rising demand for food and raw material exports of the 'regions of recent settlements' such as the United States, Canada, Australia, New Zealand etc. The stimulus provided by their rapidly expanding exports then spread to rest of the economy of these new settled lands. According to R Nurkse, the export sector was the leading sector that propelled these economies into rapid growth and development. That is, international trade functioned as an "*engine of growth"* for these countries during the 19th century.

The regions of recent settlement were able to satisfy England's growing demand for food and raw materials because of several circumstances. Firstly, these countries were richly endowed with natural resources such as fertile land, forests and mineral deposits. Secondly, workers with various skills moved in large numbers from overpopulated Europe to these mostly empty lands, and so did huge amounts of capital. The huge inflows of capital and workers made possible the construction of roads, rails, canals and other facilities that allowed the opening up of new supply sources of food and raw materials. Finally, great improvement on sea transportation enabled these new lands to satisfy rising demand for food and raw materials more cheaply than traditional sources supply in Europe and elsewhere. But there are economists such as Kravis who believe that the rapid growth of the regions of recent settlements during the 19th century was primarily due to very favorable internal conditions, with trade playing only an important supportive role.

It is generally agreed that today's developing countries can relay much less on trade for their growth and development. This is due to less favorable demand and supply conditions. *On the demand side*, it is pointed out that the demand for food and raw materials is growing much less rapidly today than the case for the regions of recent settlement during the 19th century. Main reasons are

(1) The income elasticity of demand in developed countries for many of the food and raw materials exports of developing countries is less than one, so that as income rises in developed countries, their demand for exports of developing countries increases proportionately less than the increase in income.
(2) The development of synthetic substitutes has reduced the demand for natural raw materials
(3) Technological advances have reduced the raw material content of many products
(4) The output of services (with lower raw material requirement than commodities) has grown faster in developed countries
(5) Developed countries have imposed trade restrictions on many exports of developing countries like wheat, vegetables, sugar, oils and other products

*On the supply side*, it is pointed out that most of today's developing countries are much less endowed with natural resources than were the regions of recent settlements during the 19th century. Again, most of the developing countries are overpopulated, so that most of any increase in their output of food and raw materials is absorbed domestically rather than exported. Furthermore, the international flow of capital to most developing courtiers today is relatively much less than it was for the regions of recent settlements during the 19th century and today's developing countries seem also to face an outflow of skilled labour rather than an inflow. Finally, it is said that until recently, developing countries have somewhat neglected their agriculture in favour of more rapid industrialization, thereby hampering their export and development prospects.

Thus, even though international trade, in general, cannot to be an engine of growth today, there are still ways in which it can contribute to the economic growth of today's developing countries. Haberler has pointed out the following important beneficial effects that the international trade can have on economic development:

1. Trade can lead to the full utilization of otherwise unemployed domestic resources. That is through trade, a developing country can move from an inefficient production point inside its production frontier to a point on its production frontier with trade. For such a country, trade would represent a '*vent for surplus*' or an outlet for its potential surplus of agricultural commodities and raw materials.
2. By expanding size of the market, trade make possible division of labour and economies of scale

3. International trade is the vehicle for the transmission of new ideas, new technology and new managerial and other skills.
4. Trade also stimulates and facilitates the international flow of capital from developed to the developing countries
5. In several large developing countries, the importation of new manufactured products has stimulated domestic demand until efficient domestic production of these goods become feasible and
6. International trade is an excellent antimonopoly weapon because it stimulates greater efficiency by domestic producers to meet foreign competition

## Balance of Trade

According to James E Meade balance of trade is the difference between the value of goods and services sold to foreigners by the residents and firms of the home country and the value of goods and services purchased by them from foreigners. In other words, the difference between the value of goods and services exported and imported by a country is the measure of balance of trade.

If the two sums, that is, the value of exports of goods and services and the value of imports of goods and services are exactly equal to each other, we say that there is balance of trade equilibrium. If the former exceeds the latter, we say that there is balance of trade surplus and if the latter exceeds the former we describe the situation as balance of trade deficit. Balance of trade surplus is regarded as favorable and balance of trade deficit is regarded as unfavorable. In the familiar macroeconomic equation $Y = C+I+G+(X-M)$, the expression for net exports X-M denotes balance of trade in Meade's sense.

However, some other writers define balance of trade as the difference between the value of merchandise (or goods) export and the value of merchandise imports, making it the same as goods balance or balance of merchandise trade. As per this definition, balance of trade takes into account only visible exports and imports. The visible exports and imports are those which are actually recorded at the ports.

### Balance of Payments

The balance of payment is a statistical record of all the economic transactions of the residents of a country with the residents of rest of the world during a particular period of time, usually a year. An international economic transaction refers to the exchange of a good, service or asset, for which payment is required between the residents of one country with the residents of other countries. However, gifts and certain other transfers for which no payment is required are also included in a country's balance of payments. Thus, it is a flow of goods, services, gifts and assets between the residents of one country and residents of other countries during a year.

The balance of payments is one of the important statistical statements of a country. It reveals how many goods and services the country has been exporting and importing and whether the country has been borrowing from or lending money to the rest of the world. In addition, whether or not the central bank has added or reduced its foreign exchange reserves is reported in the balance of payment statistics. The knowledge about balance of payments will inform the government about the international position of the country and help it its formulation of monetary, fiscal and trade policies.

An important point about a country's balance of payments statistics is that, in accounting sense, they are always balance. This is because they are based upon the principle of *double-entry*

*book keeping*. This means that each international transaction is recorded twice, once as a credit item and once as a debit item of equal amount. The reason for this is that, in general, every transaction has two sides. Credit transactions are those that involve the receipts of payments from foreigners and debit transactions are those that involve the making of payments to foreigners. Thus, each receipts of currency from residents of rest of the world is recorded as a credit item (a plus in the accounts) while each payment to the residents of the rest of the world is recorded as a debit item (a minus in the accounts).

Traditionally, the balance of payment statistics comprises two main sections, namely the current account and the capital account. The essential difference between the two is that the current account items refer to the income flows, while the capital account records changes in assets and liabilities.

**Current Account**

The current account records exports and imports of goods and services and unilateral transfers. The current account balance is the sum of *visible balance* and *invisible balance*. Trade balance is referred to as the visible balance because it represents the difference between receipts for exports of goods and expenditure on import of goods which can be visibly seen crossing national frontiers. The receipts of exports are recorded as credit in the balance of payments while the payments for the imports are recorded as debit. The invisible balance shows the difference between the revenue received for the export and payment made for imports of services such as shipping, tourism, insurance and banking. In addition, receipts and payments of interests, dividends and profits are recorded as the invisible items. It should be noted that unilateral transfers are included in the invisible balance. Unilateral transfers are payments or receipts for which there is no corresponding *quid-pro-quo*. Examples of such transactions are migrant worker's remittances to their family back home, payment of pensions to foreign residents, gifts which domestic residents receive from foreign residents and foreign aid. The net value of the balances of visible and invisible trade and unilateral transfers defines the balance on current account.

**Capital Account**

The capital account records all international transactions that involve a resident of the country concerned changing either his asset or his liabilities to residents of another country. Thus, it is concerned with the movement of financial capital into and out of the country. Capital comes into the country by borrowing, sales of overseas asset and investment in the country by foreigners. These items are referred to as "capital inflows" and are recorded as credit items in the balance of payments. In effect, capital inflows are decrease in the country's holdings of foreign assets or increase in the liabilities to foreigners. On the other hand, capital leaves the country due to lending, buying of overseas assets, and purchase of domestic assets owned by foreign residents as these involves payment to foreigners. These items represent "capital outflows" and are recorded as debits in the capital accounts. In effect, capital outflows are an increase are an increase in the country's holdings of foreign assets or decrease in the liabilities to foreigners. The summation of the capital inflows and outflows as recorded in the capital account gives the capital account balance.

**Remaining Items in the balance of payments**

The balance of payment accounts are completed by the entry of other minor items which do not fall comfortably into one of the standard categories. These are errors and omissions (statistical discrepancy) and changes in the official reserves and official liabilities. Errors and omissions or the balancing item reflect the difficulties involved in recording accurately all the transaction between domestic and foreign residents. Many of the reports statistics are based on sampling estimates so

that some error is unavoidable. Problem may arise when one or other parts of a transaction take more than one year. Dishonesty and desire to avoid taxes may also create problem of underreporting. Finally, there are changes in the reserves of the country whose balance of payments are considering and changes in that part of the reserves of other countries that are held in the country concerned. Reserves are held in three forms, namely, in foreign currency, as gold and as Special Drawing Rights (SDR).

**Foreign Exchange Rate**

Simply, foreign exchange rate is the price of one currency in terms of other. Since there is an essential symmetry between the two currencies, the exchange rate may be defined in one of the two ways

- Cost in domestic currency of purchasing one unit of foreign currency. That is, domestic currency units per unit of foreign currency.
- Amount of foreign currency that foreign exchange rate may be bought for one unit of domestic currency. That is foreign currency units per unit of domestic currency.

Obviously, it can be noted that the second method is the reciprocal of the first method. While it is not important which method of expressing the exchange rate is employed, it is necessary to be careful when talking about a rise of fall in the exchange rate because the meaning will be different depending upon which definition is used. In the economic literature, the practice is to use the first definition.

In general, the foreign exchange rate is determined by the interaction of the market demand curve for and market supply curve of the foreign currency. That is, the exchange rate is determined just like the price of any commodity. On the demand side, one of the principal reasons people desire foreign currencies is to purchase goods and services from another country or to send a gift or investment income payment abroad. A second reason is to purchase financial assets in a particular country. The third reason people demand foreign currency is to avoid losses or make profits that would arise through changes in the foreign exchange rate. On the other hand, the total supply of the foreign exchange in a country consists of three sources. Firstly, it results from foreigner's purchasing home exports of goods and services or making unilateral transfers to the home country. A second source arises from foreign investment in the home country. Finally, foreigner's purchase of home currency to avoid losses or to make profits from changes in the exchange rate is the third source of supply.

Since the foreign exchange market brings together those people that wish to buy a currency (which represents the demand) with those that wish to sell the currency (which represents the supply), then the exchange rate can easily be determined by the intersection of the demand and supply of the currency.

**Devaluation and Revaluation**

The terms devaluation and revaluation refers to a legal redefinition of a currency's par value under a system of fixed exchange rates. Devaluation means the reduction in the external value of the country's currency unit, undertaken by government fiat or official proclamation. It means reduction of the official rate at which one currency is exchanged for another. It is the deliberate action which reduces the value of a country's currency in terms of another (exchange rate).

The government of the country may resort to the devaluation of its currency to eliminate or to reduce the deficits in the balance of payments. Devaluation encourages exports by cheapening them in foreign countries. On the contrary, devaluation has the effect of discouraging imports by making

them more expensive within the country. For example, if the currency of a country is devalued, then its purchasing power in foreign countries automatically goes down. In other words, imported goods become more expensive than before. Hence, devaluation discourages imports into the country. At the same time, the purchasing power of the devalued currency increases in terms of foreign currencies as a consequence of devaluation. As a result, the foreigners start importing more goods from the country. This gives an incentive to the exporters of the country. Hence as a result of devaluation exports will increase and imports will fall.

Revaluation is the opposite of devaluation. Revaluation means an increase in the external value of the country's currency unit, undertaken by government or central monetary authority. It means deliberate increase of the official rate at which one currency is exchanged for another. It is an upward revision of the gold parity of the currency. When a currency is undervalued, the prices and costs in the country are low in relation to world price. The country has a strong competitive advantage in the world market for its exports, while its own demand for imports is comparatively low. The purpose of currency revaluation is to cause the home currency's exchange value to appreciate thus contracting the balance of payment surplus. The balance of payment surplus of the country grows, which makes the currency more undervalued. Therefore, the country decides to revalue its currency.

But changes in this direction are rare. A country with favorable balance of payment is under no pressure to take any corrective action. Examples of revaluation can be found in former West Germany and Holland in 1961. Their currencies had become undervalued at their existing parities and monetary authorities revalued them by about five per cent.

## Depreciation and Appreciation

A certain change in the exchange rates is always possible and also a matter of everyday importance as is the case with any commodity market. The price does not remain the same on any two given days or period due to changes in economic or political conditions or seasonal variations in demand and supply and demand or the effects of factors such as rate of interest, investment climate in the country etc. like the price of any commodity exchange rate is also subject to variation. The terms depreciation and appreciation refers to the actual impact on the market exchange rate caused by redefinition of a par value or changes in exchange rate stemming from changes in the supply of or demand for foreign exchange. Thus, Changes in the external value of currency are known as depreciation or appreciation of currency.

By exchange depreciation is meant a decline in the rate of exchange of the country's currency in terms of another. It is a decline in the external value of the currency. Like devaluation, exchange depreciation of a country will tend to cheapen its domestic goods for the foreigners so that exports will be boosted up. At the same time, its imports will be costlier so that they tend to decline. Thus, imports will be checked and exports will be stimulated by depreciation. In other words, depreciation will ordinarily improve country's balance of trade and payments by reducing foreign exchange payments for imports and increasing the foreign exchange receipts from exports.

A currency is stated to have appreciated of become costly when there is a rise in the rate of exchange. It refers to a rise in the external value of domestic currency when the exchange market is moving whereby giving a lesser amount of domestic currency against a given amount of foreign currency. If demand for foreign currencies increases they will appreciate against home currency. Similarly, a decreased supply of foreign currencies, demand remaining the same will also cause appreciation of currencies. Appreciation like revaluation refers to the rise in the value of currency relative to another currency.

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# Module V
# INDIA AS A DEVELOPING ECONOMY

Major Issues: Poverty, Unemployment and Inequality-Causes and Remedies

## Meaning of a Developing Economy

Developing country is a term generally used to describe a nation with a low level of material well-being. They are mostly middle income countries and least-developed countries in Asia (excluding Japan); Central and Eastern Europe; the Middle East and Latin America and Africa. These economies have standards of living lower than developed economies and economies in transition. Many have deep and extensive poverty. Developing countries are usually importers, rather than developers, of innovations in science and technology. They also tend to be more vulnerable to economic shocks.

There are no official definitions of "developed" or "developing" countries in the UN system. Developing countries are in general, countries which have not achieved a significant degree of industrialization relative to their populations, and which have, in most cases a medium to low standard of living.

The World Bank's main criterion for classifying economies is the gross national income (GNI) per capita. Based on its GNI per capita, every economy is classified as low income, middle income (subdivided into lower middle and upper middle), or high income. These are set each year on July 1. Economies were divided according to 2010 GNI per capita using the following ranges of income:

- Low income - $1,005 or less.
- Lower middle income - $1,006 - $3,975.
- Upper middle income - $3,976 - $12,275.
- High income - $12,276 or more

The World Bank classifies all low- and middle-income countries as developing but notes, "The use of the term is convenient; it is not intended to imply that all economies in the group are experiencing similar development or that other economies have reached a preferred or final stage of development. Classification by income does not necessarily reflect development status."

## India as a Developing Economy

Since the per capita income is the usual measure of the standard of living, the definition for developing economy can be stated in terms of per capita income: "A developing economy is an economy where per capita income is rising." On this basis it is sure that after more than 61 years of planning Indian economy is stood as a developing economy. In almost all fields there are marked and drastic improvements which can be better understood by the explanation of the following features:

### 1. Increase in National income:

National Income is considered as an indicator of a nation's growth. In 1950-51 India's national Income is Rs.2,04,924 crore at 1999-00 base year price and it rose to Rs. 52,22,027 crore

at 2004-05 base year price in 2010-11.The growth rate of India's National Income is 6.9% in 2011-12 even the economy is in the wave of global financial crisis.

**2. Increase in Per capita income**

Per capita income is considers as the best index of standard of living of people in a country. The average annual growth rate of per capita income is only 2% in 1950-51 it was Rs. 5,708 at 1999-00 base year price. But in 2010-11 the growth rate is 6.7% and it is Rs.36, 003 at 2004-2005 base year price. It is true that India's Per capita growth rate is low, because of excessive growth rate of population.

**3. Improvement in Saving and Investment:**

As National Income increases the saving and investment of the economy have also be stepped up. The rate of Investment as proportion of GDP was only 10% in 1950-51 and it rose to 36.5%in 2009-10.At the same time the rate of saving as a proportion of GDP was 10.2% and 32.2% in the respective years on current market prices. As a result of these there will be a marked improvement in capital formation of the country. The rate of capital formation in the last five decades is very high.

**4. Change in Agriculture sector**

After independence Indian agriculture sector witnessed a lot of changes. In 1950-51 around 69.7% of the people depend on agriculture. But according to the estimates in 2010-11 still agriculture is the single largest private sector occupation and 52% of people engaged in agriculture activities. The share of agriculture to GDP in 1950-51 was 55.4% while it declined to 13.9% in 2011-12.These show that the importance of agriculture sector is coming down. But the country achieved self sufficiency in food grains production. There should be marked changes in cropping pattern and Green revolution takes place in the mid of 1960's.

**5. Change in Industrial sector**

At the time of independence India's industrial structure was underdeveloped and backward. As a result basic and capital goods industries are given more priority in the early years of industrial development of the country. The growth rate in industrial sector is fluctuating. The share of industrial sector to GDP increased from 13.3% to 27% during 1950-51 and 2011-12respectively. Since independence industrial production marked a good improvement and a variety of industrial production structure is formed. The share of people participated in this sector increased from 12% to 28% during 1950-51to 2010-11.Major industries in India are; Textile, Food Processing, Cement, Paper and News Print industry, Leather, Steel, Auto mobile, Gems and Jewellery, Oil and Gas industry, Sugar industry, Civil aviation industry etc.

**6. Change in tertiary sector**

After the starting of planning, the highest rate of growth happened in tertiary sector. In 1950-51 it contributes only 28.5%, but it increased to 59% in 2011-12.Now the service sector is considered as India's work horse. The tertiary sector comprises; Trade, hotels, Transport and Communication, Financial and Insurance services, Real Estate, IT, Community, Social and Personal Services etc.

**7. Change in foreign trade**

Even though India's share in world trade is around 1%, it is highly diversified. Before independence foreign trade means only import. But after independence India started export which

is favorable to Indian economy and adopt import substitution policy. Now India's trade policy is export promotion.

**8. Social and institutional changes**

The spread of education, urbanization, political democracy, transport system, new technologies etc loosen the underling caste system and other social and institutional stringencies. This also shows India's wake up for a bright future.

**9. Urbanization**

Economic growth is associated with urbanization. The rate of urbanization clearly shows India's economic development. In 1951the rate of urbanization is only 17.3% but it increased to 27.8% in 2001 census.

**10. Expansion in science and technology**

India is Eighth among top 15 countries in the contribution of their scientists. India has over 1300 Research Institutes in different areas like atomic energy, space, defense, forestry, agriculture, electronics, health etc

**11. Improvement in social overheads or infra-structure**

Economic development is being assisted by the development in the means of transport and communication, banking system, education etc. A good deal of improvement has been made by India in this field. The Indian road net work system is now one of the largest in the world. The transport system in India has grown both in terms of capacity and modernization. The growth of commercial banks and other financial institutions are spectacular which helps to solve present financial crisis.

**12. Crisis Management**

As far as Indian economy is concerned weather and foreign exchange crisis are the main problems. But now these issues are managed to a greater extent. Even today most of the developed nations are failed to solve the recent Global Financial crisis India managed it successfully with less burden.

Indian economy, through economically backward it remained no longer in such a situation. More than six decades of development experiences created dynamism in country's economy and one can now hopefully say that it would sustain development in the future.

## Major Issues: Poverty, Unemployment and Inequality

Even though India is one of the major developing economies in the world, it faces certain crucial issues in its developmental path. They are Poverty, Unemployment and Inequality. Only by solving these issues and looking from different angles these are to be removed.

## POVERTY

### The concept of Poverty

Poverty is a plague as it is prevalent in almost all countries in the world and it has many faces and dimensions. Therefore it is difficult to define the concept poverty in precise. Poverty is always defined according to the conventions of society in which it occurs[i]. But in the recent years, the concept of poverty has been refined and made more comprehensive. The New World requires better and more scientific ways to assess the concept of poverty in the society. Now its

multidimensional aspect is recognized and uses a multidisciplinary approach to assess poverty. Poverty is not simply a social phenomenon but also include economic, political, historical, geographical and cultural aspects.

Various attempts have been made by societies to define poverty. In human terms poverty means little to eat and wear, and in economic terms the poverty means the inability to attain a minimum standard of living[ii]. It is natural to view poverty as the failure to meet the basic requirements to maintain a minimum standard of living. This minimum standard of living may vary from society to society. While biological requirement and nutritional norms provide the most elementary concept of a minimum standard of living, modern understanding of poverty requires other factors such as school enrolment, infant mortality, immunization, malnutrition, women empowerment, overall standard of living, asset holding etc.

Poverty can be defined as a social phenomenon in which a section of the society is unable to fulfill even its basic necessities of life. In India the generally accepted definition of poverty emphasizes minimum level of living rather than a reasonable level of living. In economics there are two important classification of poverty; Absolute Poverty' and 'Relative Poverty'.

**Absolute Poverty and Relative Poverty**

Absolute Poverty is the sheer deprivation or non-fulfillment of bare minimum needs of existence- of food, shelter, health or education. It is based on the absolute needs of the people and people are defined as poor when some absolute needs are not sufficiently satisfied. Hence according to this type poverty is treated as deprivation. Most of the developing countries are experiencing such type. An absolute poverty line is based on the cost of minimum consumption basket based on the food necessary for a recommended calorie intake.

Relative Poverty is related with high income countries, where people are poor because they cannot maintain or equivalent to others in the society. There should be differences in living standards among the people. It reflects economic distress, despair and dissension that stem from serious inequalities in income and wealth .The relative poverty line varies with the level of average income. Relative poverty is based on inequality and differences in standard of living. According to the relative concept of poverty, people are poor because

From this classification we know that poverty is not inequality. Poverty is only one of the evil consequences of inequality. Whereas poverty is concerned with the absolute standard of living of a part of the society i.e.; the poor, inequality refers to relative living standards across the whole society.

**Measurement of Poverty**

Once we understand poverty, it is essential to measure it with its various dimensions. The measurement of poverty is needed to plan policies to check this global phenomenon. Many factors were listed, some of them are life expectancy, mortality, maternality, safe drinking water, pure air, women empowerment, energy consumption, literacy, asset holding, sanitation, primary health facilities, clean surroundings etc. most of these are derived with income. Therefore consumption data can be used to measure poverty.

**Poverty Line**

Poverty line is the most widely used measure for assessing poverty. Under this method, people are counted as poor when their measured standard of living is below a minimum acceptable level-known as Poverty Line. The poverty line in India is defined as 'the level of private consumption expenditure, which ensures a food basket that would supply the required amount of

calories'. Actually in India the Planning Commission estimates the poverty on the basis of Calorie intake. By considering age, sex, activity etc., Indian Council of Medical Research (ICMR) proposes 2400 calorie intake for the rural person per day and 2100 calorie per person per day in urban. The calorie requirements in the rural areas is higher because people engaged in heavy work more in rural areas than in urban areas.

## POVERTY ESTIMATION IN THE INDEPENDENT INDIA

In independent India, the first official definition of poverty was given in 1962. This pegged the rural poverty line at a Monthly Family Income of Rs.100 and urban one at Rs.125.

Dandekar and Rath (1971)[iii] estimated poverty in terms of consumer expenditure needed a diet adequate at least inform of calories, they adopted 2250 calories per person per day as the norm for their study. According to them, the consumer expenditure necessary to obtain the minimum nutritional standard was an amount of Rs. 14.16 per capita per month at 1960-61 prices for rural India. Based on this norm, 30.92 percent of the rural population lies below the poverty line in 1961-62, in India.

Bhrdhan (1974)[iv] adopted the poverty line of Rs 15 at 1960-61 all India rural prices as the minimum level of living, and also estimate poverty for 1967-68 period, taking Rs. 29.90 as minimum requirement and find that in 1960-61 about 38% of rural Indians and in 1967 – 68, 53 percent of rural Indians are below poverty line.

Vaidyanathan (1974)[v] adopted Rs. 21.44 as rural poverty in India at 1960-61.prices. To his estimate the rural poverty in India is 15.65percent.

Bhatty (1974) measured the incidence of poverty for the year 1968-69. He selected poverty lines in terms of Percapita income instead of Percapita consumer expenditure. He made use of the income distribution data collected by National Council of Applied Economic Research (NCAER) for 1968-69. In order to overcome arbitrariness in using a single poverty line, Bhatty made use of five poverty lines namely Rs. 180, Rs 240 Rs. 300, Rs. 360 and Rs. 420. percapita per annum at 1968-69 prices or its percapita monthly equivalent Rs. 15, Rs. 20, Rs. 25, Rs. 30 and Rs. 35. His results show that the poverty levels vary corresponding to different income levels. The corresponding rural poverty is 21.95 percent, 39.55 percent, 55.87percent, 69.70 percent, and 78.70 percent corresponding to monthly percapita income.

Ahluwalia's (1978)[vi] "estimates shows a fluctuating trend in the incidence of poverty over time. Rural poverty in India declined from 53.4 percent in 1957-58 to 42 percent in 1960-61. Then it started rising from 42.3 percent to 57.9 percent during 1961-62 to 1967-68 and then declined to 47.6 percent in 1973-74.

Mahendra Dev (1988)[vii] estimated the poverty lines for the reference years by making use of the estimates derived by Bardhan (1974) for the year (1960-61). He adjusted the poverty lines by the Consumer Price Index of Agricultural Labourers (CPIAL) for the reference years. He found that the percentage of rural Indian population living below the poverty line was continuously declining from 46.4 percent in 1964-65 to 44.78 percent in 1972-73 and from 40.45 percent in 1977-78 to 33.20 percent in 1983-84.

The Planning Commission (1981 and 1985) measured the extent of rural poverty for 4 years taking Rs 77 (at 1979-80 prices) percapita per month as the poverty line. In 1977-78, about 51.2 percent of rural population was poor as against 54.1 percent in 1972-73. It comes down to 40.4 percent in 1983-84. The Planning Commission calculates the poverty ratio on the basis of quinquennial Consumer Expenditure Surveys conducted by NSSO. The Planning Commission's estimates of the poverty ratio for 1987-88 indicated further decline in the incidence of poverty to 33.4 percent in 1987-88.

Criticising the Planning Commission's earlier estimates, Minhas, Jain and Tendulkar (1991) measured the incidence of poverty by using correct procedure for three years 1970-71, 1983 and 1987-88. They converted the poverty norms to prices prevailing in the year for which NSS consumer expenditure data are available. They worked out State Specific Cost of Living Indices. Then, applying these indices, they calculated State Specific Poverty norms for 1970-71, 1983 and 1987-88. The poverty norms for rural India were Rs. 33.01, Rs 93.16 and Rs. 122.63 for the years considered respectively. Corresponding to these poverty lines, the percentage of population below poverty lines were 57.3, 49.02 and 44.88 for the corresponding years.

Rohini Nayyar (1991)[viii] measured the poverty line for 13 years period from 1960-61 to 1983-84 and estimated the incidence of rural poverty. Her calculations are based on actual consumption data by broad category. She made use of the calorie norm of 2200 to arrive at the poverty line. To her estimates rural poverty fluctuates over the years.

Kakwani and Subba Rao (1992)[ix] attempted a study on rural poverty for the period 1973-86. They used relative price levels in the rural areas to arrive at the poverty lines. Using the price relatives and consumer price indices for agricultural labourers they worked out the State Specific Poverty Lines at the current prices for the years 1973-74, 1977-78, 1983 and 1986 – 87. According to their estimates the rural poverty continuously declined.

Tendulkar and Jain (1995)[x] estimated the incidence of poverty for 12 years from 1970-71 to 1992. They estimated the poverty lines for various years taking the Planning Commission's all India poverty line of monthly percapita total expenditure of Rs. 49.09 at 1973-74 prices. Urban Poverty profile of the different authors are given in the Appendix,

Even though the earlier estimates of Planning Commission is based on this calorie norms which is criticised because of methodological defects and it cannot consider the other basic items like health, education etc. Therefore Planning Commission appointed an Expert Committee, under Suresh Tendulkar in 2008 and reported its recommendations in November 2009. The committee suggested a formula based on Consumption Expenditure for identifying BPL families. His recommendations are more scientific and there is some novelty in the measurement because Tendulkar committee uses a broad definition of poverty including expenditure for food, education, health etc., and uses consumer expenditure taking Mixed Recall Period as against Uniform Recall Period. According the committee the monthly consumption expenditure to measure poverty line is Rs. 446.68 per person per month in rural areas and Rs. 578.8 per person per month in urban areas. To their report India's poverty is 37.2 percent (2004-05) as against the Planning Commission's estimates of 27.5 percent in 2004-05 calculated on the basis of Dandekar- Rath formula based on calorie intake.

**Table 4.1 Poverty Rates in Various NSSO Rounds**

| Year | Round | Poverty Rate (%) |
|---|---|---|
| 1973-74 | 27 | 54.88 |
| 1977-78 | 32 | 51.32 |
| 1983 | 38 | 44.48 |
| 1987-88 | 43 | 38.86 |
| 1993-94 | 50 | 35.97 |
| 1999-00 | 55 | 26.10 |
| 2004-05 | 61 | 27.50 |

***Source:*** Planning Commission, March, 2011 and NSSO Data

Latest poverty estimates of Planning Commission are seen from the Table **4.1** Planning Commission estimates India's poverty both on the basis of Uniform Recall Period[xi] and Mixed Recall Period[xii]. It consider Cost of Living as the basis of poverty.

**Table 4.2 Poverty in India, New Estimates**

| Uniform Recall Period | | | Mixed Recall Period | |
|---|---|---|---|---|
| Years | 93-94 | 04-05 | 99-00 | 04-05 |
| Rural | 37.3 | 28.3 | 27.1 | 21.8 |
| Urban | 32.4 | 25.7 | 23.6 | 21.7 |
| All India | 36.0 | 27.5 | 26.1 | 21.8 |

***Source:*** *Economic Survey*[xiii]

In opposition to Tendulkar committee, Dr. N.C. Saxena committee was appointed by Rural Development Ministry in August 2008. This committee argued for a New BPL criterion, which suggests automatic inclusion of socially excluded groups and automatically exclusion of those who are relatively well-off. The committee recommended a new methodology of Score Based Ranking and put forwarded that Rs. 700 per month per rural person and Rs. 1000 per month per urban person to maintain 2400 and 2100 calorie intake for a day. The committee estimates that India's poverty is 49.1 percent in 2004-05.

According to Arjun Sengupta committee appointed by National Commission for Enterprises in the Unorganised Sector (NCEUS) India's poverty is 77 percent. The Committee uses the same data of NSSO and takes the norm of Rs. 20 per day per person to measure the poverty line.

Based on World Bank's estimates (2005), 41.6 percent of Indians fall below the International Poverty Line this of $ 1.25 per day (PPP)[xiv]. In nominal terms Rs. 21.69 per day in urban area and Rs. 14.3/day in the rural area. They estimate 456 million Indians lived in poverty. World Bank's new International Poverty Line is based on $ 2 per day.

Abbijith Sen found out that if we took calorie norm even then the poverty is much higher i.e.; in urban 80 percent and in rural 64 percent of the Indians are lived below poverty line. This estimate is also very higher than official estimate.

**Table 4.3: Poverty line, 1973-74 to 2004-05**

| Year | Rs per capita per month, current prices | |
|---|---|---|
| | Rural | Urban |
| 1973-74 | 49.63 | 56.76 |
| 1977-78 | 56.84 | 70.33 |
| 1983 | 89.5 | 115.65 |
| 1987-88 | 115.2 | 162.16 |
| 1993-94 | 205.84 | 281.35 |
| 1999-2000 | 327.56 | 454.11 |
| 2004-2005 | 356.30 | 538.60 |

*Source*s: Planning Commission

**Causes of Poverty in India**

Poverty is not caused by any single reason. It is the outcome of the interaction of several factors; economic, non- economic, political, social, cultural, geographical etc.

**1. Underdevelopment**

The most important cause for poverty is the underdevelopment of the economy. Due to underdevelopment a large proportion of the people have go without even the basic necessities of life. With the low national income and percapita income the country cannot increase its aggregate consumption and investment. Hence the standard of living is also so low among the people. Even though there is much improvement in the development of the country after independence still we want to go a lot.

**2. Inequality**

The second important cause of poverty in India is inequality in income and wealth. Even the New Economic policies could not reduce the depth of inequality in India. Instead there is increase in inequality among the people.

**3. Inadequate growth rate**

In the early years of planning the growth rate of Indian economy is not high enough to check the problem of poverty. Even though economy railed in a high growth path in the mid of 2000 onwards the benefits are not trickle down to the poor sections of the society. Still the gap between rich and poor is increasing.

**4. Large population**

Even though the growth rate of population is coming down still the size of it is very large. Therefore it is not capable to implement the poverty alleviation programmes successfully.

**5. Unemployment**

Another major cause for the growth of poverty is unemployment. The problem of unemployment is still so acute in the economy. Thus increasing unemployment and underemployment accentuate poverty.

**6. Poor performance of agriculture sector**

Still Indian agriculture is carried on largely with primitive techniques. High dependency on rain, small and scattered holdings, lack of inputs, exploitative land tenure system, competition from foreign markets, lack of storage and marketing facilities etc. are responsive to the poor performance of agriculture sector even after the Green Revolution.

**7. Poor performance of industrial sector**

In spite of much improvement in line with development of modern industries still performance is not up to the mark. Lack of dynamic entrepreneurs, lack of competitiveness, lack of skilled and trained workers, inadequate finance, irregular supply of power and raw materials, poor transport and methods of production etc. leads to slow industrialization of the country.

**8. Inflation**

Rise in price is an alarming problem to the economy. It is the poor who suffered a lot due to inflation. When prices are high the purchasing power of money falls and leads to impoverishment of the poor sections of the country.

**9. Social factors**

It is agreed that the poverty in India is the outcome of social factors. It includes caste system, joint family system, law of inheritance, lack of initiative and entrepreneurship etc. India is also poor in social overheads like education, health, medical facilities, illiteracy etc. The attitudes and aspirations of the people are not conducive to economic growth and development.

**10. Political factors**

Even after India escaped from the yoke of British exploitative administration still the political set up is not that much efficient to solve the problem of poverty. It is true that various programmes are initiated under five year plans. The Fifth Five Year Plan raised the slogan "Garibi Hatao" but still the poverty alleviation is a nightmare to Indian policy makers.

Thus the poverty in India is happened due to various reasons. Regional disparities, lack of investment, lack of proper implementation of public distributive system, lack of vocational training and education, migration of rural youth to cities etc. have also contributed to poverty in India.

**Remedial Measures**

Poverty is a tragedy not only for the individuals but also for the economy at large. As a result of this the remedial measures to poverty is emphasized. From the experiences of the economy we can suggest the following to alleviate poverty.

**1. Rapid Economic Growth**

Fast economic growth is a necessary condition for poverty alleviation programme for the following reasons: It changes the low income agricultural set up, helps to strengthen the redistributive activities of the government, made a radical change in production and distribution process, create more employment opportunities etc. Even there is the possibility of trickledown effect to economic growth.

**2. Accelerate agricultural growth**

No doubt that when there is agricultural growth it reduces the burden of poverty because majority of poor are lived with agriculture sector. So steps should be taken to solve the problems of small and marginal farmers.

**3. Accelerate industrial growth**

The industrial development will create more income and employment opportunities to the people. Through this the depth of poverty can be reduced.

**4. Development of small- scale and cottage industries**

In Indian economy small- scale and cottage industries have played a crucial role. This sector which being labour intensive, create more employment opportunities and help in the removal of poverty.

**5. Land reforms**

Land reforms as poverty alleviation measures aimed to break the old feudal socio-economic structure of land ownership. It aims to eliminate exploitation by providing security of tenure and regulation of rent. It also aims to bring direct contact between the state and the tiller and give social economic status of the landless by distributive measures.

**6. Better Public Distributive System**

Poverty can be reduced if people are ensured with essential commodities at fair prices. Therefore the government should establish a wide network of fair price shops to provide the essential commodities.

**7. Control Population**

Unless the population is not reduced, the additions to wealth production will be eaten up by the fresh torrent of babies. Therefore the planners should aim at the family planning measures to bring down the birth in the country.

**8. Provision of Common Services and social Security**

The government should spend for the provision of free common services like primary education, medical aid, potable drinking water, housing and other facilities to the people. This will increase their real consumption and make them feel better off and hence reduce the poverty.

**9. Improve the Status of the Women**

Gender equality can help to reduce poverty and encourage growth in variety of ways. Women are provided with direct access to institutional credit, direct membership in cooperatives, setting up of women organization etc.

**10. Good Administrative Setup**

Above all the success of any programme primarily depends on the effective working of the administrative machinery.

**A Brief Review of Poverty Alleviation Programmes**

Beginning with the launch of Integrated Rural Development Programme (IRDP, 1978) in the Sixth Five Year Plan, a number of PAPs have been formulated and implemented; many of them are have been restructured and formulated fresh from time to time . Among these PAPs the more important have been:

(a) Training of Rural Youth for Self-Employment (TRYSEM, 1979)
(b) National Rural Employment Programme (NREP, 1980)
(c) Rural Landless Employment Guarantee Programme (RLEGP, 1983)
(d) Million Wells Scheme (MWS, 1988)
(e) Nehru Rozgar Yojana (NRY, 1989).It is for the urban poor people.
(f) Jawahar Rozgar Yojana (JRY, 1989).NREGP and RLEGP are merged in this in 1989.
(g) Development of Women and Children in Rural Areas (DWCRA, 1992)
(h) Employment Assurance Scheme (EAS, 1993)
(i) Prime Minister Rozgar Yojana (PMRY, 1994)
(j) Prime Minister's Integrated Urban Poverty Eradication Programmes (PMIUPEP,1995)

Most of these programmes have been recently redesigned and restructured to improve their efficacy or impact on the poor. The important PAPs, presently in operation are;

- Self Employment Programme:
  Swarnjayanthi Gram Swarozgar Yojana (SGSY, 1999). This replaces IRDP, TRYSEM, DWCRA, SITRA, GKY and MWS and work for rural poor.
- Wage Employment Programme:
  - National Food for Work Programme (NFWP, 2004). It intensifies the generation of supplementary wage employment.
  - Sampoorna Grameen Rozgar Yojana (SGRY, 2001). Rural Employment Generation Programme (REGP, 1995) was merged in SGRY in 2001.SGRY provide additional wage employment in the rural areas. Now this programme is entirely subsumed in NREGS with effect from April, 1, 2008.
- National Social Assistance Programme (NSAP, 1995). It provides social assistance to the rural poor.
- Urban Employment and Anti-poverty Programme:
  - Prime Minister Rozgar Yojana (PMRY, 1993)
  - Swarna Jayanti Shahari Rozgar Yojana (Golden Jubilee Urban Employment Scheme, 1997). This scheme integrates three PAPs for urban areas, viz.NRY, PMIUPEP and Urban Basic Services for the poor.

## Unemployment

Another major developmental issue in Indian economy is unemployment. Although this problem had existed in the past; it has become more acute after the independence. The backwardness and increasing population are mainly responsible for this problem. The socio-economic consequences of unemployment are very dangerous. It has economic consequences for the individual as well as the society.

Unemployment means idleness of man power. It is the state in which labour possesses necessary ability and health to perform a job, but does not get job opportunities. In other words unemployment is the situation in which individuals are available for work, but are not able to find a work.

In order to explain the concept unemployment it is better to distinguish between the concepts like labour force and work force. The labour force refers to the number of persons who are employed plus the number who are willing to be employed. In India the labour force excludes

children below the age 15 and old people above the age 60 and mentally or physically handicapped. The work force includes those who are actually employed in economic activity. If we deduct work force from labour force we get the number of unemployment.

The unemployment rate means the number of persons unemployed per 1000 persons in the labour force.

The labour force participation rate and work force participation rate can be expressed in percentages and as given below.

Labour Force Participation Rate = Labour Force / Size of the population

Work Force Participation Rate = Work force / Size of the population

**Types of unemployment**

In every economy there is unemployment but the nature and magnitude differ according to the economic progress. Following are the important types of unemployment.

**1. Voluntary unemployment**

This is the main type of unemployment referred by the Classical economists. Voluntary unemployment is happened when people are not ready to work at the prevailing wage rate even if work is available. It is a type of unemployment by choice.

**2. Involuntary Unemployment**

Keynes analysed this type of unemployment. It is a situation when people are ready to work at the prevailing wage rate but could not find job.

**3. Natural rate of Unemployment.**

This is postulated by the Post-Keynesians. According to them in every economy there exists a particular percentage of unemployment.

**4. Structural unemployment**

This type of unemployment is not a temporary phenomenon. It is chronic and is the result of backwardness and low rate of economic development. The structural changes of an economy are the main reason for this type of unemployment.

**5. Disguised Unemployment**

When more people are engaged in a job than actually required, then it is called disguised unemployment. If a part of labour is withdrawn and the total production remains unchanged because their marginal product is zero. This is a part of structural unemployment.

**6. Under Employment**

This exists when people are not fully employment ie; when people are partially employed. In other words it is a situation in which a person is does not get the type of work he is capable of doing.

**7. Open Unemployment**

Mrs. Joan Robinson calls this type of unemployment as ‘Marxian Unemployment’. Open unemployment is a situation where a large labour force does not get work opportunities that may yield regular income to them. It is just opposite to disguised unemployment. It exists when people are ready to work but are not working due to non-availability of work

**8. Seasonal unemployment**

Generally this type of unemployment is associated with agriculture because the unemployment rate is changed according to the season.

**9. Cyclical Unemployment**

It is generally witnessed in developed nations. This type of unemployment is due to business fluctuation and is known as cyclical unemployment.

**10. Technological Unemployment**

When the introduction of a new technology causes displacement of workers it is called technological unemployment.

**11. Frictional Unemployment**

It is a temporary unemployment which exists when people moved from one occupation to another. It will take time lag in transferring one work to another. The market imperfections are the main reason for this.

**Measurement of unemployment in India**

The National Sample Survey Organization (NSSO), which provides estimates of the rates of unemployment in India on the basis of its quinquennial surveys, uses three different concepts. They are Usual Status Unemployment, Current Weekly Status unemployment and Current Daily Status unemployment.

**I. Usual Status Unemployment (US)**

Here the reference period is 365 days. The usual status gives an idea about long- term employment (or chronic and open employment) during the reference year. A person is considered unemployed on Usual Status basis, if he/she was not working, but was willing to work for the major part of the reference year (more than 183 days) but did not get work for even 183 days. Dividing the usual status unemployment by the size of the labour force, we get unemployment rate by usual status. This measure is more appropriate to those in search of regular employment (educated and skilled persons) who may not accept casual work.

**II. Current Weekly Status Unemployment (CWS)**

Here the reference period is one week .A person is considered unemployed by Current Weekly Status, if he/she had not worked even for one hour during the week, but was seeking or was available for work. The estimates are made in terms of the average number of persons unemployed per week. The Current Weekly Status approach gives an idea about temporary unemployment (or chronic plus temporary unemployment) during the reference week. Current Weekly Status is used by the agencies like Inter National Organisations (ILO) to estimate employment and unemployment rates based on weekly reference period for international comparison. Dividing the weekly status unemployment by the size of the labour force, we get unemployment rate by weekly status.

**III. Current Daily Status Unemployment (CDS)**

Here the reference period is each of the 7 days, preceding the date of survey in each of these days. It records the activity status of a person for each day of the 7 days preceding the survey i.e. persons who did not find work on a day or some days during the survey week. The

Current daily status approach gives a composite or comprehensive measure of unemployment, i.e., it is a measure of chronic and temporary unemployment as well as under employment. Dividing the

current daily status unemployment by the size of the labour force, we get unemployment rate by usual status.

The current daily status gives the most faithful picture of unemployment situation.

**Magnitude of unemployment in India**

A comparison between different estimates of unemployment in 2009-10 indicates that the CDS estimate of unemployment is the highest (Table 4.8). The higher unemployment rates according to the CDS approach compared to the weekly status and usual status approaches indicate a high degree of intermittent unemployment. Interestingly, urban unemployment was higher under both the usual principal and subsidiary status (UPSS) and current weekly status (CWS) but rural unemployment was higher under the CDS approach. This possibly indicates higher intermittent or seasonal unemployment in rural than urban areas, something that employment generation schemes like the MGNREGA need to pay attention to. However, overall unemployment rates were lower in 2009-10 under each approach vis-a-vis 2004-05.

**Table 4.8: All-India NSS 66th Round Rural and Urban Unemployment Rates**

| Si No | Estimates | Rural (2009-10) | Urban (2009-10) | Total (2009-10) | Total (2004-15) |
|---|---|---|---|---|---|
| 1 | UPSS | 1.6 | 3.4 | 2.0 | 2.3 |
| 2 | CWS | 3.3 | 4.2 | 3.6 | 4.4 |
| 3 | CDS | 6.8 | 5.8 | 6.6 | 8.2 |

Source: NSSO

Labour force participation rates (LFPR) under all three approaches declined in 2009-10 compared to 2004-05 (Table 4.2). However, the decline in female LFPRs was larger under each measure in comparison with male LFPRs which either declined marginally (UPSS), remained constant (CWS), or increased marginally (CDS).

**Table 4.2 All-India Employment and Unemployment Indicators (per 1000)**

| *Indicators* | NSS 66th Round (2009-10) | | | NSS 61th Round (2004-05) | | |
|---|---|---|---|---|---|---|
| | Male | Female | Total Person | Male | Female | Total persons |
| UPSS | | | | | | |
| LFPR | 557 | 233 | 400 | 559 | 294 | 430 |
| Work Participation Rate | 546 | 228 | 392 | 547 | 287 | 420 |
| Unemployment Rate | 20 | 23 | 20 | 22 | 26 | 23 |
| CWS | | | | | | |
| LFPR | 550 | 207 | 384 | 550 | 257 | 407 |
| Work Participation Rate | 532 | 198 | 370 | 527 | 244 | 389 |
| Unemployment Rate | 33 | 43 | 36 | 42 | 50 | 44 |
| CDS | | | | | | |
| LFPR | 540 | 179 | 365 | 538 | 215 | 381 |
| Work Participation Rate | 507 | 164 | 341 | 496 | 195 | 350 |
| Unemployment Rate | 61 | 82 | 66 | 78 | 92 | 82 |

*Source:* Key Indicators of Employment and Unemployment in India, 2009-10, NSSO.

**Causes of unemployment in India**

Following are the important causes of unemployment in India

1. Rapid population growth
2. Slow growth of the economy
3. Decay of small scale and cottage industries
4. Low rate of capital formation
5. Defective planning
6. Slow growth of agriculture sector
7. Global financial crisis
8. Illiteracy
9. Lack of training facilities

**Remedial Measures for unemployment**

In order to solve the problem of unemployment there is both government measures and other measures. It includes the following measures.

1. Rapid growth and expansion of the economy
2. Establishment of more work and training centers
3. Development of small scale and cottage industries
4. Establishment of poverty eradication programmes
5. Liberal institutional finance and self employment programmes
6. Establishment of more employment exchanges
7. Introduction of population control measures
8. Introduction of more public works programmes
9. Reduce illiteracy
10. Stress on vocational and technical education

## The Concept of Inequality

While the concept of poverty is rooted in the "lack of access" or "a low level of access" to food, nutrition, shelter, education and other services. Inequality is related to "unequal access" or "different degrees of access" of different individuals or groups of individuals to opportunities, services and benefits. Inequality is, thus, a more general concept than poverty. It looks at the ***relative levels of access*** of different groups to development opportunities and benefits. The "different levels of access" in the concept of inequality also include the low level of access below which people are considered poor. In fact, the low level of access or the limit (like for example, the calorie limit for consumption) that may be set for defining poverty will itself include a number of lower levels of access.

**Inequality in India**

India is shining for only a select few. The impressive economic growth of our country has brought smiles on the faces of the rich and the powerful even as the rest suffer in distress and drudgery. This was revealed by the Human Development Report, 2011 (HDR) released by Planning Commission. The report highlights the skewed income and wealth distribution in India and the widening gap between the rich and the poor. According to HDR 2011, inequality in India for the period 2000-11 in terms of the income Gini coefficient was 36.8. India's Gini index was more favourable than those of comparable countries like South Africa (57.8), Brazil (53.9), Thailand (53.6), Turkey (39.7), China (41.5), Sri Lanka (40.3), Malaysia (46.2), Vietnam (37.6), and even the USA (40.8), Hong Kong (43.4), Argentina (45.8), Israel (39.2), and Bulgaria (45.3) which are otherwise ranked very high in human development.

There are three important types of inequality exist in India, namely inequality in income and consumption, inequality in assets and regional inequality. These three forms of inequality are interrelated and mutually reinforcing. The Government of India has been concerned about rising inequalities and uneven distribution of the benefits of growth. Accordingly, the thrust of the 11th Five-Year Plan (2007-12) was on inclusive growth. The forthcoming 12th Five-Year Plan is expected to deepen and sharpen the focus on inequalities.

**Inequality in Income and Consumption**

Let us look at levels of inequality in income or consumption. Consumer expenditure of households is a good proxy for income, at least in the lower classes. A study of inequalities in levels of consumption will by itself be useful in an economy where agriculture, the unorganised sector, payment of wages in kind and the non-monetised sector still play an important role. Such an analysis will be able to pinpoint attention on specific areas of concern in the consumption pyramid. Let us, therefore, turn to levels of inequality in consumption.

The household consumer expenditure surveys of the NSSO provide the levels of consumption of expenditure in the population by Monthly Percapita Consumer Expenditure (MPCE) classes. The Average MPCE of the rural people in India is only Rs.1054 and in Urban it is Rs.1984[xv].

A comparison of the share of the bottom 10 per cent (or 20 per cent or 50 per cent) of the population in total consumption with that of the top 10 per cent (or 20 per cent or 50 per cent) of the population brings out dramatically the extent of inequality in consumption. The inequality situation is worse in urban areas than in rural areas. This is so in all States and Union Territories. Inequality in consumption is declining, *albeit* slowly, in rural areas according to all measures of inequality. On the other hand, urban inequality shows no sign of any decline.

**Table: 4.3 Share of Household Expenditure by Percentile Groups of Households (in %)**

| Percentile groups of Households | 1989-90 | 1994 | 1997 | 2004-05 |
|---|---|---|---|---|
| Lowest 20 percent | 8.8 | 9.2 | 8.1 | 8.1 |
| Second quintile | 12.5 | 13.0 | 11.0 | 11.3 |
| Third quintile | 16.2 | 16.8 | 15.0 | 14.9 |
| Fourth quintile | 21.3 | 21.7 | 19.3 | 20.4 |
| Highest 20 percent | 41.3 | 39.3 | 46.1 | 45.3 |
| Highest 10 percent | 27.1 | 25.0 | 33.5 | 31.1 |

*Source:* Various NSSO Report

**Inequality in Assets**

Incomes are derived from two main sources. Namely, assets like land, cattle, shares and labour etc. In India a few own a large chunk of income-earning assets therefore the distribution of assets is extremely unequal. The top 5 per cent of the households possess 38 per cent of the total assets and the bottom 60 per cent of households owning a mere 13 per cent. The disparity is more glaring in the urban areas where 60 per cent of the households at the bottom own just 10 per cent of the assets. Predictably, asset accumulation is minimal among the agricultural labour households in rural areas and casual labour households in urban areas. But the asset distribution is even more unequal in the urban than in the rural areas. At the one extreme there are highly rich households of industrial, commercial, financial, and real estate magnates and some ex-princes and political leaders. They own enormous assets and running for huge profits. On the other extreme there are

slums, and pavement dwellers, unemployed and casual labourers, independent workers providing petty services etc. who generally hold negligible assets.

**Regional Inequality**

Third important type of inequality that India faces is the regional inequality. Some states are economically and socially advanced while others are backward. Even within each state some regions are more developed while others are primitive. The co existence of relatively developed and economically depressed states and even regions within each state is known as regional inequality. The existence of regional inequality creates social, economic and political issues. The regional inequality is so prominent in India in the case of HDI Value, growth of the economy, poverty, unemployment, education, health, monthly percapita expenditure, rural- urban divide etc.

The India Human Development Report, 2011 shows that India has a HDI value of 0.467. The HDI is the highest for Kerala (0.790)[xvi] followed by Goa (0.617) and then Punjab (0.605) and the lowest for Chhattisgarh (0.358), Odisha (0.362) and Bihar (0.367). While the HDI scores across states show little variation the variation in the sub-indices for education and health show a greater degree of variation. The income index shows the least degree of variation. The major states are distributed between the categories of countries with 'Medium' and 'Low Human Development' as per the HDR 2011 classification. Kerala is in the 'Medium HDI' category. Other major states in this group are Punjab, Himachal Pradesh, Haryana, Maharashtra, Tamil Nadu, Karnataka, Gujarat, West Bengal and Uttarakhand. Nine other states, namely Andhra Pradesh, Assam, Uttar Pradesh, Rajasthan, Jharkhand, Madhya Pradesh, Chhattisgarh, Bihar and Odisha fall in the 'Low HDI' category India is ranked 134 out of 187 countries in the Global HDI,2011.

The best performer in terms of growth in 2009- 10 was Uttarakhand, followed by Odisha, Chhattisgarh, and Gujarat and the worst performers were Karnataka, Rajasthan, and Jharkhand. States with above 10 per cent growth rate for the period 2004-5 to 2009-10 are Uttarakhand, followed by Maharashtra, Gujarat, and Bihar.

The state-wise estimates of poverty as recomputed by the Tendulkar Committee show that the highest poverty headcount ratios (PHRs) for 2004-5 exist in Odisha (57.2 per cent), followed by Bihar (54.4 per cent) and Chhattisgarh (49.4 per cent) against the national average of 37.2 per cent.

The unemployment rate (per 1000) according to usual status(adjusted) as per the NSS 66th round 2009-10 among the major states is lowest in Rajasthan(4) and highest in Kerala(75) in rural areas and the lowest in Gujarat(18) and highest again in Kerala(73) and Bihar(73) in urban areas.

In the area of education, Madhya Pradesh has the highest GER (6-13 years) in 2008-9 while Punjab has the lowest. Pupil-teacher ratios in primary and middle/basic schools are the lowest in Himachal Pradesh and high in states like Bihar and Uttar Pradesh.

Health-wise, Kerala is the best performer and Madhya Pradesh the worst in terms of life expectancy at birth (both male and female) during 2002-6. IMR in 2010 is also the lowest in Kerala and highest in Madhya Pradesh. Kerala has the lowest and Uttar Pradesh the highest birth rate in 2010, followed by Bihar and Madhya Pradesh. Odisha has the highest and interestingly West Bengal the lowest death rate.

The MPCE indicator shows that there is disparity both in the MPCE and food share across states. Bihar has the lowest MPCE of Rs 780 with 65 per cent food share in rural areas and Rs 1238 with 53 per cent food share in urban areas whereas Kerala has the highest MPCE of Rs 1835 with 46 per cent food share in rural areas and Rs 2413 with 40 per cent food share in urban areas. States with low average MPCE tend to have a higher share of food in total consumer expenditure as food

is the primary need for survival and takes up a larger proportion of overall expenditure in the poorer sections of population. The top states spending more than the national average on food items both in rural and urban India are Bihar, Assam, Odisha, and Jharkhand.

Turning to the rural urban gap, we begin with the Monthly per capita expenditure (MPCE) defined first at household level to assign a value that indicates level of living to each individual or household. Based on the 66th round (2009-10) of the National Sample Survey (NSS), average MPCE [Modified Mixed Reference Period (MMRP) based] is Rs. 1054 and Rs.1984 respectively for rural and urban India at the all India level indicating rural-urban income disparities. Out of the MPCE, the share of food is Rs. 600(57 per cent) and Rs. 881(44 per cent) for rural and urban India respectively which shows that food share is more in rural India as compared to urban India.

**Causes of Inequality in India**

1. Private ownership of means of production
2. Poverty of the people
3. Law of inheritance
4. Concentration of economic power in the hands of a few
5. Highly unequal asset distribution
6. Inadequate employment generation
7. Inadequate development of the economy
8. Differential regional growth
9. Inequalities in professional training
10. Low investment in social sectors
11. Use of capital intensive technique of production
12. Failure of implementation of land reforms
13. Tax evasion and of the richer sections of the community
14. Inflation
15. Privatisation and globalisation

**Remedial measures**

In order to find out the remedial measures for inequality it is better to solve first the real causes of it in the country. Any how the following are the some of the measures to solve inequality.

1. Reduction in the concentration of economic power
2. Development of backward areas
3. Better distribution of income and wealth
4. Land reforms
5. Creating more employment opportunities
6. Provide more social security measures
7. Control of black money
8. Progressive income tax
9. Control of monopolies and trade restriction practices
10. High taxes on luxuries
11. Change in inheritance law
12. Use of labour intensive technique of production
13. More investment in social sectors
14. Control of inflation
15. Population control

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x. Suresh D. Tendulkar & L.R. Jain (1995), *Economic Reforms and Poverty*, EPW vol. 30, No. 23, June 10, pp. 1373-77.

xi. URP=Uniform Recall Period took consumption in which the consumer expenditure data for all items are collected from 30- day recall period.

xii. MRP = Mixed Recall Period took consumption in which the consumer expenditure data for five non-food items, namely, clothing, footwear, durable goods, education and institutional medical expenses are collected from 365-day recall period and the consumption data for the remaining items are collected from30-day recall period.

xiii. Economic Survey, 2009 – 10 Government of India, New Delhi, p.273

xiv. PPP- Purchasing Power Parity.

xv. 66 th Round of NSSO Report

**xvi.** HDI value estimated in 2007-08.

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# Module VI
# MAJOR SECTORS OF INDIAN ECONOMY

Importance; contribution and problems of agricultural sector; green revolution; land reforms; Industry: importance; contribution and problems; Services: contribution to the national economy- Impact of economic reforms on major sectors.

## 6.1 Importance of agriculture sector in Indian economy

Agriculture sector plays a strategic role in the process of economic development of the Indian economy. Agriculture is the foundation upon which the entire superstructure of the country is built. Indian Agriculture may be considered the backbone of the Indian economy. Most of the people of India lived with the agriculture sector. To Indian people agriculture is not mere an occupation rather than it is their life style. As a result of these agriculture has crucial importance in our economy. The importance or role of agriculture in Indian Economy can be better explained in the following points.

1. **Contribution to national economy or GDP**

Agriculture is the single most sector which contributes much to the national income at the time of independence. It contributes 56.5 % in 1950-51. Agriculture including allied activities accounted for 13.9 per cent of GDP at 2004-05 prices in 2011-12 as compared to 14.5 per cent in 2010- 11. In terms of composition, out of a total share of 14.5 per cent in GDP in 2010-11, agriculture alone accounted for 12.3 per cent, followed by forestry and logging at 1.4 per cent, and fishing at 0.7 per cent. Even though the contribution from agriculture sector declined still it has a dominant role in India’s economy. The average annual growth in agriculture and allied sectors realized during the Eleventh Plan Period was 3.3 per cent against the targeted growth rate of 4 per cent. The share of agriculture in national income is often taken as an indicator of economic development. Normally, developed economies are less dependent on agriculture as compared to underdeveloped countries. For example in the developed countries like USA and UK the contribution of agriculture ranges between 2 to 3 percentages.

2. **Agriculture provides raw materials**

Agriculture development is necessary for improving the supply of raw materials for agro-based industries. The shortages of agriculture sugar, goods have its own impact upon the industrial production and consequent increase in the general price level. It will impede the growth of the economy. Indian agriculture provides raw materials to many industries such as cotton, jute, sugar, flour mills, tea, coffee, etc.

3. **Agriculture provide employment**

Agriculture sector can carry more employment opportunities than any other sectors. India is basically an agricultural country and most of the people lived with agriculture sector. Agriculture is the single largest private sector occupation. At the time of independence about 80 % of the people lived with agricultural sector while according to the 2010-11 estimates 52.1 % of the people lived with agricultural sector. The employment potentiality of the sector is very high. As a result of all these the burden of unemployment gets reduced in India.

4. **Importance in international trade**

Indian agriculture is very vibrant in terms her international competitiveness. At the time of independence about 70 % of the export earning comes from agriculture sector. According to the

estimates of 2009-10, 10.59 % of the export earning is from agriculture sector. The important exportable items of agriculture include tea, sugar, oilseeds, tobacco, spices etc. Large percentage of foreign exchange can be earned through the export of agricultural products.

5. **Creation of infrastructure**

The development of agriculture requires roads, market yards, storage facilities, transportation, railways, irrigation facilities, and many other facilities. They are the infrastructure facilities helped to the development of the country.

6. **Importance in industrial development**

Agriculture development is also essential to the development of industries in the country. Both are complementary to each other in the development process. Various important industries in India find their raw material from agriculture sector; cotton, jute and plantation industries (viz., tea, coffee, and rubber), textile industries, sugar, vanaspati, etc are directly dependent on agriculture. Handloom, spinning, oil milling, rice thrashing etc., are various small scale and cottage industries which are dependent on agricultural sector for their raw material. Agriculture is also one of the biggest markets for industry.

7. **Necessary for the food stuffs**

In order to feed the large population of our country the development of agriculture is essential. The growth in population demands more and more food stuffs. It can provide only by development of agriculture.

8. **For growth with stability**

Economic development without agriculture development will create some bottle necks and inflationary pressures. Low rate of agricultural development resulted in shortage of food and essential raw materials leading to inflation.

Growth in agriculture and allied sectors remains an important objective and a 'necessary condition' for inclusive growth. However, it is a matter of concern that agricultural growth is still, to a certain extent, characterized by fluctuations due to the vagaries of nature, though there has not been actual decline in terms of output since 2002-03.

**Table 6.1 Sectoral Composition of GDP**

| Year | Agriculture | Industry | Service |
|---|---|---|---|
| 1950-51 | 53.1 | 16.6 | 30.3 |
| 1960-61 | 48.7 | 20.5 | 30.8 |
| 1970-71 | 42.3 | 24.0 | 33.8 |
| 1980-81 | 36.1 | 25.9 | 38.0 |
| 1990-91 | 29.6 | 27.7 | 42.7 |
| 2000-01 | 22.3 | 27.3 | 50.4 |
| 2010-11$^{QE}$ | 14.5 | 27.8 | 57.7 |
| 2011-12$^{AE}$ | 13.9 | 27.0 | 59.1 |

*Source*: Economic Survey 2011-12

**Table 6.2 Agriculture Sector: Key Indicators (per cent)**

| SI no | Items | 2009-10@ | 2010-11* | 2011-12** |
|---|---|---|---|---|
| 1 | GDP-Share and growth(at 2004-05 prices) | | | |
| | a) Growth in GDP in agriculture & allied sectors | 1.0 | 7.0 | 2.5 |
| | b) Share in GDP - Agriculture and allied sectors | 14.7 | 14.5 | 13.9 |
| | c) Agriculture | 12.4 | 12.3 | |
| | d) Forestry and logging | 1.5 | 1.4 | |
| | e) Fishing | 0.8 | 0.7 | |
| 2 | Share in total Gross Capital Formation in the Country (per cent at 2004-05 prices) ) Share of agriculture & allied sectors in total Gross Capital Formation | 7.1 | 7.2 | |
| | a) Agriculture | 6.6 | 6.6 | |
| | b) Forestry and logging | 0.1 | 0.1 | |
| | c) Fishing | 0.5 | 0.5 | |
| 3 | Employment in the agriculture sector as share of total workers as per census2001 | 58.2 | | |

Source: Central Statistics Office (CSO) and Department of Agriculture and Cooperation.
Notes: @ Provisional Estimates *Quick Estimates **Advance Estimates

**6.2 Problems of Indian Agriculture**

1. Lack of proper land reform measures.
2. Lack of credit facilities.
3. Lack of proper storage facilities.
4. Lack of chemical fertilizers.
5. Lack of proper agriculture research.
6. Lack of proper vision from the part the government.
7. Small and uneconomic holdings.
8. Prevalence of natural calamities.
9. Inadequate irrigation facilities.
10. Defective marketing facilities.
11. Out model technologies.
12. Absence of double cropping and crop rotation.
13. High pressure on land.
14. Soil erosion.
15. Pests and plant diseases.
16. Challenges from the international market.
17. Slow growth of agriculture sector.
18. Fall in total area of food grains production.
19. Fall in per capita availability of food grains production.
20. Very high dependency on monsoons.

## 6.3 Green Revolution (1966)

Green revolution is the term connecting the agriculture sector. Green revolution means the tremendous hike in the agricultural production and productivity during the mid of 1960's. The Green Revolution is happened due to the simultaneous use of package of inputs which is otherwise referred as New Agriculture Strategy comprises IADP, IAAP and HYVP. The Green Revolution happened in India for the first time in the Kharif season of 1966. This crucially depended on regular and adequate irrigation, fertilizers, and high yielding varieties of seeds, pesticides and insecticides. Some critics call this as the wheat revolution because due to Green revolution wheat production increased tremendously compared to all other crops. The born place of Indian Green revolution is Punjab and Dr: M.S. Swaminathan was considered as the father of Indian Green revolution.

## 6.4 New Agriculture Strategy (NAS)

New Agriculture Strategy (NAS) is a programme based on the concept of application of science and technology to farming for increasing yield per hector. It is the New Agriculture Strategy which contributes to the Green Revolution in the Indian agriculture. The NAS worked through IADP, IAAP and HYVP

### a) Intensive Agricultural District Programme (IADP)

Intensive Agricultural District Programme was introduced as a pilot project in 1960-61. This programme meant to use various agricultural resources simultaneously in selected regions. The objective of this programme was to increase the production of food grains and to prepare the basis for the rapid economic development of the country. Under this programme farmers were given inputs like irrigation facilities, seeds, fertilisers, implements etc. There were 7 selected districts under this programme. As a result of implementing this there should be a rapid rise in the agricultural production. After the initial success this programme expanded to 13 more districts also.

### b) Intensive Agricultural Area Programme (IAAP)

Intensive Agricultural Area Programme was a modified version of the IADP introduced in 1964-65. This programme was for the intensive development of major crops such as wheat, paddy, millets, cotton, sugar cane, potato, pulses etc and staff employed was on a reduced scale.

### c) High Yielding Varieties Programme (HYVP)

High Yielding Varieties Programme was launched in 1966. Both the programmes IADP and IAAP gave importance to the intensive agricultural development. These programmes worked for only some selected crops. The farmers were not satisfied with the success of these programmes and seek a new programme. During this time Indian council of agricultural Research and Agricultural Universities like Patnagar, Koyambathoor are developed high yielding seeds. A number of high yielding varieties of rice and wheat, both exotic and local, and hybrids of maize, Jowar and bajra, responsive to fertilisers were introduced. Since then a number of new high yielding varieties of these cereals and millets have been evolved and improved in the programme.

## 6.5 Components of Green Revolution

There are various factors which contribute to the happening of Green revolution in Indian agriculture in the Fourth Five Year Plan. It includes the following components.

### 1. Package of inputs

The green revolution is happened due to the application of the package or the combination of improved practices. The new agriculture strategy aims at making them adopt simultaneously all

the elements needed for increasing production. It includes high yielding varieties of seeds, chemical fertilisers, plant protection measures, mechanisation, irrigation facilities, etc.

a) HYV seeds: The most important feature of the new agriculture strategy which contribute to the green revolution was the use of HYV seeds in areas where good rainfall and irrigation facilities. HYV seeds of wheat, paddy, bajra, maize etc. were introduced since 1965-66.For wheat new Mexican dwarf varieties like Lerma Roja, 64 A, Sonara, Kalyan, and PV-18 and for bajra HB-10, For maize – Vijay etc were introduced. In the case of paddy adopt TN-1, IR 8, Tinen-3 etc.

b) Use of chemical fertilisers: The use of chemical fertilisers is one of the key elements of the strategy for accelerating the growth of agricultural output. The use of nitrogenous, phosphoric and potassic fertilisers have been increased by importing fertilisers.

c) Plant protection: another important measure used under the new agriculture strategy is plant protection by using many pesticides and insecticides.

d) Farm mechanisation: A significant aspect of green revolution is the use of modern machinery like tractors, harvesters, pump sets, tube wells etc. They are used on a large scale.

e) Extension of irrigation: Water is the basic input in agriculture. New seeds and fertilisers can produce desired results only if adequate water is made available. HYV programmes were started in those areas where sufficient water supply. Many minor irrigation facilities have started under this programme.

2. **Multiple cropping**

The NAS is concerned with not only higher yields, but with great intensity of cropping, which aimed at intensive cultivation of land by raising three or more crops in the same plots of land in a year. New crop rotations have made possible by the development of new short duration varieties of paddy, Jowar, maize and bajra suited to different agro-climatic conditions. Among other crops included in the rotation are barley, ragi, oil seeds, potato and vegetables. As a result of this there was not only tremendous increase in production but the fertility of the land was also maintained.

3. **Improved credit-facilities**

Credit has played an important role in popularising the use of HYV programme among the farmers. Short term and medium term loans were given to farmers through Primary Co-operative Societies, Land Development Banks, Commercial Banks, Regional Rural Banks, and Farmers' Service Co-operative etc. They have helped the farmers in buying the seeds, fertilizers, implements, machines and other inputs.

4. **Processing , storage and marketing facilities**

These facilities are also speedily extended and improved so that the increased agriculture production is put into profitable use.

5. **Dry land development**

To promote agricultural development in dry land areas, cultivation of drought resistant and short duration varieties of seeds based on latest dry farming technology was encouraged.

6. **Price incentives**

Another contributing factor to the green revolution has been the policy of support price of food grains. In 1965 Agricultural Price Commission and Food Corporation of India were set up for the purpose ensuring price stability and fare price. All these boosted agriculture.

7. **Farmer's training and education**

A pilot scheme for Farmer's training and education was started in 1966-67 in 5 selected districts. In subsequent years it was extended to other districts. This programme emphasis the literacy of the farmers and they were given agricultural information through audio-visual media and formation of the formation of farmer's discussion group.

8. **Agricultural research and technology**

NAS give emphasis agricultural technology as a major input of agricultural production and to development of agricultural research. The Indian Council of Agricultural Research (ICAR) and agricultural universities in different states has been undertaking the task of research in agricultural products.

9. **Setting up of new institutions**

In view of the importance assumed in inputs and services in the NAS new institutions were set up provided with funds to support agricultural production. Among them more prominent are, National Seeds Corporation, Agro-Industries Corporation, Agriculture Refinance and Development Corporation etc.

In brief it can be observed that the New Agricultural Strategy (NAS) or the package programme improves the agricultural pattern in the country and brings tremendous hike in agricultural production and productivity. All the above points are the contributing factors and bring much needed Green Revolution in the country.

## 6.5 Impacts of Green Revolution

No doubt that New Agricultural Strategy brings lot of changes in Indian agriculture. It has far reaching impact upon the agriculture and the economy as well. After 1966 there is substantial increase in food grains production especially wheat, but it is clear that the New Agricultural Strategy led to an increase in inter regional and interpersonal inequalities. Thus The Green Revolution had both positive and negative impacts.

### (A) Positive Impacts of Green Revolution

1. Hike in agricultural production and productivity
2. Increase in food production
3. Boost the production of cereals
4. Fall in poverty
5. More employment is created
6. Use of modern technology
7. Use of chemical fertilisers
8. More irrigation facilities developed
9. More research work is taking place
10. More saving and investment are created
11. More infrastructures is created
12. More land is added to agriculture
13. Better distribution of land

**(B) Negative Impacts of Green Revolution**

1. Increase in both inter-regional and intra regional inequalities
2. Environmental degradation took place
3. Reduction in employment elasticity
4. Increase in personal inequality
5. Traditional knowledge was lost
6. Neglects the production of coarse cereals and pulses
7. Ground water level down
8. Health problems due to excess of mosquitoes in waterlogged area around lands
9. Irrigation of fields without proper drainage led to stalenization and alkalization of soils

**Rainbow Revolution**

*The Rain bow revolution means the 'Food Chain Revolution' to put a check on destroying food grains, vegetables and fruits. The Rain bow revolution includes the following:*

***Revolution*** ***Area***

1. *Green Revolution..................Agriculture (Food grains production)*
2. *White Revolution...................Milk*
3. *Blue Revolution.....................Fish*
4. *Yellow Revolution.................Oilseeds*
5. *Golden Revolution................Fruits/Apple*
6. *Black Revolution...................Petroleum/non-conventional energy*
7. *Silver Revolution...................Eggs*
8. *Round Revolution..................Potato*
9. *Red Revolution......................Meats/Tomato*
10. *Grey Revolution....................Fertilizers*
11. *Pink Revolution.....................Shrimp*
12. *Brown Revolution.................Leather*

## 6.6 Land reforms

In abroad sense land reforms refer to all kinds of policy –induced changes relating to the ownership, tenancy and management of land. It includes the whole agrarian structure within which a peasant operates. In a sense the changes brought about in the agrarian structure through direct intervention are characterised as land reforms. In other words land reform means abolishing the existing defective structure of land holding by introducing a rationalised structure in order to increase the agriculture productivity.

### 6.7 Land Tenure System in India

Land Tenure refers to the system of land ownership and management. The various features that distinguish a land tenure system from the others relate to the following: (a) Who owns the land; (b) Who cultivate the land; (c) Who is responsible for paying the land revenue to the government. On the basis there are three different types of land tenure existed in India before independence. They are Zamindari system, Mahalwari system and Ryotwari system.

1. **Zamindari system or the Land lord-Tenant System**

This system was created by the British East India Company, when in 1793; Lord Cornwallis introduced 'Permanent Settlement Act'. Under this system the land lords or the Zamindars were declared as the owner of the land and they are responsible to pay the land revenue to the government which is fixed. The share of the government in total rent collected is fixed at 10/11 th, the balance going to the Zamindars as remuneration. The actual tiller does not come into contact with the state and thus the Zamindars act as an intermediary between the state and the tiller. The land lords lease land to the tenants and collect rent from them. The land lord gets pre-determined share of the produce. The cultivators do not have any owner ship rights on the land and they are only tenants under the Zamindari system. Under this system nobody is interested for the development of the agriculture. This system is more prominent in West Bengal, Andhra Pradesh, Madhya Pradesh, Utter Pradesh, Bihar and Orissa. In pre independence India, about 25% of area was covered by this system.

2. **Mahalwari System or Communal System of Farming**

This system was introduced by William Bentinck in Agra and Oudh. It was later extended to Madhya Pradesh and Punjab. Under this system the ownership of the land is maintained by the collective body usually the villagers which serves as a unit of management. They distribute land among the peasants and collect revenue from them and pay it to the state. But this system also leads to absentee landlordism. About 39 % the land area is covered under this system before independence in India.

3. **Ryotwari system or the Owner –Cultivator System**

This system was initially introduced in Tamil Nadu and later extended to Maharashtra, Gujarat, Assam, Coorg, East Punjab and Madhya Pradesh. Under this system the owner ship rights of use and control of land are held by the tiller itself. There is the direct relationship between owner –cultivator i.e. state and the tiller in revenue collection. Therefore this system is considered as the least oppressive system among the land tenure systems that existed in India before independence. About 36 % the land area is covered under this system before independence in India.

## 6.8 Objectives of Land reforms in India

1. Restructuring of agrarian relation to achieve egalitarian social structure
2. Elimination of exploitation in land reforms
3. Actualisation of the goal of "land to the tiller"
4. Improvement of the socio-economic conditions of the rural poor by widening their land base
5. Increasing agricultural production and productivity
6. Facilitating land base development of rural poor
7. Infusion of a greater measure of equality in local institutions

## 6.9 Measures and Progress of land Reforms in India

For the fulfilment of the above objectives, the major steps adopted under the land reforms programme are ; Abolition of Zamindari System, Tenancy Reforms, Ceiling on holdings, Consolidation of Holdings and Co-operative Farming. No doubt that there are certain improvements in land reforms due to the efforts undertaken by the various State Governments in India since it is come under State List.

### a. Abolition of Zamindari System

After independence a strong voice was raised against the Zamindari system. As a result a high priority was given to the abolition of Zamindari system. Accordingly, every state enacted its own legislation for the abolition of this system. Among the Indian states Utter Pradesh enacted Zamindari Abolition and Land Reforms Act in 1950. By 1952, necessary legislations had been enacted in all the states.

### b. Tenancy Reforms

Various tenancy reform measures were under taken by the government of India and state governments. It includes Regulation of rent, Security of tenure and Conferment of Ownership Right on Tenants. It would not be in correct to say that barring some backward regions and tribal areas where the poor are too poor to resist, tenancy relations today are less exploitative than they were in the pre-independence period.

### c. Ceiling on holdings

By a ceiling on land holdings we mean the fixing of the maximum size of holdings that an individual cultivator or a household can possess. Beyond this maximum size all the land belonging to the land lords is taken by the government and distributed to the land less. Ceiling on land holding is considered as the most important methods to accomplish ‘land reforms’. Different laws were enacted by the states in India regarding the ceiling on land holdings. Even though various legal hurdles existed, the ceiling on land holding is successfully implemented in certain states like, Kerala, Bengal etc. The ceiling law generated a hope in the minds of rural masses initially, but progress made in acquiring surplus land suffered a setback due to judicial proceedings.

### d. Consolidation of Holdings

The major cause for the low productivity in agriculture is the sub divisions and fragmentations of agricultural land. Therefore the consolidation of holdings is essential to avoid the evils of fragmentation of agricultural land. Under consolidation several scattered pieces of land should taken together and implemented different types of cultivating system. All states except Kerala, Tamil Nadu, Andhra Pradesh (Partially) and North-Eastern states have passed the law for consolidation of holdings. The consolidation can be either on voluntary or compulsory. However the progress of consolidation of holdings has been very slow.

### e. Co-operative Farming

Co-operative farming means adopting the idea of co-operation in farming. Under this method, several farmers, while retaining their ownership of land and managing it individually adopted the principle of co-operation for non-farm operations like marketing the products, processing the products, obtaining inputs of agriculture like seeds, fertilisers, tools etc. In spite of the efforts made so far, the actual progress of co-operative farming is very meagre.

## 6.10 Economic Reforms and Indian Agriculture

Globalization has caused misery and despair among millions of Indian farmers, driving large numbers of them to suicide. Since agriculture continues to be a tradable sector, this economic liberalization and reform policy has far reaching effects on (I) agricultural exports and imports, (ii) investment in new technologies and on rural infrastructure (iii) patterns of agricultural growth, (iv) agriculture income and employment, (v) agricultural prices and (vi) food security. The GATT Agreement signed in 1995 will fundamentally change the global trade picture in agricultural sector. Any how the impacts of economic reforms on agriculture can be pointed out as follows.

**1. The deceleration in the growth of crop yields**

The first and foremost important impact of economic reforms on agriculture is the deceleration in the growth of crop yields as well as total agriculture output. The deceleration is due to fall in investment in irrigation and other rural infrastructure and also non availability of yield raising cost reducing new technology.

**2. Deceleration in net sown area in the country.**

There is deceleration in net sown area especially in major food crops except in central region of India and in some states like Punjab, Haryana, and Gujarat etc.

**3. Diversification of cropping pattern.**

Another important change due to reforms is the cropping pattern from food crops to non food crops. The cultivation of non food crops like oilseeds, fibre crops, sugar cane, fruits and vegetables increased. There is also a decline in the production of coarse cereals.

**4. Problems related with the input seeds.**

The biggest input for farmers is seeds. Before liberalisation, farmers across the country had access to seeds from state government institutions. With liberalization, India's seed market was opened up to global agribusinesses like Monsanto, Cargill and Syn Genta. The seed market was well regulated, and this ensured quality in privately sold seeds too. These hit farmers doubly hard: in an unregulated market, seed prices shot up, and fake seeds made an appearance in a big way. Genetically modified pest resistant seeds like Monsanto's BT Cotton are introduced but it again raises many issues in the agriculture sector. The abundant availability of spurious seeds is another problem which leads to crop failures.

**5. Export drive.**

One measure of the liberalisation policy which had an immediate adverse effect on farmers was the devaluation of the Indian Rupee in 1991 by 25% (an explicit condition of the IMF loan). Indian crops became very cheap and attractive in the global market, and led to an export drive. Farmers were encouraged to shift from growing a mixture of traditional crops to export oriented 'cash crops' like chilli, cotton and tobacco. These need far more inputs of pesticide, fertilizer and water than traditional crops.

**6. Reduction in export subsidy and tariff**.

Liberalisation policies reduced subsidy to agriculture a greater extent. (another explicit condition of the IMF agreement).As a result of this prices of pesticides, fertilizer have increased . Electricity tariffs have also been increased. With a view to open India's markets, the liberalization reforms also withdrew tariffs and duties on imports, which protect and encourage domestic industry. By 2001, India completely removed restrictions on imports of almost 1,500 items including food. As a result, cheap imports flooded the market, pushing prices of crops like cotton and pepper down.

**7. Development of corporate style farming.**

The reform policies encouraged corporate style of farming. Even though this will encourage the regular agricultural production and productivity it will harm to the land ownership and crop diversity to a greater extent.

**8. Reduction in smooth credit facilities.**

Earlier the farmers are given cheap credits from various financial institutions. In lieu of reforms process and recommendations of Khusrao Committee and Narasingham Committee, there is a reduction in Commercial Bank credit to agriculture. It might lead to a fall in farm investment and impaired agricultural growth.

**9. Marginalization of Small farmers.**

The most neglected section from the benefits of reform is the marginal farmers. The size of them increased they even forced to subdue their ownership rights. Both Information Technology, Genetic Engineering and Bio-Technology, which are the "drivers" of globalization with their complementarities of liberalisation, privatisation and tighter Intellectual Properties Rights, are bound to create new risks of marginalisation and vulnerability.

**10. Debt of the farmers**

The biggest problem Indian agriculture faces today and the number one cause of farmer suicides is debt. Forcing farmers into a debt trap are soaring input costs, the plummeting price of produce and a lack of proper credit facilities, which makes farmers turn to private moneylenders who charge exorbitant rates of interest. In order to repay these debts, farmers borrow again and get caught in a debt trap.

## 6.11 Industry

Indian manufactures had a worldwide market before the rise of modern industrial system. Indian muslin and calicoes were in great demand. It is true that British industrial and economic policies had brought a mixture of impact upon the industrial front of India. Industrial development is essential for the rapid development of any nation. Therefore immediately after independence the government of India take necessary steps to accelerate the growth of industry. The first industrial Policy Resolution was passed on 6 th April 1948. This policy established the base for Mixed and Controlled Economy in India and clearly divided the industrial sectors into private and public sectors. Any how the second five year plan laid foundation to the development of basic and key industries and referred as the 'Industrial Plan'.

## 6.12 Industrial Performance

The index of industrial production (IIP), released each month, is the key indicator of industrial performance. The new IIP series with 2004-05 as base was released in June 2011 replacing the earlier IIP series with base 1993-94 .Since the IIP is a fixed weight and fixed base series, a dated base often has limitations in reflecting the industrial scenario. The new series not only has a more recent base, it has a larger and more representative product basket and weights that appropriately reflect the relative importance of the sectors, products, and product groups. Recent industrial growth, measured in terms of IIP, shows fluctuating trends. Growth had reached 15.5 per cent in 2007-8 and then started decelerating. Initial deceleration in industrial growth was largely on account of the global economic meltdown. There was, however, a recovery in industrial growth from 2.5 per cent in 2008-09 to 5.3 per cent in 2009-10 and 8.2 per cent in 2010-11. Fragile economic recovery in the US and European countries and subdued business sentiments at home affected the growth of the industrial sector in the current year growth of IIP in terms of its major components is indicated in Table 6.3

**Table 6.3 Growth in the IIP and its major components (per cent)**

| | Weight | 2008-09 | 2009- 10 | 2010-11 |
|---|---|---|---|---|
| Overall IIP | 100.0 | 2.5 | 5.3 | 8.2 |
| **In terms of structured national industrial classification** | | | | |
| Mining | 14.16 | 2.6 | 7.9 | 5.2 |
| Manufacturing | 75.53 | 2.5 | 4.8 | 9.0 |
| Electricity | 10.32 | 2.7 | 6.1 | 5.5 |
| **In terms of use-based classification** | | | | |
| Basic goods | 45.68 | 1.7 | 4.7 | 6.0 |
| Capital goods | 8.83 | 11.3 | 1.0 | 14.8 |
| Intermediates | 15.69 | 0.0 | 6.0 | 7.4 |
| Consumer Goods | 29.81 | 0.9 | 7.7 | 8.6 |
| Durables | 8.46 | 11.1 | 17.0 | 14.2 |
| Non-durables | 21.35 | -5.0 | 1.4 | 4.3 |

Source: MOSPI.

### 6.13 Importance of industrial sector in Indian economy

The industrial sector had poured much vitality into the growth dynamics of Indian economy.

1. **Increase in the share of GDP**

The share of the industrial sector in Gross Domestic Product has slowly but consistently increased over the planning period. For example, the share of industry in 1950-51is 16.6 % and it rose to 27 % in 2011-12. This is a good sign.

2. **Growth of infrastructure industries.**

The development of infrastructure is essential for the development of a nation. In India, electricity, coal, steel, crude petroleum and cement industries act as the basic infrastructure industries and they provide ample scope for the further development and industrialisation of the nation.

3. **Building up of heavy and capital goods industries**

The second five year plan gave importance to the development of heavy and capital goods industries. As a result of these a wide range of engineering goods, iron and steel, metals and metal based products are now produced within the country itself and the dependence on other countries has considerably declined.

4. **Diversification of industrial structure**

At the time of independence only four industries namely, food products, textiles, wood and furniture, and basic metals were contributed more than two-thirds of production. But now there is much diversity in the industrial structure. The share of electrical and non-electrical machinery, chemicals, transport equipment, etc had risen considerably. Thus, now the country has a well diversified industrial structure.

5. **Growth in consumer durables**

Due to the liberalisation policies of the government, the output of consumer durables had expanded at a faster rate. The intermediate goods sector also grows considerably.

## 6.14 Problems of Industrial sector

The major problems that happened in Indian industries are the following.

**1. Gaps between targets and achievements**

Except the periods 1980's the achievements were below the targets. In many years the targets are much higher than the achievable level.

**2. Underutilisation of installed capacity**

A large number of industries in India are suffering from underutilisation of capacity. It may be due to many reasons like, raw material shortage, power failure, government policies, labour problems, demand problems etc.

**3. Poor performance of the public sector**

During the early years of planning the public sector has an advantage in industrial development. But large losses of public sector units is a serious matter and calls for immediate corrective measures.

4. **Infrastructural constrains**

It is said that one of the important constraints in the industrial development is the poor quality and quantity of infrastructure and high cost particularly power and transport. As a result the competitiveness of Indian industries lost.

**5. Growth of regional imbalances**

The industrial development in India is mainly concentrated in few states like Maharashtra, Gujarat and Tamil Nadu and others are lagged behind. Thus regional imbalances increased.

**6. Industrial sickness**

In India numbers of industries are plagued by sickness due to bad and inefficient management. Adequate attention was not given to the improvements in technology and quality of products.

**7. High cost industrial economy**

Another major issue related with the industrial sector is the hike in the cost of industrial products. Compared to the products of other countries Indian industrial products priced high.

**8. Increasing capital-out put ratio**

The industrial sector in India shows an increasing capital out-put ratio which definitely act as an obstacle in the development of industrial sector.

**9. Creation of environmental problems**

Liberalisation give way for the establishment of many new industrial concerns. Some of them creates environmental problems.

**10. New challenges**

The Indian industrial sector faces new challenges from the globe. The recent global financial shock raises many problems to Indian industries. Many trading partners of India dump heir products in the Indian market. The large scale industrial production create environmental and demand problems. Many big corporates handled the production process of certain profit making industrial ventures.

## 6.15 The impact of economic reforms on the industry in India

The economic reforms of 1991 changed the Indian business context from one of state-centered, control orientation, to a free, open market orientation, especially for hi-tech companies. It allowed Indian companies to start competing effectively on a global scale. As evident, the economic reforms benefited corporations in numerous ways. The reform process in India has benefited the nation tremendously and is now irreversible. In fact, successive governments have continued the reform process. These governments irrespective of their political affiliations have introduced measures to improve the speed and flexibility of decision-making of corporations. These include measures such as allowing listing on foreign exchanges, and formulating acquisition norms as well as regulations for Employee Stock Option Plans (ESOPs).

1. **Increase competitiveness.**

Decentralization of power to regional and state offices led to speedier decision-making and reduction in friction to business. Entry of multinational companies enhanced the competitive environment for Indian companies, thus, forcing them to benchmark themselves against global standards. Moreover, Indian companies should benchmark themselves globally in terms of quality, cost, time, customer responsiveness, investor friendliness and corporate governance practices. Further, our government has to enhance its efficiency in every interface it has with businesses. Finally, we, Indians, can succeed only if our political leadership, bureaucracy, corporate leadership and academia work collaboratively.

2. **Increase exports**

Indian export industries show an upward trend during the reform period. It helps to get more foreign exchange earning to the country.

3. **Increase imports**

During the reform period the imports are also in hike. Many sophisticated technological products imported to India.

4. **Growth in industrial sector**

The industrial sector helps to the robust growth of the economy. Now industry is the second largest growing productive sectors in India.

5. **Creation of more employment opportunities**

Even though closure of less competitive firms and therefore job losses and income reduction in the initial phase following trade liberalization, however, that by 1999 it was possible to expect the impact of increased productivity, competitiveness and accelerated growth.

6. **Reduction in poverty**

In the industrial sector more employment opportunities are created thereby there is the reduction in poverty of the masses. More income is also passed into the hands of the people.

7. **Increase in investment**

However, the more substantial benefits were reduction in the interference of the bureaucracy, enhancement of the confidence of Indians in exploring global markets, and India emerging as an attractive destination for Foreign Institutional Investors (FIIs).More investments are flow to India.

8. **Entry of multinational companies**

Economic reform measures liberalise the licensing system and there by encouraged the entry of multinational companies. This itself is creating certain negative impacts upon the economy also.

9. **Flow of foreign capital**

Market determined pricing of Initial Public Offerings (IPOs) made equity a viable financing option. The balance of payment position of India improved drastically.

10. **Better consumer products and services**

Indian consumers deserve better products and services. This can be provided through liberal economic policies. They are met with world class products due to liberalisation.

11. **Increase foreign relations**

Current account convertibility removed restrictions on availing foreign currency, led to easier foreign travel, and facilitated hiring of foreign consultants and international branding efforts.

## 6.16 INDIA'S SERVICES SECTOR

The services sector has been a major and vital force steadily driving growth in the Indian economy for more than a decade. The services sector covers a wide range of activities from the most sophisticated information technology (IT) to simple services provided by the unorganized sector, such as the services of the barber and plumber. National Accounts classification of the services sector incorporates trade, hotels, and restaurants; transport, storage, and communication; financing, insurance, real estate, and business services; and community, social, and personal services. In World Trade Organization (WTO) and Reserve Bank of India (RBI) classifications, construction is also included in the service sector. Different indicators like share in national and states' GDP, FDI, employment, and exports indicate the importance of the services sector for the Indian economy. The share of services in India's GDP at factor cost (at current prices) increased from 33.5 percent in 1950-51 to 55.1 per cent in 2010-11 and 56.3 per cent in 2011-12 as per Advance Estimates. Trade, hotels, and restaurants as a group, with 16.9 per cent share, is the largest contributor to GDP among the various services sub-sectors, followed by financing, insurance, real estate, and business services with 16.4 per cent share. Community, social, and personal services with a share of 14.3 per cent is in third place. Construction, a borderline service inclusion, is at fourth place with an 8.2 per cent share. If construction is also included, the service sector's share increases to 63.3 per cent in 2010-11 and 64.4 per cent in 2011-12 (Table 6.4).

The service sector growth rate at constant prices has always been above the overall GDP growth rate since 1996-97 except for 2003-04. The compound annual growth rate (CAGR) of the services sector at 10.2 per cent for the period 2004-5 to 2010-11 has been higher than the 8.6 per cent GDP growth rate during the same period. In the years 2009-10 and 2010-11, the services sector registered a growth rate of 10.5 per cent and 9.3 per cent respectively. In 2011-12, as per the Advance Estimates, the growth rate of services has been placed at 9.4 per cent.

## 6.17 Composition of Service Sector in India

In India, the national income classification given by Central Statistical Organization is followed. In the National Income Accounting in India, service sector includes the following:

1. Trade, hotels and restaurants (THR)
    1.1 Trade
    1.2 Hotels and restaurants
2. Transport, storage and communication
    2.1 Railways
    2.2 Transport by other means
    2.3 Storage
    2.4 Communication
3. Financing, Insurance, Real Estate and Business Services
    3.1 Banking and Insurance
    3.2 Real Estate, Ownership of Dwellings and Business Services
4. Community, Social and Personal services
    4.1 Public Administration and defence (PA & D)
    4.2 Other services

**Table 6.4 : Share of different services categories in GDP at factor cost (current prices)**

| Category of services | 2008-09 | 2009-10 | 2010-11 | 2011-12 |
|---|---|---|---|---|
| Trade, Hotels, & Restaurants | 16.9 | 16.6 | 16.9 | 25.2 |
| Transport, Storage, & Communication | 7.8 | 7.8 | 7.7 | NA |
| Financing, Insurance, Real Estate, &Business Services | 15.9 | 15.8 | 16.4 | 16.9 |
| Community, Social, & Personal Services | 13.3 | 14.5 | 14.3 | 14.2 |
| Construction | 8.5 | 8.2 | 8.2 | 8.1 |
| Total Services (Excluding Construction) | 53.9 | 54.7 | 55.1 | 56.3 |
| Total Services (Including Construction) | 62.4 | 63.0 | 63.3 | 64.4 |

While agriculture continues to be the primary employment-providing sector, the services sector is the principal source of employment in urban areas. As per the National Sample Survey Organization's (NSSO) report on the 'Employment and Unemployment Situation in India, 2009-10', for every 1,000 people employed, 679 and 75 people are employed in agriculture sector in rural and urban areas respectively (measured in terms of usually working persons in the principal status and subsidiary status). On the other hand, the services sector accounted for 147 and 582 of every 1,000 persons employed in rural and urban areas respectively.

## 6.18 Problems/Challenges Ahead

The sustainability of impressive growth of Indian economy has been questioned in the wake of some challenges in the form of lack of social infrastructure, physical infrastructure; IT infrastructure (Joshi, 2008b, 2006a), agricultural and industrial sector reforms, rupee appreciation and U.S sub-prime crisis, etc. Besides, challenges in the field of IT and ITES like rising labour costs, rapid growth in demand for talented manpower/quality staff, high attrition rate, outsourcing backlash etc are some other limiting factors (Joshi, 2008a, 2006). The growth of IT and ITES is having social, economic, health, ethical and environmental implications also Further, delay in the promotion of conducive business environment and good governance will un able us to catch up with the global giants in terms of world –wide presence and scale. It is also important to point out here that the measurement of output , productivity , non-availability of data or availability of data after a time lag are other problems confronted with in case of services. The problem gets further compounded because of the entry of new species of services (like IT, ITES etc ) and lack of development of concepts on the one hand and non-inclusion of unpaid households on the other. Further, quality of each unit of the same service varies from the other.Further, quality improvements stemming from the application of new technologies are extremely hard to measure.

## 6.19 Prospects for Growth in the Services Sector

One of the major drivers of service sector growth in the post globalization era in India is the IT and ITES sector. That is why NASSCOM (2005) says that, The IT and BPO industries can become major growth engines for India, as oil is for Saudi Arabia and electronics and engineering are for Taiwan. India’s IT and BPO industries could account for 10-12% of India’s GDP by 2015. According to NASSCOM (2005), India’s offshore IT and BPO industries hold the potential to create over 9 million jobs by 2010, 2.3 million direct jobs and 6.5 million indirect induced jobs. The revenue generation from total software and services segment is likely to touch $ 60-billion mark by 2010 as per NASSCOM estimates. In addition, there is a huge potential for growth in the services sector because of increase in disposable income, increasing urbanization, growing middle class, a population “bulge” in the working age groups providing ‘demographic window of opportunity,’ and emergence of a wide array of unconventional new services like IT, ITES, new financial services (ATMs, credit cards) and tourism services (eco-tourism, health tourism) etc.

## 6.20 The Impact of Reform on Service Sector

Service sector is the main sector which is affected by economic reforms in the past two decades of economic liberalisation. Now service sector is the leading sector in the contribution to the GDP.

1. **Growth of service sector**

At the same time, the services sector grew by an average of 11 percent per year, with the more liberalized sectors generally growing at relatively faster rates. The share of services in overall value added rose from 39 percent in 1993 to 59 percent in 2011-12.Growth has been particularly strong in the services sectors. Communication services displayed average annual growth rates of 13.6 percent in the 1990s, while banking grew by 12.7 percent on average, transport grew at an average rate of 6.9 percent and insurance grew at a rate of 6.7 percent. Output per worker in the services sectors in India has increased by over 7.5 percent per year during the 1990s, clearly outpacing the agricultural or industrial sectors. Other evidence suggests that strong total factor productivity growth was at the root of this remarkable performance, not capital deepening or higher

mark ups. Indeed, services prices decreased relative to manufacturing prices, as indicated by a slower pace of growth in the services deflator than the overall GDP deflator. The overall growth rate of service sector in 2011-12 is 9.4%

2. **Increase the competitive spirit**

The reforms produced striking improvements in sectoral performance. In 1990, the average turn-around time for a container at major ports in India was 8 days, and at major Mumbai ports the average was 11. This meant that manufacturing companies exporting their products or importing inputs had to factor in more than a week of transit time for their goods, which increased the cash outlays necessary for exporting and importing. By 2005, the average turn-around time at major ports in India had decreased to 3.5 days, with 4.5 days as the average time at Mumbai ports .This reduction in transit time is likely to have improved the ability of Indian firms to compete in highly variable markets such as textiles and electronics in which the ability to respond quickly to changes in demand is crucial.

3. **Change in financial sector**

Prior to liberalization even at the most efficient public sector banks, bank loan approvals in 64 percent of cases were mechanically made for the same loan amount as prior loans. The rationing of credit by the public sector reduced the ability of companies to respond to new business opportunities and finance improvements in products or production processes. Because liberalization allowed banks to set interest rates at their risk adjusted cost of capital and choose diversified loan portfolios, by 2005 the level of investment by banks increased to 4.75 times the size of investment in 1994. The share of investment by foreign and private banks also increased during the period from 11 percent in 1994 to 24 percent in 2005. Despite the slow pace of reforms, credit provision and investment have increased across the sector, led by foreign and locally-owned private banks.

4. **Inflow of FDI**

The elimination of barriers to entry in services provoked a dramatic response from foreign and domestic providers. FDI inflows into services following liberalization by far exceeded those into other sectors. Ten percent of FDI inflows during 1990-2005 went into the transport sector, 9.6 percent of the inflows were into the telecommunications sector, and 9.6 percent of the inflows were into the financial and other services sector.

5. **Change in telecommunication**

Before the beginning of the reforms in telecommunications, the sector was controlled by MTNL, a publicly owned company which provided local telephone service, and VSNL, a publicly owned company which provided long distance service. Both companies were plagued by faults, which averaged 19 faults per 100 stations per month in 1991. In addition, service was poorly distributed and access to new lines was difficult.10 Businesses were severely handicapped in their ability to communicate with their customers and suppliers and to coordinate activity across plants. Liberalization has interacted powerfully with technological change to transform the telecommunications market. By 2005, the number of faults had declined to 7.5 percent and the waiting lists for telephone services had virtually disappeared in urban areas. Even rural customers, projected by critics of the liberalization reforms to lose from the privatization, saw increases in access to phone lines. Access to internet services, provided initially only by MTNL, increased quickly as private providers were allowed to enter the market.

### 6. Change in transport services

In the 1980s, air transport providers and several of the largest shipping companies were publicly-owned companies. After liberalization, increasing competition from foreign companies put pressure on Indian carriers to improve their performance. They responded positively, and operating efficiency increased. In fact, operating revenue per employee in Indian Airlines increased over 5 times over the period 1990-2004 from 0.5 million per employee to 2.5 million per employee. The increased efficiency has led to continued growth of India carriers in the period 1990-2005, of nearly 15 percent yearly in passenger traffic and 11 percent yearly in cargo traffic .

### 7. Change in insurance sector

Until 2002, private sector competition in the insurance market was proscribed, severely limiting the range of insurance services on offer. Market penetration of insurance quickly increased following the entry of private and foreign insurers. After decades of public monopoly, premiums were equal to only 1.9 percent of GDP in 1999-2000, but they jumped to 2.86 percent of GDP by 2002-2003. Government projections at the time of liberalization suggested that market participation by foreign firms in 2005 would reach only five percent of the market, but by November 2005, private firms with foreign shareholding had acquired a 34 percent market share. This corresponded to limited contraction by Indian public sector incumbents.

In sum, liberalization led to a metamorphosis of services in India from narrow range of products of sub-standard quality and poor distribution, to the current environment in which service providers are highly competitive and offer their consumers, including manufacturing firms, a wide range of new and high quality services products.

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# Module VII
# PLANNING

Economic Planning and its objectives; Five Year Planning in India – Achievements and Failures

## Introduction

Economic Planning has become part and parcel of economic development since the dawn of the 20th Century. All countries of the world have adopted some kind of planning to achieve their development objectives. Several factors have been responsible for the institutionalization of planning across countries. Hence, an understanding of the evolution, meaning and definition of planning in general and the various dimensions of planning in India is interesting as well as meaningful. This module is an attempt to familiarize you with the technical as well as functional aspects of economic planning. After studying this module you will be able to define planning, elucidate the planning attempt before independence and also the performance of eleven five year plans of our country.

The 20th century was an era of planning. Almost every country had some sort of planning. In socialist countries, planning is almost a religion. Even in countries like the U.S.A. and the U.K, with a capitalistic system, they have partial planning. The 19th century State was a Laissez faire state. It followed a policy of non – intervention in economic affairs. As you know, the apostle of Laissez faire, Adam Smith set apart only three main activities of an economy to the Government. They were: maintenance of law order, construction of social and economic overheads and protecting the country from internal and external aggregation. But the modern State is a welfare State. The two World Wars, the Great Depression of 1930s and the success of planning in the erstwhile Soviet Union have underlined the need for planning. Planning is really a gift of former Soviet Russia to the world, for; it was the first country to practice economic planning on a national scale.

## Justification for Planning

Many economists today agree that planning is an organized, conscious and continuous attempt to select the basic available alternatives to achieve specific goals. Planning involves the economizing of scarce resources. Most of the underdeveloped countries of the world became independent only fifty or sixty years back and most of them were poor at that time. So it became the main business of the Governments of the newly emergent nations to provide food, clothing and shelter to their people. For that, first of all, they had to increase their national income. Since most of them were agricultural countries, they had to evolve some programmes for agricultural development. Not only that, they had to industrialize their economies, they had to provide more jobs to their people. That means, they had to do something for expanding employment opportunities. Further, as most of them were wedded to some kind of socialism, they had to reduce inequalities of income and wealth. To realize these goals at early time, the poor countries embrace the way of economic planning.

Another main reason for the emergence of planning in underdeveloped countries is the failure of the market mechanism. Market failures refer to the set of conditions under which a market economy fails to allocate resources efficiently. The self promoting actions of the participants in an economy do not lead to an efficient outcome. The capitalist economy is basically a market economy and price mechanism works through the market system. The price system is a basic institution of capitalism. The allocation of resources and distribution of rewards

are done through the price system. All decisions of the businessmen, farmers, industrialists and so on are guided by the profit motive. If the market is perfect, price system is good. But if there is monopoly and other types of imperfect competition, the market system fails and necessitates government intervention by way of planning.

Due to recent developments in the socialist countries, rationale of planning and state intervention came under increasing question. The focus of discussion shifted from market failure to Government failure or distortions caused by state intervention. The causal factor for the failure is not state intervention *per se* but the incentive system entrenched in a planned economy. Despite this recent dilemma in the question of *state versus market*, many a countries still believe in the efficacy of economic planning.

**Define Economic Planning?**

Planning involves ex ante co-ordination and conscious direction of economic activity with a view to achieve certain social objectives. The attainment of certain social objectives provides an extensive justification for planning. Mixed economy framework was adopted in the Indian case to achieve these objectives. In this context it is interesting to go through some of the attempts to define the term planning.

One can see several definitions of economic planning. Here we recapitulate some of those definitions for the utility of the learners. According to Lionel Robbins, “strictly speaking, all economic life involves planning…. To plan is to act with a purpose, to choose and choice is the essence of economic activity”. In the words of Barbara Wooten, “Planning may be defined as the conscious and deliberate choice of economic priorities by some public authorities”.

## Planning in India

The necessity of economic planning in India was realized not only in the post-independence era but a number of efforts were made in this direction even during the pre-independence period. The first effort at introducing economic planning in India was made in 1934 by Dr. M. Visvesvarayya who at that time published his book Planned Economy for India. He formulated a 10 year development plan. However, it remained merely of academic interest and did not directly influence any social action. An effort to evolve a national plan was made in February 1938 when Subhas Chandra Bose in his Presidential Address to the Indian National Congress at Haripura emphasized that, ‘the very first thing which our future national government will have to do would be to set up a Commission for drawing up a comprehensive plan for reconstruction. The plan will have two parts-an immediate programme and a long period programme’. But nothing has done effectively. In the next few years, the eight leading industrialists of Bombay took the initiative of preparing ‘A plan of Economic Development for India’. It was published in January 1944 and came to be known as the ‘Bombay Plan’. Though the Bombay plan was also not implemented as suggested by the industrialists, it may be emphasized here that the publication of the Bombay Plan acted as a signal for many other similar exercises viz., the ‘Peoples’ Plan’ under the leadership of M.N. Roy and a ‘Gandhian Plan’ under the leadership of S.N. Agarwal.

Another important step in the sphere of planning was the setting up of a planning Advisory Board by the Interim Government in October 1946 for a review of the projects prepared by the various Government departments and to report on them. The Board submitted its Report in December 1946.

Soon after Independence, the All-India Congress Committee appointed the Economic Programme Committee under the Chairmanship of Pt. Jawaharlal Nehru in November 1947. The Committee submitted its Report in January 1948 and recommended the institution of a permanent Planning Commission which was set up by the Government of India in March 1950 with a view to prepare a blueprint of development taking into consideration the needs and resources of the country. The draft of the first five-year plan was published in July 1951 and it was approved in December 1951. The period of various Five Year Plans in India is given in the table.

**Table 7.1: Five Year Plans in India (Period-wise)**

| **Five Year Plan** | **Period** |
|---|---|
| I plan | 1951-56 |
| II Plan | 1956-61 |
| III Plan | 1961-66 |
| Annual Plans | 1966-69 |
| IV Plan | 1969-74 |
| V Plan | 1974-79 |
| Rolling plan (Annual Plan) | 1979-80 |
| VI Plan | 1980-85 |
| VII Plan | 1985-90 |
| Annual Plans | 1990-92 |
| VIII Plan | 1992-97 |
| IX Plan | 1997-2002 |
| X Plan | 2002-07 |
| XI Plan | 2007-12 |
| XII Plan | 2012-17 |

**Broad Objectives of Five Year Plans in India**

The Indian economy has now the experience of more than six decades of economic planning. Broadly, the objectives of the five year plans can be summarized as increasing the national and per capital income, raising the investment-income ratio, reducing inequalities in the distribution of wealth and income, and providing additional employment opportunities, maintaining price stability, removal of poverty and attainment of self-reliance. However, each of the Plans also laid special emphasis on particular objectives.

The principal aim of the First Plan was to rehabilitate the Indian economy devastated by the effects of he Second World War and the partition of the country. The Second Plan laid stress on rapid industrialization with particular emphasis on the development of basic and heavy industries. The Third Plan gave top priority to agriculture with a view to achieve self-sufficiency in food grains and increase agricultural production to meet the requirements of industry and exports. The fourth Plan laid stress on growth with stability. In between the Third and the Fourth Plan, there was a Plan holiday and between 1966 and 1969 three Annual Plans were formulated because the situation created by the Indo-Pakistan conflict, two successive years of drought, devaluation of the currency, general rise in prices and erosion of resources available for plan purposes had delayed the finalization of the Fourth Plan. The two strategic objectives of the Fifth and Sixth Plan were removal of Poverty and attainment of economic self reliance. In the 7th plan, modernisation was stressed. The government which assumed in 1991 virtually abandoned these long term objectives of economic planning. Its entire concern was to implement a programme of Macro economics and

stablisation through Fiscal correction. Moreover, trade, industrial and public sector policies aimed at undermining the very system of economic planning. For the first eight Plans the emphasis was on a growing public sector with massive investments in basic and heavy industries, but since the launch of the Ninth Plan in 1997, the emphasis on the public sector has become less pronounced and the current thinking on planning in the country, in general, is that it should increasingly be of an indicative nature. The 9th plan focused on accelerated growth, recognizing a special role for agriculture, for its stronger poverty reducing and employment generating facts which will be carried out over a period of 15 years. The eleventh plan has given top priority to inclusive growth.

**Role of Planning Commission and NDC in the Planning Process**

Two important agencies in the process of planning in India is the Planning Commission and the National Development Council. It is meaningful to understand the constitution and functions of these two bodies.

**a) Planning Commission**

Rudimentary economic planning, deriving the sovereign authority of the state, first began in India in 1930s under the British Raj, and the colonial government of India formally established a planning board that functioned from 1944 to 1946. Private industrialists and economist formulated at least three development plans in 1944.

After India gained independence, a formal model of planning was adopted, and the planning commission, reporting directly to the Prime Minister of India was established. Accordingly, the Planning Commission was set up on 15 March 1950, with Prime Minister Jawaharlal Nehru as the chairman. Planning Commission though is a non statutory as well extra constitutional body, i.e. has been brought by an executive order. Jawahar Lal Nehru was the chairman of the first Planning Commission of India.

The composition of the Commission has undergone a lot of change since its inception. With the Prime Minister as the ex-officio Chairman, the committee has a nominated Deputy Chairman, who is given the rank of a full Cabinet Minister. Mr. Montek Singh Ahluwalia is presently the Deputy Chairman of the Commission. Cabinet Ministers with certain important portfolios act as part-time members of the Commission, while the full-time members are experts of various fields like Economics, Industry, Science and General Administration. The majority of experts in the Commission are Economists, making the Commission the biggest employer of the Indian Economic Services.

**Functions**

The Planning Commission's functions as outlined by the Government's 1950 resolution are following:

1. To make an assessment of the material, capital and human resources of the country, including technical personnel, and investigate the possibilities of augmenting those resources which are found to be deficient in relation to the nation's requirement.
2. To formulate a plan for the most effective and balanced utilisation of country's resources.
3. To define the stages, on the basis of priority, in which the plan should be carried out and propose the allocation of resources for the due completion of each stage.
4. To indicate the factors that tend to retard economic development.

5. To determine the conditions which need to be established for the successful execution of the plan within the incumbent socio-political situation of the country.
6. To determine the nature of the machinery required for securing the successful implementation of each stage of the plan in all its aspects.
7. To appraise from time to time the progress achieved in the execution of each stage of the plan and also recommend the adjustments of policy and measures which are deemed important vis-a-vis a successful implementation of the plan.
8. To make necessary recommendations from time to time regarding those things which are deemed necessary for facilitating the execution of these functions. Such recommendations can be related to the prevailing economic conditions, current policies, measures or development programmes. They can even be given out in response to some specific problems referred to the commission by the central or the state governments.

From a highly centralised planning system, the Indian economy is gradually moving towards indicative planning where the Planning Commission concerns itself with the building of a long-term strategic vision of the future and decide on priorities of nation. It works out sectoral targets and provides promotional stimulus to the economy to grow in the desired direction. It also plays an integrative role in the development of a holistic approach to the policy formulation in critical areas of human and economic development. In the social sector, schemes that require coordination and synthesis like rural health, drinking water, rural energy needs, literacy and environment protection have yet to be subjected to coordinated policy formulation. It has led to multiplicity of agencies. The commission has now been trying to formulate and integrated approach to deal with this issue.

**b) The National Development Council**

The Government of India set up a National Development Council on 6th August, 1952. The N.D.C. consists of the Prime Minister, all Union Cabinet Ministers, Chief Ministers of all States and Union Territories and the Members of the Planning Commission. The Lt. Governor and the Chief Executive Councilor of the remaining Union Territories and the respective Chief Ministers represent the Delhi Administration. It is also provided that other Union and States Ministers may be invited to participate in the deliberations of the N.D.C. The Secretary of the Planning Commission is Secretary of the Council also.

Its functions are:

(1) To review the working of the National Plan from time to time,

(2) To consider important questions of social and economic policy affecting national development.

(3) To recommend measures for the achievement of the aims and the targets set out in the National Plan, including measures to secure the active participation and co-operation of the people, improve the efficiency of the administrative services, ensure the fullest development of the less advanced regions and sections of the community and, through sacrifice borne equally by all citizens, build up the resources for national development.

Thus, it is now the N.D.C., which prescribes the guidelines for the formulation of the National Plan. In this new set-up the function of the Planning Commission is to prepare the Plan according to these guidelines. In this way, the National Development Council has emerged as the top- most policy-laying agency in the Government. Thus success of this new planning organization could depend mainly upon the tact and sagacity of the Prime Minister and Chief Minister.

**An overview of India's Five Year Plans:**

Having gone through the various aspects of Five year plans, let us review the features of various Plan implemented so far.

## First Five Year Plan (1951-56)

The 1st five year plan was presented by Jawaharlal Nehru, who was the then Prime Minister. The primary aim of the 1st five year plan was to improve living standards of the people of India. This could be done by making judicious use of India's natural resources. The total outlay of the plan was Rs.2,069 crore. This amount was assigned to different sectors viz., Industrial sector, Energy, Irrigation, Transport, Communications, Land rehabilitation, Social services, Development of agriculture and community, Miscellaneous issues The target set for the growth in the gross domestic product was 2.1 per cent every year. In reality, the actual achieved with regard to gross domestic product was 3.6 percent per annum. This is a clear indication of the success of the 1st five year plan. The First Plan was basically an Agricultural Plan as this sector had got the largest outlay. The following Irrigation projects were started during that period: Mettur Dam, Hirakud Dam and Bhakra Dam.

## 2nd Five year plan(1956-61)

Industries got more importance in the 2nd five year plan. The focus was mainly on heavy industries. The Indian government boosted manufacturing of industrial goods in the country. This was done primarily to develop the public sector. The 2nd year five year plan, functioned on the basis of Mahalanobis model. The Mahalanobis model was propounded by the famous Prasanta Chandra Mahalanobis in the year 1953. His model addresses different issues pertaining to economic development. As many as five steel plants including the ones in Durgapur, Jamshedpur as well as Bhilai were set up during the plan. During the term of the 2nd five year plan, Atomic Energy Commission came into being. The Commission was established in the year 1957. During the same period, Tata Institute of Fundamental Research was born. The institute conducted several programs to search for talented individuals. These individuals would eventually be absorbed into programs related to nuclear power.

## 3rd five year plan (1961-66)

The 3rd five year plan laid considerable stress on the agricultural sector. In addition to the above the Planning Commission aimed at I ncreasing the national income by 5 percent per annum, m aking India self sufficient by increasing agricultural production, minimizing rate of unemployment and ensuring that people enjoy equal rights in the country. However, with the short lived Sino Indian War of 1962 India diverted its attention to the safety of the country. Due to the Sino Indian War, India witnessed increase in price of products. The resulting inflation was cost push in nature. As a result of these developments, most of the targets set for the project could not be realized.

**Three Annual Plans (1966 – 69)**

The fourth Plan could not be started immediately on completion of the Third Plan due to the War and other problems. So there were only annual plans for three years from 1966 to `1969. It was considered as plan holiday. The prevailing crisis in agriculture and serious food shortage necessitated the emphasis on agriculture during the Annual Plans. During these plans a whole new agricultural strategy involving wide – spread distribution of High – Yielding Varieties (HYVs) of seeds, the extensive use of fertilizers, exploitation of irrigation potential and soil conservation was

put into action to tide – over the crisis in agricultural production. During the Annual Plans, the economy basically absorbed the shocks given during the Third Plan, making way for a planned growth.

## 4th five year plan (1969-74)

The 4th five year plan of India also served as a stepping stone for the economic growth. India had to reform and restructure its expenditure agenda, following the attack on India in the year 1962 and for the second time in the year 1965. India had hardly recuperated when it was struck by drought. India also had a stint of recession. Due to recession, famine and drought, India did not pay much heed to long term goals. Instead, it responded to the need of the hour. It started taking measures to overcome the crisis. Food grains production increased to bring about self sufficiency in production. With this attempt, gradually a gap was created between the people of the rural areas and those of the urban areas. The need for foreign reserves was felt. This facilitated growth in exports. Import substitution drew considerable attention. All these activities widened the industrial platform.

## 5th five year plan (1974-79)

The objective of the 5th Five Year Plan was to increase the level of employment, reduce poverty and to attain self sufficiency in agriculture. The plan was in the backdrop of a deteriorating international scenario. The world economy was in a troublesome state when the fifth five year plan was chalked out. This had a negative impact on the Indian economy. Prices in the energy and food sector skyrocketed and as a consequence inflation became inevitable. Therefore, the priority in the fifth five year plan was given to the food and energy sectors. Other important cardinal objectives of the Plan were: Reducing the discrepancy between the economic development at the regional, national, international level; improving the agricultural condition by implementing land reform measures; improving the scope of self-employment through a well integrated program; reducing the rate of unemployment both in the urban and the rural sectors; encouraging growth of the small scale industries; enhancing the import substitution in the spheres including chemicals, paper, mineral and equipment industries; stressed on the importance of a labour intensive production technology in India.

## 6th five year plan (1980-85)

The sixth plan also marked the beginning of economic liberalization. Price controls were eliminated and ration shops were closed. This led to an increase in food prices and an increase in the cost of living. This was the end of Nehruvian Plan and Rajiv Gandhi was prime minister during this period. Family planning was also expanded in order to prevent overpopulation. In contrast to China's strict and binding one-child policy, Indian policy did not rely on the threat of force. More prosperous areas of India adopted family planning more rapidly than less prosperous areas, which continued to have a high birth rate. The major objectives of the plan were Increase in National Income, Modernization of Technology, Ensuring continuous decrease in Poverty and Unemployment, Population Control through Family Planning, etc. The target growth rate of the plan was 5.2 per cent and the actural growth was 5.4 per cent. In that sense the sixth plan was a great success.

## **7th five year plan (1985-90)**

The Seventh Plan emphasized policies and programs which aimed at rapid growth in food – grains production, increased employment opportunities and productivity within the framework of

basic tenants of planning. The plan laid stress on improving the productivity level of industries by upgrading of technology. As an outcome of the sixth five year plan, there had been steady growth in agriculture, control on rate of Inflation, and favourable balance of payments which had provided a strong base for the seventh five Year plan to build on the need for further economic growth. The 7th Plan had strived towards socialism and energy production at large. The thrust areas of the 7th Five year plan have been:

- Social Justice
- Removal of oppression of the weak
- Using modern technology
- Agricultural development
- Anti-poverty programs
- Full supply of food, clothing, and shelter
- Increasing productivity of small and large scale farmers
- Making India an Independent Economy

Based on a 15-year period of striving towards steady growth, the 7th Plan was focused on achieving the pre-requisites of self-sustaining growth by the year 2000. The Plan expected a growth in labour force of 39 million people and employment was expected to grow at the rate of 4 per cent per year. Under the Seventh Five Year Plan, India strove to bring about a self-sustained economy in the country with valuable contributions from voluntary agencies and the general populace. It was a great success, the economy recorded 6% growth rate against the targeted 5%.

## 8th five year plan (1992-97)

The period 1989–91 was a period of economic instability in India and hence no five year plan was implemented. Between 1990 and 1992, there were only Annual Plans. In 1991, India faced a crisis in Foreign Exchange (Forex) reserves, left with reserves of only about US$1 billion. Thus, under pressure, the country took the risk of reforming the socialist economy. P.V. Narasimha Rao was the twelfth Prime Minister of the Republic of India and head of Congress Party, and led one of the most important administrations in India's modern history overseeing a major economic transformation and several incidents affecting national security. At that time Dr. Manmohan Singh (currently, Prime Minister of India) launched India's free market reforms that brought the nearly bankrupt nation back from the edge. It was the beginning of privatisation and liberalisation in India.

Modernization of industries was a major highlight of the Eighth Plan. Under this plan, the gradual opening of the Indian economy was undertaken to correct the burgeoning deficit and foreign debt. Meanwhile India became a member of the World Trade Organization on 1 January 1995. This plan can be termed as Rao and Manmohan model of Economic development. The major objectives included, controlling population growth, poverty reduction, employment generation, strengthening the infrastructure, Institution building, tourism management, Human Resource development, Involvement of Panchayat raj, Nagar Palikas, N.G.O'S and Decentralization and people's participation. Energy was given priority with 26.6% of the outlay. An average annual growth rate of 6.78% against the target 5.6% was achieved.

## 9th five year plan (1997-2002)

The Ninth Five Year Plan India runs through the period from 1997 to 2002 with the main aim of attaining objectives like speedy industrialization, human development, full-scale employment, poverty reduction, and self-reliance on domestic resources. Ninth Five Year Plan was formulated amidst the backdrop of India's Golden jubilee of Independence.

The main objectives of the Ninth Five Year Plan of India are:

- to prioritize agricultural sector and emphasize on the rural development
- to generate adequate employment opportunities and promote poverty reduction
- to stabilize the prices in order to accelerate the growth rate of the economy
- to ensure food and nutritional security.
- to provide for the basic infrastructural facilities like education for all, safe drinking water, primary health care, transport, energy
- to check the growing population increase
- to encourage social issues like women empowerment, conservation of certain benefits for the Special Groups of the society
- to create a liberal market for increase in private investments

During the Ninth Plan period, the growth rate was 5.35 per cent, a percentage point lower than the target GDP growth of 6.5 per cent.

## 10th five year plan (2002-07)

The 10th Five Year Plan (2002-2007) targets at a GDP growth rate of 8% per annum. Taking note of the inabilities of the earlier Five Years Plans, especially that of the 9th Five Year Plan, the Tenth Five Year Plan decides to take up a resolution for immediate implementation of all the policies formulated in the past. This amounts to making appeals to the higher government authorities, for successful completion of their campaigns associated with the rapid implementation of all past policies.

The primary aim of the 10th Five Year Plan is to renovate the nation extensively, making it competent enough with some of the fastest growing economies across the globe. It also intends to initiate an economic growth of 10% on an annual basis.

*Chief Objectives of the 10th Five Year Plan:*

- The Tenth Five Year Plan proposes schooling to be compulsory for children, by the year 2003.
- The mortality rate of children must be reduced to 45 per 1000 livings births and 28 per 1000 livings births by 2007 and 2012 respectively
- All main rivers should be cleaned up between 2007 and 2012
- Reducing the poverty ratio by at least five percentage points, by 2007
- Making provision for useful and lucrative employments to the population, which are of the best qualities
- According to the Plan, it is mandatory that all infants complete at least five years in schools by 2007.
- By 2007, there should be a decrease in gender discriminations in the spheres of wage rate and literacy, by a minimum of 50%
- Taking up of extensive afforestation measures, by planting more trees and enhance the forest and tree areas to 25% by 2007 and 33% by 2012
- Ensuring persistent availability of pure drinking water in the rural areas of India, even in the remote parts
- The alarming rate at which the Indian population is growing must be checked and fixed to 16.2%, between a time frame of 2001 and 2011

- The rate of literacy must be increased by at least 75%, within the tenure of the Tenth Five Year Plan
- There should be a decrease in the Maternal Mortality Ratio (MMR) to 2 per 1000 live births by 2007. The Plan also intended to bring down the Maternal Mortality Ratio to 1 per 1000 live birth by the year 2012.

The achievement of the 10th plan was 7.7 per cent compared with the target growth of 8.0 per cent.

## 11th five year plan (2007-12)

The Eleventh Five Year Plan had aimed at achieving faster and more inclusive growth. Rapid GDP growth, targeted at 9.0 per cent per annum, was regarded necessary for two reasons: first, to generate the income and employment opportunities that were needed for improving living standards for the bulk of the population; and second, to generate the resources needed for financing social sector programmes, aimed at reducing poverty and enabling inclusiveness.

The economy has performed well on the growth front, averaging 8.2 per cent in the first four years. Growth in 2011-12, the final year of the Eleventh Plan was originally projected at around 9.0 per cent continuing the strong rebound from the crisis, which saw an 8.5 per cent growth in 2010-11. Instead, the economy actually slowed down somewhat in 2011-12 compared to the previous year – a phenomenon common to all major economies reflecting the fact that 2010 was a rebound from depressed levels in 2009. Growth in 2011-12 is likely to be around 8.0 per cent. The economy is therefore, likely to achieve an average GDP growth of around 8.2 per cent over the Eleventh Plan period, which is lower than the 9.0 per cent targeted originally, but higher than the 7.8 per cent achieved in the Tenth Plan. This implies a nearly 35 per cent increase in per-capita GDP during this period. It has also led to a substantial increase in government revenues, both at the Centre and the States, resulting in a significant step-up of resources for the programmes aimed at inclusiveness. A healthy increase in aggregate savings and investment rates, particularly in the private sector, testifies to the strength of our economy as it enters the Twelfth Plan period.

## 12th Five Year Plan (2012-17)

As India's government prepares to submit its approach paper for its 12th five-year plan (a plan which covers years 2012 to 2017), the Planning Commission's focus on instilling "inclusive growth" is making headway. The plan is expected to be one that encourages the development of India's agriculture, education, health and social welfare through government spending. It is also expected to create employment through developing India's manufacturing sector and move the nation higher up the value chain. Prime Minister Manmohan Singh, however, warned that maintaining fiscal discipline is important as well. The commission will likely strive to enact policies that will achieve somewhere around a 10 percent growth rate in factories and a 4 percent growth rate in farm produce, though Prime Minister Singh has asked the plan to set the nation's growth rate firmly at 9 percent to 9.5 percent.

As indicated from the planning commission's presentation to the prime minister on April 21, the quantitative metrics known thus far in the early stage of the five-year plan are:

- A target of GDP growth in the 9 percent to 9.5 percent range
- An increase in literacy rates to 100 percent between the plan's period from 2012 to 2017
- An increased expenditure on health from 1.3 per cent to 2.0 per cent of GDP

In a boon for industry, the planning commission indicated that it aims to have industry and manufacturing-related activities grow by 11 percent over the next five years, contrasted to 8 percent over the previous 11th five-year plan. It also aims to undertake somewhat vaguely defined, but certainly well-intentioned, structural and regulatory reforms to facilitate investment. The plan has also emphasized the importance of the energy sector development considering the point that commercial energy demand is expected to increase by 7 percent per year over the next five years. To address that increase in demand, the planning commission recommended that all methods of current energy production and distribution be developed, from coal to nuclear energy to solar and wind, and proposed that existing taxes on electricity should not be raised.

All told, in its early stages, the 12th five-year plan promises a lot for rural development and growth. In that sense, it is similar to China's latest reiteration of its five-year plan, which seeks to improve the lot of rural Chinese peoples by increasing urbanization and industrial efforts in central and western China. But, by contrast, while the Chinese government seems to be continuing with nation-wide industrialization efforts, the Indian government may be attempting to promote a policy of reverse migration by making rural living more attractive with some access to modern amenities, but hopefully without the accompanying chaos that goes with it.

**Achievement of Economic Planning**

In India the Five Year Plans have helped strengthen the foundations of economic and social life and stimulated Industrial and Economic Growth as well as promoted Scientific and Technological advancement. Each Five Year Plan is both and assessment of the past and a call for the future. The Five Year Plans seek to translate into practical action the aspirations and ideas of the millions in the country and also generate opportunity of service in the common cause of elimination of poverty and raising standards of living. Let us examine the major achievements of our planning efforts.

**Increase in National Income**

During planning period national income has increased manifold. The average annual increase in national income was registered to be 1.2 percent from 1901 to 1947. This increase was recorded to be 3 percent in two decades i.e. 1950-70. Moreover, average annual growth rate of national income was 4 per cent in 1970-80 which, further, increased to 5 percent in 1980-90. From 1980-81 to 2000-01, it increased to 5.8 per cent. During the eleventh five year plan, the growth of the economy was around 8 per cent. Thus, a rise in national income has been key indicator for economic development of India.

**Increase in Per capita Income**

Before independence, increase in per capita income was almost zero. But after the adoption of economic planning in India, per capita income has continuously been increased.

**Development of agriculture**

Agricultural productivity has also marked an upward trend during the plan period. The production of food grains which has 510 lakh tones in 1950-51 increased to 1804 lakh tones in 1990-91 and further to 212.0 million tones in 2000-01. During 2010-11, food grains production stood at 225 million tones. Thus, agriculture production during planning period has increased. During the entire planning period, growth rate of agricultural production remained 2.8 per cent per annum. However, use of chemical fertilizer, better seeds, irrigation and improved methods of cultivation has increased productivity per hectare and per worker many times. This development has laid the foundation of green revolution and other institutional changes in agriculture sector.

**Increase in industrial production**

The industrial production has increased manifold during the plan. A number of steel plants were built during the period of economic planning.

**Self Reliance:**

During the last six decades, considerable progress seems to have been made towards the achievement of self reliance. We are no longer dependent on other countries for the supply of food grains and a number of agricultural crops. In the same fashion, we have made substantial investment in basic and heavy industries. We are in a position to produce all varieties of basic consumer goods. The foreign exchange reserves of the country have also gone up.

**Employment:**

During the planning period, many steps have been taken to increase the employment opportunities in the country. In the first five year plan employment opportunities to 70 lakh people were provided. In the fourth and fifth plans about 370 lakh persons got employment. Subsequent plans have given due importance in generating more employment through the implementation of a number of rural and urban employment generation programmes.

**Development of Science and Technology:**

In the era of planning, India has made much progress in the field of science and technology. In reality, the development is so fast that India stands third in the world in the sphere of science and technology. Indian engineers and scientists are in a position that they can independently establish any industrial venture.

**Failures of planning in India**

Despite the fact that India had made rapid progress in the sphere of agricultural as well as industrial sectors but it is most disheartening to observe that it has miserably failed on many fronts. Its gains turn into insignificance when we highlight how it has failed to achieve declared objectives. Let us now discuss the major failures of our plans.

**Poverty:**

Though eradication of poverty has been one of the avowed objectives of India's five year plans, one third of our population still lives below the poverty line. These five year plans have miserably failed to make a dent on poverty as 40 per cent of population is still in tight grip of poverty. Poverty is greatly responsible for poor diets, low health and poor standard of living.

**Unemployment:**

The unemployment is a constant threat to the social atmosphere of the country as they resort to various unlawful activities. The NSSO estimates of unemployment give us the gravity of the problem. The pitiable position is found in rural areas where disguised unemployment and white collar unemployment (educated unemployment) in urban areas are in a deplorable position. The rising unemployment may be attributed to galloping population, capital intensive techniques, defective j education system and unstable agriculture.

**Unequal Distribution of Income and Wealth:**

Another failure of the planning is that the distribution of income and other assets in rural and urban areas continues to be skewed. The bulk of increased income has been pocketed only by the rich few while weaker section of the society lives from hand to mouth and lead a very miserable life. This inequality is mostly seen in the possession of land, building and the like.

**Inflationary Pressure:**

Inflation has started with the onset of heavy doses of investment programmes during different five year plan periods. Now, it turned to the gravity of the problem as it has created serious imbalances in the socio-political and economic relations. During the beginning of the XIth Five year plan, rate of inflation has crossed double digit. The people with fixed income group find it extremely difficult to maintain the standard of living. Abnormal rise in prices has generated other problems of corruption, black marketing, dishonesty and immorality etc.

**Other issues**

Along with the failures noted above, our planning has failed in other fronts too. The planning has not succeeded in controlling galloping population growth. Balance of payment problem is frequently disturbing our economy badly. High imports especially the POL items have given way to balance of payment difficulties. Corruptions are on the high end. Our Ministers and top officials are often found to be the culprits in scams and corruptive cases. Deficient capital formation cripples our economic growth. Heavy dependence on foreign capital is increasing.

**Conclusion**

Indian experience with economic planning is not an unmixed blessing. We have succeeded in several fronts while limitations are there in many areas. Unless concerted efforts are made systematically our efforts to become a developed country in the near future will only be a dream. Let us hope our planners and policy makers will rise up to the occasion and lead our country to a developed one through an efficient planning process.

# MODULE VIII

# KERALA ECONOMY

Unique features, Sectoral contribution, land reforms, decentralized planning, people's planning, achievements and challenges in Health and Educational Sectors, Role of Migration and remittances, tourism and development.

## 8.1 Unique Features of Kerala Economy

Kerala was unique region compared to the rest of the country and even to the world. She was unique in its geographical position itself. In Education, Health services, Standard of living, Poverty reduction, Road mileage, Sex ratio, Equality, Land reforms etc. Kerala stands head and shoulders above the rest of the states in the country. As a cash crop economy Kerala has near monopoly in the production of Coconut, Rubber, Pepper, Cardamom, Lemon grass oil, Coffee, and the like. In forest and marine resources she is yet unrivalled. She is the single largest foreign exchange earner in India. Barring the metropolitan areas, Kerala is probably the most densely populated regions on the globe. No wonder, Kerala has attracted worldwide attention both of academicians and policy makers. Kerala astonished the rest of the world with her developmental experience, scenic beauty, quality of life, political awareness, land reform measures, historical migration etc. Not only her economy, but political and social structure demonstrates a unique pattern of development experience. All these can be better understood from the following points.

Firstly, Kerala one of the tiny states in India situated in the southern tip of the country with the land area of 38,863 Sq Km ie;1.18% of total land area of the country and occupies 21$^{st}$ position.

Secondly, according to the National Human Development Report 2011 Kerala occupies top among the Indian states with HDI value 0.79. Thirdly, Kerala achieved high quality of life especially in the case of Life expectancy, Low Infant Mortality, Low Maternal Mortality Rate, Low fertility Rate, Low poverty rate, High Literacy rate and education facilities, Good health care facilities etc. Fourthly, change in demographic profile. According to the census 2011 Kerala stood at 12$^{th}$ position in the country in total population 3,33,87,677 i.e. 3.1 % of the India's population. Kerala has the lowest growth rate of population and birth and death rate. Kerala entered in the third stage of Theory of Demographic Transition.

Fifthly, Kerala is the only states where the sex ratio is in fovour to the female.ie.1084 females for 1000 males. Sixthly, there is the absence of rural- urban polarization. 52.28% of the people lived in rural areas while 47.72% of people lived in urban areas. Seventhly, Kerala is the largest foreign exchange earner in the country. Eighthly, People enjoy greater degree of social justice and equality. Ninthly, Kerala is the first state where the land reforms were implemented effectively. Finally, Kerala is the only state where the public distribution system is so wide spread throughout the state and effective.

**Table 8.1**
**Demographic Profile of Kerala (2011 Census)**

| | |
|---|---|
| Total population | 3,33,87,677 |
| Male | 1,60,21,290 |
| Female | 1,73,66,387 |
| Growth rate of population | 0.486 per annum |
| Birth rate of population | 14.8 |
| Death rate population | 7.0 |
| Sex ratio | 1084/1000 male |
| Total rural population | 1,74,55,506 (52.28%) |
| Total urban population | 1,59,32,171 (47.72%) |
| Density of population | 859/Sq. Km. |
| Literacy rate | 93.91% |
| Male literacy | 96.02% |
| Female literacy | 91.98% |
| Infant Mortality Rate | 13 |
| Maternal mortality rate | 81 |
| Total fertility rate | 1.8 |

Source: Census Report 2011

### 8.1.1 Paradoxes in Kerala Economy

Kerala economy had experienced certain paradoxes in her development process which may be attributed due to the spread of education, Sectoral priorities in the state's five year plans, progressive socio-economic policies, interferences of the private sector etc. which are explaining below.

1. **Development without growth:** Kerala achieved a high developed stage comparable to developed counties without attaining much in growth aspect of the economy. The traditional growth theories proposed that growth is the pre condition for development but Kerala achieved a high degree of development in standard of living, educational and health aspects, quality of life, poverty reduction, change in demographic profile, etc without much improvement in quantitative growth aspects like state domestic product and percapita income.
2. **Lopsided development:** The traditional growth theories proposes that development picks in the primary sector then moved into the industrial sector and lastly to the tertiary sector. This is the way of development or growth moves. But in Kerala economy the paradox exists where there is a lopsided development i.e. development jumps to the tertiary sector from the primary sector totally neglecting the secondary sector.
3. **Good health with low cost:** Kerala achieved good health facilities with low cost in the past. The life expectancy is highest in Kerala. The state shows lowest birth rate, death rate, IMR, MMR, TFR etc. The heath infrastructure facilities are well developed but there is high degree of morbidity rate at present.

4. **Good individual cleanness but poor social cleanness:** It is in Kerala only where people take bath at least two times daily with bathing soap. But their social cleanness is so poor.
5. **High level of education and high level of educated unemployment:** The educational attainment of the people of Kerala is high but the problem of educated unemployment is highest in Kerala because of problems with educational system and attitudes of the people.
6. **Lowest food intake but best BMI figures:** Even though the percapita food intake is lowest in Kerala the Body Mass Index(BMI) for the people are well ahead among Indian states. The Percentage of adult population with BMI less than 18.5 is low in Kerala. According to the estimates of 2005-06 only 18 % of women are BMI>18.5 in Kerala while it is 33% in all India. For men it is 21.5%in Kerala and 34.2% in all India.
7. **Low income but high consumption:** Even though the percapita income of the Kerala people is low they attained a higher level of per capita consumption in the past with the help of foreign money and loans.

### 8.1.2 Kerala's Development Experiences

Kerala's development experiences that Kerala witnessed for the past few decades arouse the attention of social scientists, planners, administrators, politicians and even economists and international development agencies across the world. It was later popularly referred as 'Kerala Model of Development'.

The term 'Kerala Model' was initially associated with the study, *'Poverty, Unemployment and Development Policy: A Case Study of Selected Issues with references to Kerala'',* conducted by the scholars at the Centre for Development Studies (CDS) and published by the Centre and United Nations in 1975. At the meeting of the publication of the study , Dr: K.N. Raj, the coordinator of the study , explained its background and the major conclusions and went on to say : "At no stage, however, has the Centre has described its findings on the set of issues as constituting in effect a Kerala Model". The same view was expressed by T.N. Krishnan, the close collaborate of K.N. Raj in the study. He says that it is the international scholars who launched the "Kerala Model of Development" using the CDS study as its foundation. The authors of the CDS study never claimed that Kerala presented a model of development because they are already aware of the various problems and constraints operating in the Kerala Economy. The Nobel Laureates of Economics 1998, A.K. Sen also not agreed to call it as Kerala Model.

If there is a model it should be a new one. Achieving high levels of human development with low levels of per capita income is conveyed as the Kerala Model, the same has not been happened anywhere in the world. But it is well known that Sri Lanka has been a good instant for this type of development paradigm. Costa Rica, Jamaica, and Peru were also in the same line of development experience. Thus the so called "Kerala Model" does not relate to Kerala alone. Its sustainability is also questioned now. These truths are hijacked by certain people with definite objective and refer the development experiences of Kerala economy as "Kerala Model of Development''. The protagonists of the Kerala Model have their own opinion to raise it as a model.

### 8.1.3 Features of Kerala Model of Development

Kerala attained a unique development paradigm as against the traditional development strategy based on income, per capita income, investment, saving, capital-output ratio etc. As the conventional model developed by Colin Clark and Simon Kuznets the economy in its development process go through three stages. In the first stage the entire economic activity of the

country revolves around the agriculture sector. As the economy progress the growth process moved into the industrial sector, then to the service sector. The miracle of the so called Kerala Model of Development is that development has occurred even before growth in productive sectors. The important features of the Kerala model are the following.

1. The high physical quality of life index with low income.
2. High investment in human development.
3. Good health care with low cost.
4. Low per capita income and high standard of living
5. Development without growth.
6. More equitable distribution of land and social justice.
7. Creation of more social infrastructure rather than productive infrastructure.
8. High consumption with low domestic production and income.
9. Low incidence of poverty.
10. Higher gender equality.
11. More public action and people's participation.

Any how the Kerala model can be better understand with the critical analysis of the achievements and limitations that the Kerala economy attained by the developmental experiences.

**8.1.4 The Achievements of Kerala's Development Experience**

1. Low growth rate of population.
2. Low birth and death rates.
3. Low rates of IMR, MMR and TFR.
4. Low poverty ratio.
5. Sex ratio infavour to females.
6. High life expectancy.
7. High literacy.
8. Near universalisation of primary education.
9. Low dropouts.
10. High standard of living.
11. Better sanitation facilities.
12. High wages to the workers.
13. Good health infrastructure facilities.
14. Universalisation of Public Distribution System.
15. Good education facilities.
16. Change in caste system even at the bottom level.
17. High political awareness of the people.
18. Good housing facilities.
19. Better transport facilities
20. Implementation of land reforms.
21. High gender equality.
22. Development of social services.
23. Low rural- urban polarization.

### 8.1.5 Limitations of Kerala's development experience.

1. Development of consumerism.
2. Aging of the population.
3. High dependency ratio.
4. High preference for male child.
5. Low growth of agriculture sector.
6. Subdivision and fragmentation of agricultural land.
7. Fall the production of food crops.
8. Extension of commercial crops.
9. Militant trade unionism.
10. Stagnant industrial sector.
11. Increase in urban poverty.
12. Increase in educated unemployment.
13. Increase in morbidity rate.
14. Increase in cost of health facilities.
15. Increase in suicide rate.
16. Increase in road accidents.
17. Prevalence of life style diseases.
18. Alcoholism.
19. Increase in crime against women.
20. Preference for white collar jobs.
21. Low work participation rate.
22. Political interference and nepotism.
23. Decay in social customs and values.
24. Over imitation of western culture.
25. Financial crisis of the state.
26. High pressure on land with construction boom.
27. Over dependence on foreign money.
28. Neglect of environmental pollution.
29. Emergence of nuclear families.
30. Over influence of private and religious institutions.

## 8.2 STATE INCOME

According to the statistics published by the Department of Economics and Statistics, the quick estimate of gross state domestic product (GSDP) at factor cost at constant prices (2004-05) was Rs. 193383.39 crore in 2010-11 as against the provisional estimate of Rs.177209.32 crore during 2009-10, registering a growth rate of 9.13 percent in 2010-11 compared to 8.95 percent in 2009-10 (Fig 8.1).At current prices, it was estimated at Rs. 276996.70 crore (quick estimate) in 2010-11 against the provisional estimate of Rs. 232381.05 crore in 2009-10 (Table 8.2).

**Table 8.2**
**Growth Rate of GSDP at Constant (2004-05) Prices – Kerala**

| Year | Growth Rate |
|---|---|
| 2005-06 | 10.09% |
| 2006-07 | 7.90% |
| 2007-08 | 8.77% |
| 2008-09 | 7.22% |
| 2009-10 | 8.95% |
| 2010-11 | 9.13% |

Source : Department of Economics and Statistics

The quick estimate of net state domestic product at factor cost at constant prices (2004-05) was Rs.171897.32 crore in 2010-11 compared to the provisional estimate of Rs.157078.22 crore in 2009-10, a growth rate of 9.43% in 2010-11. At current prices the State income was estimated at Rs. 246212.72 crore (quick estimate) in 2010-11 compared to the provisional estimate of Rs. 206200.31 crore in 2009-10 (Table 8.3).

**Table 8.3**
**State Domestic Product and Per capita Income of Kerala**

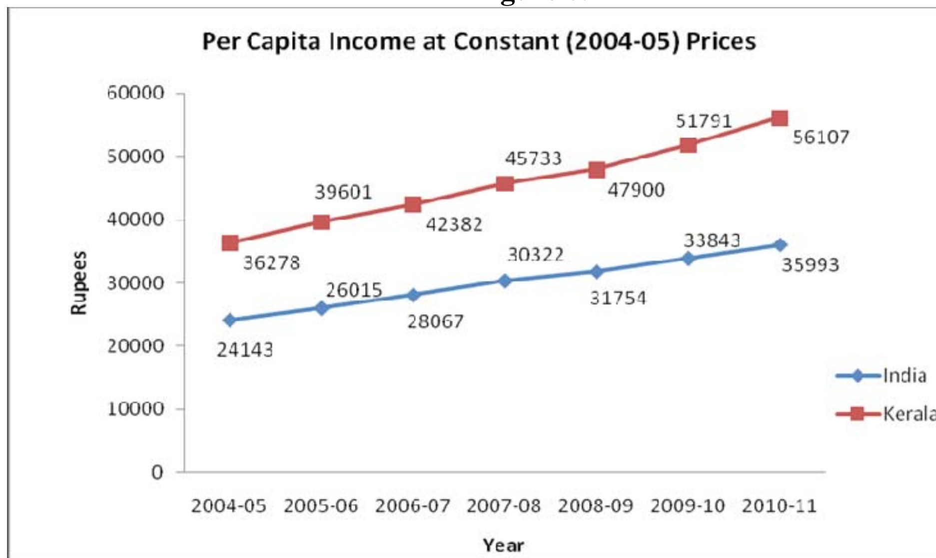
| Si. No. | Item | Income (In Crore) | | | Growth Rate (%) | |
|---|---|---|---|---|---|---|
| | | 2008-09 | 2009-10 (P) | 2010-11 (Q) | 2009-10 (P) | 2010-11 (Q) |
| 1. | GSDP | | | | | |
| | a)At Constant Price (2004-2005) | 162659.20 | 177209.32 | 193383.39 | 8.95 | 9.13 |
| | b) At Current Price | 202782.79 | 232381.05 | 276996.70 | 14.60 | 19.20 |
| 2. | NSDP | | | | | |
| | a)At Constant Price (2004-2005) | 144093.92 | 157078.22 | 171897.32 | 9.01 | 9.43 |
| | b) At Current Price | 180134.36 | 206200.31 | 246212.72 | 14.47 | 19.40 |
| 3. | PCI (Rs) | | | | | |
| | a)At Constant Price (2004-2005) | 47900 | 51791 | 56107 | 8.12 | 8.33 |
| | b) At Current Price | 59716 | 67916 | 80366 | 13.73 | 18.33 |

Source: Department of Economics and Statistics. P: Provisional, Q: Quick Estimate

### 8.2.1 Per Capita State Income

As per the quick estimates in 2010-11, the per capita gross state domestic product at constant (2004-05) prices was Rs.56107 against the provisional estimate of Rs. 51791 in 2009- 10, a growth of 8.33% in 2010-11. At current prices, the per capita GSDP in 2010-11 was Rs. 80366 registering a growth of 18.33% over the estimate of Rs. 67916 in 2009-10. The graph (Fig. 8.1) below shows that during the period 2004-05 to 2009-10, the per capita state income is higher than the per capita national income.

**Figure 8.1**




**Source: Central Statistical Organization & Department of Economics and Statistics**

### 8.2.2 Sectoral Distribution of Gross State Domestic Product

The contribution from primary, secondary and tertiary sectors to the GSDP in 2010-11 at constant prices (2004-05) was 11.06%, 20.13% and 68.80%, respectively. At current prices, the same was 14.94 %, 21.08% and 63.98%, respectively. While analysing the sectoral distribution of state income it is seen that the contribution from primary sector has been decreasing and while that of the tertiary sector has been increasing. The contribution of secondary sector remained almost stagnant. Sectoral distribution of GSDP during 1960-612008-09, 2009-10 and 2010-11 are shown in the Table 8.4.

**Table 8.4**

**Sectoral Distribution of GSDP at constant Prices**

| Sectors | Sectoral Shares | | | |
|---|---|---|---|---|
| | 1960-61 | 2008-09 | 2009-10 | 2010-11 |
| Primary | 56 | 13.07 | 12.00 | 11.06 |
| Secondary | 15 | 20.98 | 20.70 | 20.13 |
| Tertiary | 29 | 65.95 | 67.30 | 68.81 |
| Total | 100 | 100.00 | 100.00 | 100.00 |

Source: Department of Economics and Statistics

### 8.2.3 Growth of the Sectors

The analysis of annual sectoral growth in GSDP showed that tertiary sector recorded the highest rate of growth of 11.57% in 2010-11 at constant (2004-05) prices followed by secondary sector (6.12 %) and primary sector (0.64%). At current prices, the tertiary sector recorded a growth rate of 20.50 %, primary sector 19.97% and secondary sector 14.91% (Table 8.5).

**Table 8.5**
**Sectoral Growth Rate at constant Prices**

| Sectors | Sectoral Growth Rate | | |
|---|---|---|---|
| | 2008-09 | 2009-10 | 2010-11 |
| Primary | 2.18 | 0.01 | 0.64 |
| Secondary | 0.30 | 7.51 | 6.12 |
| Tertiary | 8.07 | 11.17 | 11.57 |
| Total | 5.56 | 8.95 | 9.13 |

Source: Department of Economics and Statistics

## 8.3 Land Reforms in Kerala

Land reforms being the State subject, considerable options have been left to the State governments. The Land reforms in Kerala is one of the most radical and egalitarian measures resorted by the government of Kerala in the agricultural front. It was considered as an important feature of the Kerala's unique development experience and a model to other states of India. Of the three regions that made Kerala state in 1956- Travancore, Cochin and Malabar- Malabar had the greatest struggle over land rights where the most oppressive land tenure systems exist.

### 8.3.1 Objectives of land Reforms in Kerala

1. Abolition of intermediaries between the state and the tiller**.**
2. Conferment of security of tenure on cultivating tenants.
3. Regulation of rent.
4. Consolidation of holding.
5. Establishment of cooperative farming.

### 8.3.2 Different Land Reform Measures after the Formation of the State

After the formation of the Kerala state on 1st November 1956 by rejoining Travancore, Cochin and Malabar the tempo of land reform measures was accelerated.

1. **The Kerala Stay of Eviction Proceeding Act (1957):** This act was intended to maintain the status quo in land relations till comprehensive reform measures could be undertaken.
2. **The Kerala Land Tax Act (1957):** This act was to extend the basic tax system of assessment to Malabar which up till then was part of the erstwhile Madras state. This act removed most of the tenure disparities arising from the modus operandi of the different modes of land revenue and generally helped the cultivators.
3. **The Kerala Conservancy Act:** It was enacted to check encroachment on government lands.
4. **The Kerala Relinquishment Act:** It legalise the relinquishment of lands by owners in fovour of the government.
5. **The Kerala Agrarian Relations Bill:** This was the most revolutionary measure in the field of land reforms that the state had ever undertaken. This was necessitated because of the failure of the initial measure.
6. **The Kerala Agriculturists Debt Relief Act (1958):** Helped to the agriculturists who are in debt.

7. **The Kerala Tenants Improvement Act (1958):** This act benefited the agriculturists of the whole state, provided compensation at the rate of 15 times the net annual yield for trees planted by tenants and the actual value for permanent structures put up by them, even if there was a contract to the contrary stipulated in the deep providing lease or Otti.

8. **The Kerala Agrarian Reforms Act (1960):** This act widened the definition of plantations, and consequently contiguous land interspersed with agricultural land within the boundaries of the plantations were made part and parcel of the plantations and those Kudiyans who had homesteads in the plantation area were brought under the mercy of the plantation owner. The act exempted the land belonging to religious, charitable and educational institutions of public nature, or a public trust from the purview of the ceiling. The definition of small holder was broadened and he was defined as one who had rights in less than 10 acres of double crop wet land but possessed only less than 5 acres of land. Under this act compensation is provided to landlords who surrender the surplus land to the state. This act was not effectively implemented as the Kerala High Court declared it to be unconstitutional.

9. **The Kerala Land Reforms Act (1963):** This act came into force on 1-4-1964 and enacted by the Congress Government. The Kerala Land Reforms Act superseded The Kerala Agrarian Reforms Act, 1960 implemented by the first communist ministry. The Kerala Land Reforms Act is the foremost of the land legislation. The Kerala Land Reforms Act laid down that no family or adult unmarried person shall own or hold more than 12 standard acres subject to a minimum of 15 acres and a maximum of 37 acres. The 1964 Act reduced the maximum area into 36 acres.

   It gave absolute fixity of tenure to the tenants of a Kudikidappu and fixity of tenure to others subject to the landlord's right of resumption for personal cultivation. Resumption was allowed only for extension of any place of public religious worship and for the construction of residential buildings by land owners actually needed it and for self-cultivation. The tenants were given the right of purchase of the superior interest in their holdings. According to this act the enhancement of rent was left to contracts between the landlords and tenants. The act also created land boards and land tribunals for implementing the various provisions of the act. Special protection was given to the landlords who owned small holdings keeping in view that the interests of the tenants do not suffer. The act retained certain conditions for eviction such as gross neglect and mismanagement on the part of tenant or for the landlord's direct operation of the land for himself.

10. **The Kerala Land Reforms (Amendment) Act (1969):** The Kerala Land Reforms Act, 1963 failed to give maximum benefits to the Kudikidappukars and actual cultivators of land. By taking into account the actual difficulties in the implementation of the act, the Kerala government has introduced another revolutionary bill which is termed as the Kerala Land Reforms (Amendment) Bill. This bill was passed in 1969 and came into force in 1st January 1970 with the following objectives.

    (a) To grant more benefits to tenants and Kudikidappukars.
    (b) To include certain classes of cultivators who do not fall within the category of tenants.
    (c) To provide for the compulsory vesting of the rights of the landlords and other intermediaries with the government on a date to be notified by the government.
    (d) For the assignment of those rights to the cultivating tenants and to provide for the constitution of a new fund of not less than Rs. 10 million called the Kudikidappukars' Benefit Fund.

In order to implement the provisions of the bill, land tribunals are established in each and every Taluk in the state.

### 8.3.3 Measures of Land Reforms in Kerala

The measures of land reforms in Kerala include abolition of intermediaries, tenancy reforms and land ceiling.

**(1) Abolition of Intermediaries**

The Land Reforms Act has abolished once for all landlordism and intermediary tenures in the state. The elimination of the intermediaries was a pre-requisite for the reorganization of agriculture. Therefore top priority was given to abolition of these intermediaries. With the abolition of intermediaries lakhs of 'Kudiyans' and 'Kudikidappukars' became the land owners and the exploitation by the land lords was put to an end. The property rights of the landlords were acquired by the state on the payment of the compensation. With the disappearance of the semi-feudal land ownership system, the cultivators now breathe the air of freedom and equality.

**(2) Tenancy Reforms**

The progress of implementation of land reforms has been commendable in the state. The provisions relating to the tenancy reforms and the purchase of Kudikidappu Rights have been almost implemented in full. The Land Tribunals received more than 86 lakhs of application from tenants and 'Hutment' dwellers. Since the commencement of the implementation of land reforms, about 16 lakhs out of 25 lakhs 'Kaivasakudiyanmars' had secured 'Janmavakasam'. Lakhs of tenants have not been paying rent because they have become defacto owners of the land they till. Evictions and other type of exploitation have become merely stories of the past.

**(3) Land Ceiling**

The land ceiling prescribed in the Kerala Land Reforms Act 1969 is 5 standard acres for the adult unmarried person, or a family consisting of two or more adult members but not more than five, with one additional standard acre for each additional member in excess of five. In case of companies and associations, the ceiling is 10 standard acres. As the social conditions, productivity of land, nature of the crop grown etc vary in different parts of the state, on an average one and half ordinary acres are considered equivalent to one standard acre. The maximum a family can own is fixed at 20 ordinary acres. The excess land would be taken over by the government for distribution among landless labourers and other weaker sections of the community.

### 8.3.4 Achievements of Land Reforms

1. Absentee landlordism was abolished.
2. Change the structure of ownership and operation of land holdings.
3. Surplus land is distributed to the people.
4. All tenants and hutment dwellers have been made owners of the land.
5. Reduce inequality among the people.
6. Helped to social justice.
7. Reduce poverty among the people.
8. Reduce the number of landless people.
9. Fair rent was fixed.
10. Land ceiling was fixed.
11. Improve the status of the tenants.

### 8.3.5 Defects of Land Reforms

1. It leads to the subdivision and fragmentation of land holdings.
2. Reduction in total agricultural land
3. Still the slogan 'Land to the tiller' is not achieved
4. Land is transferred to non farmers especially to teachers, layers. Shop keepers, Layers, political leaders etc.
5. No substantial improvement in production and productivity.
6. Agricultural land is changed into non agricultural purposes.
7. Change in cropping pattern.
8. Misinterpret land reform laws.
9. Delay in redistribution of surplus land.
10. Political interference.

## 8.4 Decentralized Planning

Planning in India is designed to ensure economic growth and social change in all regions, sections and to the life of the people. The Planning Commission formulates the plans and allocates the resources. The involvement and participation of the people are very minimum and indirect in the planning process. Participation would strengthen the democracy and thus promotes good governance. The proximity between the state and the people facilitates better understanding of the needs of the people. The experiment of planning from above is not fully successful therefore now the emphasis is shifted from centralized planning. Decentralized planning means 'planning from below'. It is the 'planning from the grass root level'. There is no concentration of authority in the hands of a single person or small body of persons. This type of planning is highly representative and covers people's needs, aspirations and priorities. People feel involvement in planning directly or through their elected members. There is several regional and even lower level planning bodies which enjoy the power of formulating plans for their own regions taking into consideration local needs, local back ground, local priorities and so on. Kerala State lying in the south-west part of India is considered a fertile land for decentralization and People's planning in Kerala is the best example for decentralized planning.

## 8.5 The Planning Progress: People's Campaign for Decentralised Planning

The 73rd and 74th constitutional amendments in 1993 marked a watershed in India's quest for democratic development within a pluralistic, parliamentary, electoral framework. The real test of the effectiveness of the mandate of decentralization, however, depends on the success of those states which took up this task seriously, viz. Kerala. While the constitutional amendments came as a golden opportunity for serious decentralization, there were compelling internal dynamics that contributed to the political acceptability and commitment to this task. When the constitutional amendments took effect in 1993, the way was cleared for passing legislation in the state assembly. The then Congress-led government came up with a bill, but it was more marked by provisions to throttle the spirit of decentralisation. In the ensuing public debate, pro-decentralisation leaders from all political parties including the Congress, lobbied for introducing amendments for a more genuine legislation on decentralisation. Intellectuals and voluntary organisations took the lead in organising public opinion and finally an amended version of the bill was passed. The Kerala Panchayat Raj Act, 1994 and the Kerala Municipalities Act, 1994 were enacted by the Congress led UDF Government in 1995. The People's Campaign for Decentralised Planning was formally inaugurated on the first day of the Malayalam year, 17$^{th}$ August 1996. Elections to the local bodies were conducted by the Congress government under the chief ministership of A.K. Antony who replaced K. Karunakaran. 60% of the local bodies were won by the then opposition Left Democratic Front

(LDF) candidates while the remaining 40% went to the United Democratic Front (UDF) candidates. The first elected local bodies with constitutional backing took charge on October 2nd 1995. When the LDF came to power in the 1996 elections to the state assembly, thanks to the sustained efforts of the late E.M.S. Namboodiripad, the agenda of decentralisation was strengthen then.

It was decided that 40% of the Ninth plan budget of the state would be earmarked for expenditure by the local bodies at the village, block and district levels, as decided by them. People's needs were to be assessed through meetings of the *Gram Sabhas* with the village Panchayat making it into a plan, coordinated and vetted at the block level and approved at the district level by a district planning committee constituted to assist the Panchayats. This was the 'People's Campaign for Ninth Plan' (1996-02), popularly known as 'People's Planning' *(Janakeeya Aasoothranam)*. The word 'decentralisation' or 'Panchayat raj' was nowhere in circulation. The United Democratic Front (UDF), which came into power in Kerala in 2001, did not alter the methodology of the planning substantially but changed the name into Kerala Development Plan (Kerala Vigasana Pathathi) and 10th Five Year Plan (2002-07) is known as 'Kerala Development Plan'. The 11th Plan (2007-12) also referred as *Janakeeya Aasoothranam.*

### 8.5.1 Stages in People's Planning

The Campaign was organised in a phased manner with clearly defined objectives for each phase. Each of the six phases had a nodal event and involved a separate round of training at state, district and local level.

**Phase I: Grama Sabha (August-October 1996)**

Identification of the felt needs of the people is the first step in the decentralised planning exercise. It is accomplished by convening the Grama Sabhas, ensuring maximum participation of people, especially, women and other weaker sections of the society in order to discuss the local development problems. Squads of volunteers visit households and explained the programme. Preparatory meetings of mass organisation are held. It is estimated that nearly 2.5 million persons participated in these Grama Sabhas/ward conventions. Of the participants about 27 per cent were women. The most important outcome of the Grama Sabha was the listing of local development problems. They have also instrumental in bringing about a welcome change in the attitude of the people towards development activities.

**Phase II: Development Seminars (October-December 1996)**

After the identification of the felt needs in the Grama Sabhas, as a next step, in the Development Seminars make an objective assessment of the natural and human resource potentiality of the locality. The approach to planning had to be such as to secure a judicious blend of local needs with local resource availability. They were also come out with a list of tentative solutions to the development problems identified. A series of participatory studies are also usually undertaken in every Grama Panchayat and municipality, most important of which were the following.

1. Collection of secondary data
2. Study of local geography and natural resources
3. Review of ongoing schemes
4. Survey of local history
5. Consolidation of Grama Sabha reports

It is assumed that around 5 lakhs of people, consisting of representatives from Grama Sabhas, elected representatives, local leaders of political parties, line department officials, local experts, etc. participated in the Development Seminars.

**Phase III: Task Forces (December 1996-January 1997)**

Sector-wise task forces constituted at the grass root level were supposed to projectise the recommendations and suggestions, which emerged from the Development Seminars. On as average, 12 task forces were constituted in each local body to cover various development sectors. As many as 12,000 task forces were organised at the village level alone with a total participation of at least 1.2 lakhs persons. The task forces prepared around one lakh projects for the considerations of the Panchayats. A simple and transparent format was proposed for the projects to be prepared by the task forces. In order to ensure uniformity, it was suggested that the project reports should generally have the following components.

1. **Introduction**: Explaining necessity and relevance of the project.
2. **Objectives:** A well defined (as far as possible in quantitative/measurable) terms.
3. **Beneficiaries:** Criteria proposed to be followed in selecting beneficiaries or benefiting areas.
4. **Activities:** technical analysis and time-frame of all project activities.
5. **Organisation:** Agencies and their role in implementing the project activities.
6. **Financial analysis:** Investment needed for each activity and identification of source of funds.
7. **Net Benefits:** Analysis of likely direct and indirect benefits and costs.
8. **Monitoring:** Details of the proposed monitoring mechanism.

A separate set of guidelines for the preparation of Special Component Plan (SCP) and Tribal Sub Plan (TSP) projects are also given. Further, it is recommended that the local bodies earmark minimum 10 per cent of the plan assistance for projects meant for the development of women. Special care is also taken to see that the task forces prepare projects with an integrated approach.

**Phase IV: Annual Plan Finalisation (February-April 1997)**

At the end of the third phase every Grama Panchayat and Municipalities had a shelf of projects corresponding to the development problems identified by the people. By then the Grants-in Aid allocated to each body by the state government was also made known. This set the stage for the fourth Stage of the campaign, wherein the projects prepared by the task forces were prioritised and incorporated in the Five Year Plans of the Panchayats. For finalising the plans the Panchayats had to:

1. Made an assessment of their capacity to mobilise resources from various sources to finance the plan.
2. Evolve a development strategy on the basis of problems identified and resource potential of the locality, prioritise and select projects to be implemented, and
3. Decide on a monitoring mechanism for successful implementation of each project selected.

On the basis of the above analysis, each Panchayat was supposed to prepare a plan document comprising of eight chapters, viz., Introduction, The development strategy, Resource mobilisation, Sectoral programmes, Integrated development, Welfare of the SC and STs, Women's development programmes and Monitoring.

### Phase V: Annual Plan of Higher Tiers (April-September 1997)

Block and District Panchayats are supposed to prepare their annual plans only after Grama Panchayats had drafted their plants. These plans are complementary to each other. A simple method of integrating the analysis and programmes of the Grama Panchayats at block and district level is also proposed. Every Block Panchayat is to prepare a printed Development Report in which the problems identified in the Development Reports of the Grama Panchayats in the block area and the type of projects included in their plan were integrated for each sector.

In each sector all the major development problems identified are listed in rows and in each column under the relevant Grama Panchayat the rank order of the problem marked according to its relative gravity. Emphasis was laid on the importance of integrating the different centrally sponsored poverty alleviation programmes being implemented through the community development blocks with the block Panchayat plans. Each District Panchayat should also to prepare a development report integrating the analysis and programmes of the lower tiers. The guidelines for the preparation of the projects and the plan documents for both the block and district Panchayats are similar to those of the Grama Panchayats.

### Phase VI: Plan Appraisal (April-1997)

A sample review of the projects prepared by the local bodies revealed that a significant proportion of them had to be modified to ensure their technical soundness and viability before they were approved for implementation. Realising that the District Planning Committees (DPCs) did not have the technical manpower or infrastructure in undertake a proper scrutiny of the projects, a major improvisation in the original programme of the Campaign was called for. Therefore, a new (sixth) phase was added for the technical and financial appraisal of the projects and plans. More than one lakh projects have to be evaluated each year. The evaluation was not for selection or rejection of the projects, but to actually rectify the technical and financial weaknesses of the project proposals. Technical specifications and even designs might have to be prepared. Further, the entire work has to be undertaken within a span of three to four months. It was evident that the official machinery would not be able to cope with the task. This was how the concept of technical support committees emerged.

Retired technical experts and professionals are encouraged to enroll themselves as volunteers to appraise the projects and plans of the local bodies besides officials. Such a volunteer expert is committed to spending at least one day a week giving technical assistance to the Panchayats. District level conventions are arranged for the experts who formally offer to join second committee. Special orientation courses were organised for those volunteers who expressed their willingness to serve in the Voluntary Technical Corps (VTC) after the conventions. Expert Committees are formed at block (BTSC), Municipal (MLtSC) and corporation (CLTSC) levels drawing from the technical support group members and certain categories of mandatory officers.

The support committees are on the one hand, an advisory arm of the DPC helping the latter to appraise the plans and projects and on the other hand a body to render technical assistance to the local bodies. The support committees have no right whatsoever to change the priorities set by the local bodies. In course of time, the expert committees or the technical support committees were also given the power to approval of technical sanctions and tender excesses within certain limits. They were also given a role in plan implementation such as approval of revised estimates, settling disputes in measurement, inspection of all works and verification and approval of performance/completion reports of works within certain financial limits. The District Level support Committee consisted of the senior most officials and non official expert with Collector as chairperson.

### 8.5.2 Limitations of Local Governments in Kerala

However many glaring weaknesses or limitations are in evidence in the functioning of local self governments (LSGs) in Kerala.

1. A significant part of the funds allocated to the local governments is spent without deriving much benefit.
2. There is un utilisation of funds
3. There was lot of evidence of corruption and mismanagement of funds.
4. Many 'productive sector' (especially in productive sectors of agriculture and industry) schemes of LSGs have turned ineffective by unproductive investments and creating sick units.
5. There is a serious confusion on what local governments should (shouldn't) do or what they can (cannot) do effectively.
6. The weakest outcome of decentralization in Kerala is in the realm of basic governance and service delivery. For example, services such as issuance of birth certificate or collection of building tax etc.
7. Cleaning of public spaces, another local public good is also indifferently carried out.
8. There is extreme competition taking place among elected representatives to get a share of the cake, which sometimes works against the provision of public goods located in one place serving large groups of the population or against the need-based implementation of financial-transfer and merit-good schemes.
9. The attendance in *Grama Sabhas* used to be thin even from the beginning, and they, later on, became assemblies of persons who expect direct benefits and of activists of dominant political groups.
10. There is lack of adequate monitoring and evaluation of schemes implemented.
11. In the execution of projects there is the existence of '*benami'* contractors.
12. Resistance of government employees and their trade unions, who are unwilling to move out of their comfortable postings in cities, and in large organizations with great possibilities of corruption.
13. Thus local governments struggle to cope up with the workload with few employees, over whom the elected representatives do not have much control.
14. The elected representatives themselves do not have adequate incentives or ability to carry out the tasks entrusted upon them.
15. Little progress made in the use of IT in improving the governance of LSGs.
16. Continuation of a dominant role for centralized bureaucracies (whether through-centrally sponsored schemes or the requirement of getting permissions from line departments) in many activities that could have been planned and implemented at the local level.
17. Thus Kerala experiences several second generation problems in decentralization like improving efficiency and effectiveness, designing of incentives for stakeholders to align their interests with those of society as a whole and ultimately of creating institutions that lead to sustainable welfare of local people, that the State currently encounters.
18. First generation problems include difficulty in convincing the political and administrative elites of the need for genuine decentralization, actual transfer of resources to local governments, even if there is agreement on formal forms of decentralization and elite capture – by which the local elite take over the control over local governments and decentralized allocation of resources. The first generation problems have been sorted out to some extent in Kerala.

19. Women in leadership positions in the Panchayats have often felt the heat from men and some have been forced to abdicate, even though many women representatives are related by family and kinship to men in politics.
20. Nepotism and corruption are decentralized in the case of beneficiary selection.

### 8.5.3 Achievements of People's Planning

1. The state has undoubtedly progressed well on certain dimensions of local governance. Around 25 to 30 per cent of the plan resources of the state are spent through these local governments.
2. A cadre of local leadership (including women) has developed along the process, with many of them sincere, committed and reasonably knowledgeable.
3. There is also evidence of money spent on poverty eradication or individual oriented schemes increasingly reaching the needy unlike during the earlier department-driven delivery system (since it is difficult to neglect the really needy when resource allocation decisions are taken at the local level).
4. One visible improvement that we see as an impact of decentralization in Kerala is in the construction and, to some extent, maintenance of rural roads.
5. For the first time, village Panchayats have been freed from the clutches of the Public Works Department in matters relating to the design and implementation of construction works.
6. Women participation in decision making increased.
7. The awareness of the people increased.
8. More self employment opportunities are provided.
9. Many self help groups are formed in various Panchayats.
10. More social services are provided to the people.
11. Homeless and land less are given assistance.
12. Improvement into the positive functions of the government which include the provision of public services such as health care, child immunisation, primary education, social security, environmental protection and rural infrastructure.

## 8.6 HEALTH SECTOR IN KERALA

Kerala has a long history of health care. Even before the advent of the Allopathic medicine Kerala was in the care of indigenous Ayurveda medicine. Now in the state along with this Allopathy, Homeopathy and Unani are working effectively. It is said that the commendable achievements that gained by the Kerala state in birth rate, death rate, gender equality, life expectancy, infant mortality, maternal mortality etc is due to the well health care facilities provided by the state. This has been considered as a paradox, ***'good health at low cost'***. The latest India Human Development Report 2011 placed Kerala on top of all the other states in India, because of easy accessibility and coverage of medical care facilities. The State is reported to have the lowest rural-urban inequalities in public health status. The success of Kerala health indicators is more due to the investment in the social capital rather than only in the public health care, resulting in a more accountable and integrated primary health care system High levels of education especially among women and greater health consciousness have played a key role in the attainment of good health standards in Kerala.

Health sector in Kerala is at a cross road. Early success in reducing mortality has led to an ageing population suffering from degenerative diseases associated with the demographic shift. The morbidity rate is high as compared to the national estimate which is 25.15 and 9.11 respectively according to the 2004 estimate. As a result of surpassing all the Indian states in morbidity rate, the state is suffering with the prevalence of chronic and acute illness like diabetes, heart diseases,

mental, asthma, blood pressure, cancer etc. Having abandoned the public health strategies that helped the State control communicable diseases in the past the State is witnessing the re-emergence of these diseases. Increase in alcoholism and accidents are worrying the state. Kerala has to recapture the basic structure and policies that helped us reduce mortality in the past and to develop the capacity to deal with the problems associated with non-communicable which now affect all segments of the population.

### 8.6.1 Health Care Infra structure in Government Sector

The Health Care system in Kerala comprises mainly under three heads namely Alopathy, Ayurveda and Homoeopathy. The Health infrastructure consists of 2724 institutions with 52893 beds. Besides there are 5403 sub centres under Directorate of Health Services .Out of the total institutions 46.44% are under Allopathy, 32.2 % under Ayurveda and 21.36 % under Homoeopathy department. Medical services are also provided through the co-operative sector and the Private sector. There are 74 hospitals with 6767 beds under the Co-operative sector in the State.

**Table 8.6**

**Health Infrastructure in Government Sector during 2011**

| SI. No. | System of medicine | Institutions | Beds | Patients treated | |
|---|---|---|---|---|---|
| | | | | IP | OP |
| 1 | Allopathy(DHS) | 1255 | 37750 | 1831724 | 53057551 |
| 2 | Allopathy(DME) | 10 | 10079 | 347334 | 3341592 |
| 3 | Ayurveda(ISM) | 874 | 2860 | 41102 | 10481288 |
| 4 | Ayurveda Medical Education | 3 | 1259 | 9072 | 386721 |
| 5 | Homoeopathy | 582 | 945 | 53442 | 11839811 |
| | **Total** | **2724** | **52893** | **2282674** | **79106963** |

Source: Allopathy, Medical Education, Ayurveda and Homoeo Departments

Table 8.7 shows the basic health indicators of both Kerala and India during 2011.

**Table 8.7**

**Basic Health Indicators 2011**

| SI No | Health Indicators | Kerala | India |
|---|---|---|---|
| 1. | Crude Birth rate (‘000 population) | 14.8 | 22.1 |
| 2. | Crude Death rate (‘000 population) | 7.0 | 7.2 |
| 3. | Infant mortality rate(‘000 population) | 13 | 47 |
| 4. | Child mortality rate 0-4 years(‘000 population) | 14 | 64 |
| 5. | Maternal mortality rate (per lakh live birth) | 81 | 212 |
| 6. | Total fertility rate (children per woman) | 1.7 | 2.6 |
| 7. | Couple protection rate (in percent) | 62.3 | 52 |
| 8. | Life expectancy Male | 96.02 | 82.14 |
| 9. | Female | 91.98 | 65.46 |

Source: Directorate of Health Services

### 8.6.2 Department of Health Services

The department of Health Service is formed mainly for the establishment and maintenance of medical institutions with necessary infrastructure. It offers services such as control of communicable diseases, Family Welfare services including maternal and child health services,

implementation of National control / eradication programmes, providing curative services and administration. Details of major medical institutions under DHS during 2010 & 2011 are shown in Table 13.3 below. There are 1254 institutions and 37177 beds under the Directorate of Health services which include 835 Primary Health Centres, 237 Community Health Centres, 78 Taluk Hospitals, 17 TB clinics/ centres, 29 grand- in- aid institutions and 3 leprosy control clinics/units. Besides, there are 5403 sub centres. Out of the 835 PHCs, 174 are now categorized as 24x7 PHCs.

**Table 8.8**

**Major Medical Institutions Under DHS (No.)**

| SI.No | Institution | 2010 | 2011 |
|---|---|---|---|
| 1 | Primary Health Centres (including MCH Centres) | 835 | 835 |
| 2 | Community Health Centres | 237 | 230 |
| 3 | Taluk/District /Women &Children Hospitals | 95 | 103 |
| 4 | Dispensaries | 24 | 25 |
| 5 | T.B. Clinics/Centres | 17 | 17 |
| 6 | Grant-in-aid institutions | 29 | 29 |
| 7 | Leprosy Control Units | 3 | 3 |
| 8 | Sub Centres | 5403 | 5403 |

Source: Directorate of Health Services

### 8.6.3 Medical Education

There are 23 Medical Colleges in the State of which only five are in the public sector. Medical Education in the Government sector in the State is imparted through five Medical Colleges, three Dental colleges and five Nursing colleges. Government has announced the intention to start four new Medical Colleges in Idukki, Kasargod, Pathanamthitta, Harippad and Malappuram during 2011-12.

### 8.6.4 Ayurveda

The Department of Indian System of Medicine has 119 Hospitals and 745 dispensaries across the State. Besides, there are around 900 small to medium size Hospitals in the private sector. The Directorate of Ayurveda Medical Education manages 16 institutions; 3 are in Government sector, 2 in private sector (Aided) and 11 in self financing sector.

### 8.6.5 Homoeopathy

The Department of Homoeopathy has 551 dispensaries and 30 Hospitals with total bed strength of 945. Out of the 30 Hospitals, 13 are District Hospitals and 17 Taluk Hospitals. In addition, Kerala State Homoeopathic Co-operative Pharmacy (HOMCO) Alappuzha, a medicine manufacturing unit is also functioning under the Directorate of Homoeopathy. Under Homoeo Medical Education, there are two Govt. Homoepathic Medical Colleges, one functioning at Thiruvananthapuram and the other at Kozhikode.

### 8.6.6. MAJOR DISEASES IN KERALA

1. **Life Style diseases**

Longevity and changes in life style have contributed to the growth of chronic and

degenerative diseases also referred to as non-communicable diseases. These include diseases such as heart disease, stroke, high blood pressure, cancer and diabetes.

It is estimated that there are about 1.5 million diabetic patients in Kerala. These people need lifetime management involving lifestyle modifications, drugs and diet. Recent surveys in different categories of subjects in Kerala reveal that one out of three adults in Kerala is a hyper tenssive. Hyper tension leads to heart attacks, stroke and kidney failure. It is a lifelong disease and needs careful and sensible management throughout life. Alcohol consumption is increasing in the State.

According to WHO estimates, there are about 2 billion people who consume alcoholic beverages and 76.3 million with diagnosable alcohol-use disorders. Excessive drinking can cause a variety of health problems. More than 72 per cent accidents on national highways were related to drunken driving. Domestic violence is also on the increase due to high alcohol consumption. Alcohol related diseases are growing. Chronic alcohol use can lead to adverse immunological consequences resulting in poor response to medication and avoidable mortality. Similarly, over weight and obesity leads to heart attack, hypertension, breast cancer, and diabetes and diseases of bones and joints.

**2. Communicable Diseases**

Kerala which had effectively eliminated indigenous malaria through public health

measures are finding it difficult to deal with communicable diseases like Chikungunia, Dengue fever, Malaria, Leptospirosis, Cholera, and Typhoid. We need to have a systematic programme to deal with each communicable disease, based on their seasonality, to prevent them and manage complications that arise from their incidence.

**3. Cancer**

Cancer is a major disease that affects all sections of human population. Every year 35000 new cases of Cancer are detected in Kerala. It is estimated that almost 5 lakhs of persons will develop cancer every year in the country and in any given year there will be almost 15 lakhs cancer patients.

**4. Aids**

The estimated number of people infected with HIV in Kerala is 55167 in 2010. The route of HIV transmission in Kerala is categorized as heterosexual 82%, homosexual 2%, through injection and drug use 7.85%, mother to child 7%, through blood /blood products 1% and unspecified 5.5%.

**5. Mental Health**

Mental health problems including higher suicide rates, health problems and death due to road traffic accidents are increasing. Total number of suicide in the state is 8556 during 2010. Compared to other states suicide rate among youngsters and family suicide are also on the higher side in Kerala. During 2010, 19.2% of the suicides were in the age group 15-29. Sex distributions of the suicide victims are also significant. Suicide is more among males (74%). The Male female ratio is 2.8:1. But the suicide attempts are high among the females. Rates of suicide are higher among those with physical disorders than among other people, this is especially marked in elderly people. Depression is associated with reduced levels of functioning of immune system and an increased risk of other physical disorders People suffering from chronic physical conditions such as 'heart disease, diabetes and cancer have a heightened probability of developing mental disorders such as depression. The percapita alcohol consumption is 8 liters which is higher than the national average of 1.8 liter and international average of 5 liter and stood top among the Indian states.

### 8.6.7 Actions to be taken

1. Control and Management of Communicable diseases:
2. Prevention and management of lifestyle related diseases:
3. Prevention of accidents, trauma care:
4. Reduction of mortality and morbidity, IMR, MMR:
5. Mental Health:
6. State specific treatment protocols, referral systems, quality of care, safety:
7. Health of the aged and palliative care:
8. Infrastructure:
9. Health Manpower Medical education training:
10. Health Care Financing:
11. Governance for a good medical sector

### 8.6.8 Achievements of Health Sector in Kerala

Kerala enjoys a unique position in the health map of India. The health indicators in Kerala are at par with the Western world. The important achievements are the following.

1. Low Birth and death rate.
2. Low infant mortality rate.
3. Low child mortality rate.
4. Low Maternal mortality Rate.
5. Low cost medical facilities.
6. High life expectancy
7. High Couple protection rate.
8. High percapita medical expenditure.
9. High public and private participation in medical facilities.
10. Good medical infrastructure facilities.
11. Good Public health information system.
12. Good sanitation facilities.
13. Equality in rural-urban medical facilities.
14. Expansion of primary health care centers.
15. Institutionalization of delivery.
16. More gender equality.
17. Nearly full immunization.

### 8.6.9. Challenges to the Health Sector in Kerala

1. Spread of modern diseases.
2. Aging of the population.
3. Increase in suicide rate.
4. Increase in cost of medical facilities.
5. Death due to road accidents.
6. Mental health problems.
7. High Morbidity rate.
8. Prevalence of life style diseases.
9. Lack of infrastructure and trained personals.
10. Poor performance of the public sector.
11. Emergence of private sector.
12. Alcoholism.
13. Obesity.

14. Lack of physical exercise.
15. Increase in female foeticides.
16. Increase in communicable diseases.
17. Increase in low weight new born babies.
18. Increase in stress and strain
19. Unhealthy food habits.
20. Marginalization of the backward classes.
21. Child sex ratio is infavour to the male.
22. Nutritious problems.

## 8.7. EDUCATION IN KERALA

Kerala has achieved a well developed educational system through the progressive State policies in education, community involvement in developing and sustaining village schools and Madrassas, efforts by Missionaries and indigenous Christian organizations and efforts by various associations formed by other communities (like SNDP by the Ezhava Community and NSS by the Nair Community). Their efforts to establish schools and enroll children have played a significant role in shaping the educational progress of the Kerala state.

Modern Education in the former Travancore State began with the Proclamation of 1844 by the Maharaja of Travancore that those educated in English school would be given preference in Public Service. Government established the Raja's Free School at Thiruvananthapuram as early as 1834 and it was the first school to import English education in the former Travancore State. In the former Cochin State, the Govt. comes in to the field of education in 1818 with the Proclamation, by which there established 33 Vernacular schools. The study of English language was helped by the missionary Rev. Dawson who opened on English school at Mattancherry in 1818. Thereafter, English schools were opened at Thrissur, Thrippunithura and Ernakulam. In 1868, the first batch was presented for the Matriculation examination. In Malabar area, the Local Boards Act of 1834 helped the establishment of schools. Later, the Elementary Education Act enabled the establishment of several Elementary schools and grant-in-aid was paid to Private schools by the District Educational Councils. From 1939 onwards, the disbursement of grant-in-aid to private schools was done by the District Educational Officers. The progressive educational policies of enlightened rulers of the erstwhile states of Travancore and Cochin and the educational activities initiated by the Christian Missionaries and other social organizations yielded remarkable development in the field of education in the State even before Independence.

The Private Secondary School Scheme was introduced in Travancore-Cochin from 1st December 1951 onwards. Payment to the teachers of private schools was mace direct from the treasury from that date. Payment to non-teaching staff of private schools was mode by management till 31st June 1959.

The Kerala Education Act and Kerala Education Rules come in to force with effect from 1st June 1959. The post of the Director of Public Instruction was included in IAS cadre from the year 1960-61. The Examination Section which was functioned as port of the Directorate of Public Instruction was separated and Commissionarate of Govt. Examinations (Pareeksha Bhavan) was started with effect from 1st Oct. 1964 under the Directorate of Public Instruction. The Director of Public Instruction has been continuing as the Commissioner for Govt. Examinations since 1964. During the year 1956-57 there were 10,079 institutions under the Education deportment in the Kerala State. These consisted of 17 Arts and Science colleges in the Cochin and Malabar areas, two training colleges at Thrissur and Kozhikode, one post graduate training college at Thrissur, one

Physical education college at Thiruvananthapuram, 762 High school, 1589 Middle schools, 6699 Primary schools, 87 Training schools, 7 Music and Fine arts schools, 5 schools for the physically handicapped, 33 Fisheries schools, 13 Nursery and Kinder Garden schools, 6 Technical schools, 2 Certified schools, 460 Basic schools, 32 Social Education Centers and 363 other special schools. Of these, 2129 were Govt. institutions and the remaining 7950 were under private management.

At present, there are 12271 Schools consists of 6712l L.P. Schools, 2951 U.P Schools and 2608 High Schools in the State. Of these, 4492 are Government Schools (2551 LP, 957 UP and 984 HS), 7282 are Private aided Schools (4003 LP, 1870 UP and 1409 HS) and 497 are Private Unaided Schools (158 LP.124 UP and 215 HS). In addition to these, there are 102 Teachers Training Institutes, 43 Special Schools for the handicapped children and 8 Anglo Indian High Schools.

During the year 1956-57, the enrolment of students was 2709271. It increased steadily and reached a maximum of 5901101 in 1990-91. There onwards the trend was reversed. The present enrolment is 4881585. The percentage of women to the total number of teachers significantly increased during the last five decades. It was 41% in 1956-57,50% in 1976-77 and 68% in 2002-03. There is a slight decrease in the drop out rate during the last 5 years, which is an encouraging feature.

In accordance with the National Policy of Education (1986), District Institute of Education and Training (DIETs) were established In 14 districts of the State. The main function of DIETs is to provide academic and resource support at district level for the success of various program being undertaken in the field of primary and adult education.

The Vocational Higher Secondary Education was introduced In the State during 1983-84. It is designed to prepare skilled work force in the middle level in one or more group of occupations, trade or job after matriculation at 10+2 stage of Education. The objective of the course is to enhance individual employability to provide an alternative for those pursuing higher education without particular Interest or purpose. Consistent with the National Policy of Education (1986), Government have decided to de-link Pre degree Courses from Colleges in a phased manner and to Introduce 10+2 system in High schools of Kerala. Accordingly, Higher Secondary Course was introduced during the year 1990-91 as a step for reorganizing the secondary and collegiate education. The above two courses are functioning in High Schools by upgrading the classes, but the Administrative control is vested with separate Directorates.

The District Primary Education Program (DPEP) introduced in the State during 1994-95 was discontinued and a new scheme - Sarva Siksha Abhliyan (SSA) has now been started to universalize Elementary education by community ownership of the school system. The State Council of Educational Research and Training (SCERT) was established in the year 1994 as an autonomous organization by reorganizing the State Institute of Education (SlE) to provide academic support to General Education in the State. The Director of SCERT is the head of the Organization. It has a general body with the Hon'ble Minister for Education as chairman. A governing body with Secretary to Govt.(Gen.Edn) as Chairman and the Director of Public Instruction as Vice-Chairman supervises the functioning of SCERT.

In brief, there was enormous expansion of educational facilities in the State since Independence. The development of Education over the years was tremendous.

As literacy development is concerned; Kerala has the distinction of being a historic state in India so far. Kerala's literacy rate is comparable to the most advanced regions of the world. Kerala's literacy rate which was only 47.18% in 1951 has almost doubled to 93.91% in 2011. Male, female literacy gap which was 21.92% in 1951 has narrowed down to 4.04% in 2011.

### 8.7.1 The School Education

There were 12644 schools in Kerala during 2010-11. Out of these 4504 were government schools, 7277 aided schools and 863 unaided schools. In the state, during 2010-11, 57.55% of total schools were aided schools, 35.62% government schools and 6.83% unaided schools. Compared to government upper primary and high schools more number of LP schools are functioning under government sector. Aided schools outnumber government schools in all sections.

### 8.7.2 Higher Secondary Education

Education after the first 10 years was a part of the higher education system for many decades. Higher Secondary courses were introduced in the state during 1990-91 to reorganize the secondary level of education in accordance with National Education Policy. Higher Secondary Course is the turning point in the entire school education in our state. The department serves as a professional institution in formulating and maintaining the standards of Higher Secondary Education and in providing need based timely, scientific, effective and sustainable services to the students and teachers at the Higher Secondary level. 1907 Higher Secondary schools were there in 2011 in the state. Out of these 760 (39.86%) are Government schools, 686 (35.97%) are Aided schools and the remaining 461 (24.17%) are Unaided schools. Among the districts Malappuram has the largest number of Higher Secondary schools (233 nos) in the state followed by Thrissur (190 nos) and Ernakulam (179nos) districts respectively.

### 8.7.3 Vocational Higher Secondary Education

Vocational Higher Secondary Education was introduced in the state in 1983-84 Vocational Higher Secondary Education in the state impart education at plus two level with the objective to achieve self/wages/direct employment as well as vertical mobility. The course is designed to prepare skilled work force at middle level in one group or more of occupations, trade

or job after matriculation at 10+2 stage of education. 389 Vocational Higher Secondary Schools are there in the state with a total of 1100 batches. Out of the 389 Vocational Higher Secondary Schools 261 are in the Government sector and 128 in the Aided sector. Kollam District ( 52 nos) has the largest number of Vocational Higher Secondary Schools in the state.

### 8.7.4 University and Higher Education

There are a total of 9 universities functioning in the state. Out of these four universities viz. Kerala, Mahatma Gandhi, Calicut and Kannur are general in nature and are offering various courses. Sree Sankaracharya University of Sanskrit, Cochin University of Science and Technology and Kerala Agricultural University offer specialized courses in specified subject areas. Besides these, the National University of Advanced Legal Studies (NUALS) established in 2005 and the Central University established in Kasargode district are also functioning.

### 8.7.5 Arts and Science Colleges

Including 150 Private Aided Colleges and 39 Government Colleges there are 189 Arts and Science Colleges in the State. Ernakulam district (25nos) has the largest number of Arts and Science colleges in the state followed by Kottayam (22 nos), Thiruvananthapuram (20 nos) and Thrissur (20 nos) districts. A new Govt. Arts and Science college has started functioning in Ambalapuzha, Alappuzha district with BSc. Maths, BA Economics, and B.Com during the academic year 2010-11 Thiruvananthapuram district has the largest number of Government colleges (8 nos) in the state.

### 8.7.6 Technical Education

Directorate of Technical Education is the nodal department for Technical Education in the state. Details of technical institution, under the administrative and financial control of the Directorate of Technical Education are given in Table8.

**Table 8.9**

**Technical Institutions under Directorate of Technical Education-2011**

| SI.No | Institutions | Nos |
|---|---|---|
| 1 | Government Engineering Colleges | 9 |
| 2 | Private Aided Engineering Colleges | 3 |
| 3 | Government Polytechnic Colleges | 36 |
| 4 | Government Women's Polytechnic Colleges | 7 |
| 5 | Private Aided Polytechnics | 6 |
| 6 | Fine Arts Colleges | 3 |
| 7 | Government Technical High Schools | 39 |
| 8 | Government Commercial Institutes | 17 |
| 9 | Tailoring and Garment making training centres | 42 |
| 10 | Vocational Training Centres | 4 |

Source: Directorate of Technical Education

### 8.7.1 Achievements in Education

1. High literacy
2. Low gender difference
3. Low dropout
4. High enrolment ratio
5. Better primary education
6. No discrimination in education
7. Better results

### 8.7.2 Challenges to Education

1. Lack of quality education
2. Low enrollment ratio of males in higher education
3. Political interference
4. Religious or Community interference
5. Over influence of private
6. Out dated syllabus
7. Lack of technical education
8. Lack of vocational education
9. Over emphasis on arts subjects
10. Problems related to bureaucratic set up
11. Delay in publication of results
12. Mismanagement of allotted funds
13. Problems in pedagogy
14. Poor performance of the students

## 8.8 Migration

Migration has occurred throughout history, and current trends certainly indicate that it will continue to increase in the future. While the forces of globalisation have created opportunities for greater integration of labour markets, a complex web of national immigration laws and border controls has restricted the mobility of people across borders. Yet growing disparities in wealth, incomes, human security, human rights and demographic trends across the countries are all exerting upward pressure on migration. Every year, many millions of young men and women enter the labour force in developing countries where jobs are not created fast enough to absorb them. The impact of demographic trends in the form of population decline and ageing is being felt most profoundly in advanced destination countries, where scarcities of labour are emerging in many sectors. The shrinking of labour force in the countries has generated a demand for workers in many sectors of the economy, particularly in services, which has been met to a significant extent by migrants. New technologies also allow more people to acquire the information they need to access the global labour market.

### 8.8.1 Migration and economic growth

Migrants contribute to economic growth in numerous ways-by filling labour market needs in high skill and low-skill segments of the market, rejuvenating the population, improving labour market efficiency, promoting entrepreneurship, spurring urban renewal, and injecting dynamism and diversity into destination countries and societies. The World Bank has used a general equilibrium model to estimate overall economic gains to the global economy through international migration. Assuming a modest increase in migration from developing countries to high income countries (14.2 million workers, consisting of 4.5 million skilled and balance low skilled), the share of migrants in the stock of workers in high income countries will increase by 3 percent by the year 2025. 5.43 The current emphasis on migration and development projects a positive image of international migration. This has resulted in greater international co-operation to maximize the positive aspects and minimize the negative ones. The ILO Director General has emphasized, "gains from migration and protection of migrant rights are indeed inseparable. Migrant workers can make their best contribution to host and source countries when they enjoy decent working conditions, and when their fundamental human and labour rights are respected''.

### 8.8.2 Migration in Kerala

A recent trend in the employment sector in the State is the inflow of interstate migrant labour from other States like West Bengal, Bihar, Orissa, Chattisgarh, Jharkhand etc, besides from the adjacent States. Higher wages for unskilled labour in the State, large opportunities for employment and shortage of local labour, paradoxically, despite the high unemployment rate in the State, led to massive influx of migrant labour to the State. These workers are less advantaged group in the labour market working for a subsistence living. Even though a comprehensive data on migrant labour is not available, different micro studies indicated that the incidence of migrant labour is increasing in the State. Since they are not engaged through a contractor or an intermediary, the legal protections envisaged under the Interstate Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979 are alien to them in their employment. According to Census, 2001, among the districts, Ernakulam district, recorded the highest inflow of migrants from other States.

### 8.8.3 Migration

Migration has been a significant factor in helping reduce poverty, unemployment and relative deprivation in Kerala. For over three decades there has been steady migration from the State of Kerala to countries in the Gulf and different parts of India and the world. It is estimated that today over 10% of the population of Kerala lives outside the State, in various parts of India and abroad particularly in the Gulf region, the US and Europe. According to the latest study 'Kerala Migration Survey 2011' conducted by Shri.K.C.Zahariah and Shri.S.Irudaya Rajan of the Centre for Development Studies(CDS), Thiruvananthapuram, 22.8 lakh Kerala emigrants are living abroad in 2011.The number of Kerala migrants living in other States of India in 2011 is estimated at 9.31 lakh.

### 8.8.4 Highlights of the study 'Kerala Migration Survey 2011' undertaken by CDS

The 2011 study is the fifth in the series of comprehensive studies on international and internal migration from Kerala since 1998 and it is based on primary data collected from 15,000 households selected at random by a stratified multistage random sampling technique covering all the 63 taluks in the state.

**(a)External Migration**

It is estimated that the number of Kerala emigrants living abroad in 2011 is 2.28 million, up from 2.19 million in 2008, 1.84 million in 2003 and 1.36 million in 1998.

The number of Kerala emigrants who returned and living in Kerala in 2011 is estimated to be 1.15 million. It was 1.16 million in 2008, 0.89 million in 2003 and 0.74 in 1998.

On-Resident Keralites (EMI+REM) numbered 3.43 million in 2011, 3.35 million in 2008, 2.73 million in 2003 and 2.10 million in 1998.

Only about 18.2 per cent of the Kerala households had an emigrant in 2011 and only 27.1 per cent had an NRK. The vast majority of the households – nearly 82 per cent – did not have an emigrant member. Nearly three-fourths had neither an emigrant nor a return emigrant.

The vast majority of the emigrants from Kerala in 2011 were Muslims (about 45 per cent), although their share in the total population was only about 26 per cent. They retained their lead through all these years. On the other hand, the Hindu emigrants were only 37.5 percent of the total, although their share in the total population is about 56 per cent. However, over the years, the Hindus have improved their share, from 29.5 per cent in 1998 to 37.5 per cent in 2011. The gain among the Hindus was mostly at the expense of the Christians whose share shrank from 25.1 in 2003 to 17.9 by 2011.

The largest number of emigrants originated from Malappuram district, a position it retained from the beginning. However, its share has shrunk somewhat in recent years, from 21.8 per cent in 1998 to 17.9 per cent in 2011.

The principal countries of destination of Kerala emigrants have remained more or less unchanged over these years, with 90 per cent of the Kerala emigrants going to one or other of the Gulf countries.

Within the Gulf region, the UAE retained its number one rank, with Saudi Arabia coming in the second position. Nearly 40 per cent of Kerala's emigrants live in the UAE and 25 per cent in Saudi Arabia. In the last 3 years, especially, after global crisis, Saudi Arabia has gained about 2 percentage points and UAE has lost out by the same proportion.

**(b)Internal Migration**

The number of Kerala migrants living in other states in India (OMI) in 2011 is estimated to be 9.31 lakh, up from 9.14 lakh in 2008. In 2003, the number of OMI was higher, i.e.111.15 lakh, though in 1998, however, it was only 6.91 lakh. There was no substantial increase in out-migration from Kerala since 2008. More and more Keralites are opting for external migration in place of internal migration.

The number of Kerala out-migrants who returned and are now living in Kerala (return out-migrants) in 2011 is estimated to be 5.11 lakh. The corresponding number was 6.86 lakh in 2008, 9.94 lakh in 2003 and 9.59 lakh in 1998. There was a consistent decline in the number of return out-migrants. More and more Kerala migrants in the other states in India tend to stay back in their host state or move abroad instead of returning to their native state.

Interstate migrants (ISM) (Omi+Rom) numbered 1.44 million in 2011, 1.60 million in 2008, 2.11 million in 2003 and 1.65 million in 1998.

The vast majority of the out-migrants from Kerala (59.7 percent in 2011) were Hindus, a little more than their share in the population (56 per cent). On the other hand, the Christians were about 26.7 per cent of the total, much higher than their share in the total population which was about 19 per cent. Muslims were only 13.7 per cent of the out-migrants, much lower than their share in the total population, which stood at about 26 per cent. Between 2008 and 2011, the share of the Hindu out-migrants declined from 61.7 per cent to 59.7 per cent, the share of the Christian out-migrants also declined from 30.9 per cent to 26.7 per cent, but the share of the Muslim out-migrants increased from 7.4 per cent to 13.7 per cent.

Palakkad district accounted for the largest number of out-migrants from Kerala, a position it retained from the beginning. Thus the Palakkad-Malappuram corridor is the most migration-prone area in the state, with Palakkad topping in the field of out-migration and Malappuram in the case of emigration. Kottayam district comes second in the order of out-migration followed by Kannur district. Pathanamthitta district, which led all districts in 1998 in the matter of out-migration, is almost at the bottom of the list in 2011.

What Pathanamthitta has gone through in the last 10-15 years in the matter of migration transitions can be expected to be replicated in many of the other districts in the state in coming years.

The principal states of destination of Kerala' out-migrants remained more or less unchanged over these years. Karnataka was number one in 2008; it is number one in 2011 also, with 29 per cent of Kerala's out-migrants. Tamil Nadu and Maharashtra are the other two major states where Kerala out-migrants have made a living.

**8.8.5 Remittances**

The total remittances in Kerala in 2011 were estimated to be approximately Rs. 50,000 (Rs.49,695) crores compared with Rs. 43,288 crores in 2008. Remittances were Rs. 63,315 per household in 2011 and Rs. 57,227 per household in 2008. Among the 14 districts in the state, Malappuram received the largest amount of remittances, i.e., Rs 9,040 crores which works out to Rs. 114,313 per household. In general, the southern districts experienced a decline in their share of remittances and the northern districts experienced an increase. Muslim households received Rs. 23,089 crores or 46.5 per cent of the total remittances in 2011. Hindus received Rs 18,089 crores or 36.4 per cent of the total. The Christian community received Rs. 8,508 crores or 17.1 per cent. The shares of the Hindus and the Christians were below their respective shares of the total population of the state. On an average, a Muslim household received Rs. 135,111 as remittances in a 12-month

period. A Christian household, on the other hand, received not even half of what a Muslim household received (Rs. 59,175). In the case of the Hindus, the average remittance a household received is only about one-fourth of what a Muslim household received (Rs. 38,489).

**NRE Deposit**

NRE deposits in Kerala has increased to Rs.37690 crore in 2011 against Rs.36886 crore during 2010.The share of NRE Deposit to total deposit in the State during 2011 was 23.33 percent. The State Bank Group has the highest share (9.97%) of NRE deposit in the State followed by Private Sector Banks (6.74%) and Nationalised Banks (5.77%).

### 8.8.6 Causes of Migration

Even though there are so many reasons for the migration of Kerala people, theoretically they are of two factors viz., (a) Push factors and (b)Pull factors.

**(a) Push Factors**

Push factors are those conditions in the home country. It encourages the people to move out of their country. There are several such factors in Kerala, which push out job seekers to other countries. It include High density of population, Low and declining work participation rate, High rate of un employment, Stagnant agriculture, Backward industrial sector etc.

**(b) Pull Factors**

Pull factors are those conditions in the host country, which attract people into those countries. The structural changes that occurred in the foreign countries especially in the gulf countries due to hike in oil prices provide better opportunities for employment, better income and better future prospects are some of the pull factors.

Apart from these push and pull factors, the historical experience of the Keralites in international migration, the religious, marital and trade links of the Muslims of Kerala for several centuries with the Gulf region and high levels of literacy and education of Keralites are the other important factors in the large scale emigration of Keralites to the Gulf and other countries. Although both the factors were at work, the push factors have been stronger in Kerala,

### 8.8.7 Impact of Migration

Large scale migration has brought tremendous impact on the growth process of the state of Kerala. There is economic, social, cultural and demographic impact along with some adverse effects.

(a) Economic Impact

Among the economic front the remittance plays a crucial role. Remittance cause social and economic changes. Besides cash, households received several items in kind - clothing, ornaments and jewellery, electric and electronic gadgets. The economic impact can be better under stood in the areas like; housing, transportation, town planning, educational and religious institutions, amenities and other infrastructural facilities. The housing revolution increases the price of the land and leads to a real estate boom in the state. There is the growth of number of commercial complexes, jewellery outlets, hotels and hospitals with international standards. Conspicuous consumption is a hallmark of an emigrant, especially a Kerala emigrant.

They buy consumer durables like television sets, refrigerator, washing machines, mobile phones, vehicles etc. Any how one of the major benefits of the migration is the reduction in unemployment and there by reduction in poverty. Studies revealed that the migrant households

spent a major share of their income for consumption, clothing, education, health and entertainment etc.

Regarding the savings of the emigrants there is an increase in the asset holdings compared to the non emigrants. Assets like land, buildings, gold ornaments, motor vehicles, consumer durables etc. are possessed by the migrants. But their investments in productive sectors are less except some tertiary sectors like education, health, communication, transport etc.

(b) Social Impact

Emigration made impact on the demand for education, health care, social customs and values, life styles etc. People spent more to the technical and vocational education. The propagation of English medium schools in the private sector in Kerala is definitely the outcome of emigration. The emergence of self-financing institutions both in professional and non-professional is also in this line of thinking. There is the development of various institutions which provide construction related courses, motor and machine operations, catering, tailoring and paramedical courses. Boys are more concentrated on this type of courses therefore the number of boys enrolled for the traditional degree and post graduate courses are come down.

The growth of private hospitals and other paramedical institutions in private sector in Kerala indicates the influence of emigration on health sector.

Now the life style of the young generation is very much similar to the western culture. They spend lot of time and money for e-mail, chatting, and on the face book. Distant is not a hurdle to them.

(c) Demographic Impact

Emigration has brought both structural and behavioural changes in the demography of Kerala. Reduction in growth rate of population, Sex ratio infavour to the females, reduction in working age people, existence of small and women headed families etc are the some of the behavioural changes in the Kerala population. Migration leads to fall in fertility due to the separation of the spouse and fall in mortality due to better health care.

### 8.8.8 Adverse Impact of Migration

Despite various benefits due to migration there are some adverse effects of migration on Kerala state. They are:

1. Kerala's labour market experienced considerable shortage for semi- skilled labourers. Such as carpenters, welders, plumbers, drivers, electricians, motor mechanics and other craftsmen. It will leads to in-migration of workers from Tamil Nadu, Bengal, Orissa, Bihar etc.
2. Raise the wage rate in Kerala especially to the semi-skilled and unskilled labours.
3. Hike in the price of land.
4. Decline in the share of agriculture sector.
5. Stagnation in the manufacturing sector.
6. Leads to weak production base for the economy.
7. Leads to unnecessary consumption.
8. The construction boom leads to plunder of paddy land.
9. Shift in cropping pattern from food crops to non food crops.
10. Hike in the price of construction materials.
11. Decay in values and culture.
12. Hike in the expenditure for non productive activities.
13. Excessive consumerism.

## 8.9 TOURISM IN KERALA

Kerala, a state situated on the tropical Malabar Coast of southwestern India, is one of the most popular tourist destinations in the country. Named as one of the *ten paradises of the world* by the National Geographic Traveler, Kerala is famous especially for its ecotourism initiatives. Its unique culture and traditions, coupled with its varied demography, has made Kerala one of the most popular tourist destinations in the world. Kerala is an established tourist destination for both Indians and non-Indians alike. Kerala is popular for her beaches, backwaters, mountain ranges and wildlife sanctuaries. The city of Kochi ranks first in the total number of international and domestic tourists in Kerala. Other popular attractions in the state include the beaches at Kovalam, Cherai and Varkala; backwater tourism and lake resorts around Vembanad Lake, Kumarakom and Alappuzha; hill stations and resorts at Munnar, Wayanad, Nelliampathi, Wagamon and Ponmudi; and national parks and wildlife sanctuaries at Periyar and Eravikulam National Park. The "backwaters" region - an extensive network of interlocking rivers, lakes, and canals that centre on Alleppey, Kumarakom, and Punnamada - also see heavy tourist traffic. Heritage sites, such as the Padmanabhapuram Palace, Hill Palace, and Mattancherry Palace are also visited. The city of Kochi ranks first in the total number of international and domestic tourist arrivals in Kerala.

### 8.9.1 Development of Tourism as an Industry

Since its incorporation as a state, Kerala's economy largely operated under welfare-based democratic socialist principles. This mode of development, though resulted in a high Human Development Index and standard of living among the people, lead to an economic stagnation in the 1980s (growth rate of 2.3% annually ) This apparent paradox — high human development and low economic development — lead to a large number of educated unemployed seeking jobs overseas, especially in the Gulf countries. Due to the large number of expatriates, many travel operators and agencies set shop in the state to facilitate their travel needs. However, the trends soon reciprocated with the travel agencies noticing the undermined potential of the state as a tourist destination. First travel agency in Kerala, Kerala Travels was founded by Col G.V. Raja of the Travancore royal family along with P.G.C. Pillai .

Until the early 1980s, Kerala was a relatively unknown destination, with most tourism circuits concentrated around the north of the country. Aggressive marketing campaigns launched by the Kerala Tourism Development Corporation—the government agency that oversees tourism prospects of the state—laid the foundation for the growth of the tourism industry. Kerala strongly realized the importance of Tourism during the mid 80’s. Tourism was recognized as an industry in Kerala in 1986 – vide an order dated July 11, 1986. Kerala was the first state to declare tourism as an industry. The first tourism policy of the state was announced in 1995 underlining the importance of Public- Private Partnership. The Tourism Policy of Kerala stated as its main aim “to serve as a guiding force to make maximum use of Kerala’s tourism potential and also to make it an ideal instrument of social and economic growth”. During early 2000 tourism became a multi Billion dollar industry in the state. Tourism has come a long way since capturing new markets with its innovative products and marketing strategies. From hardly 50000 foreign tourist arrivals and 0.13 Billion rupees as foreign exchange in 1986, it has reached a status of 0.6 million foreign tourist arrivals and 37.97 Billion rupees as foreign exchange in 2010. Total employment generated from tourism is estimated as 1.2 million.

India Government bestowed industry status on tourism only in 1992. Kerala Tourism subsequently adopted the tagline *God's Own Country* in its advertisement campaigns. Aggressive

promotions in print and electronic media were able to invite a sizable investment in the hospitality industry. By the early 2000s, tourism had grown into a fully fledged, multi-billion dollar industry in the state. The state was able to carve a niche place for itself in the world tourism industry, thus becoming one of the places with the 'highest brand recall'. Today, growing at a rate of 13.31%, Kerala is one of the most visited tourism destinations in India. The tourism industry has taken the state of Kerala to the global map with its branding. The brand name of Kerala, 'God's Own Country' has become popular around the world. Kerala has an active tourism industry which has been accepted as one of the most suited industries for Kerala. Foreign Tourist arrival to Kerala during the year 2010 was 659,265**.** It showed an increase of 18.31 % over the previous year. Domestic Tourist arrival to Kerala during the year 2010 was 8,595,075**.** It shows an increase of 8.61 % over the previous year. The foreign exchange earnings for the year 2010 was Rs.3, 797.37 Crores. This recorded an increase of 33.09 % over the previous year. Total Revenue (including direct & indirect means) from Tourism during 2010 was Rs.17, 348 Crores, showing an increase of 31.12% over the previous year's figure**.** In India, Foreign Tourist Arrival during 2010 was 5.58 million with a growth rate of 8.1% as compared to the previous year.

### 8.9.2 Kerala's Uniqueness in Tourism Success

The state's tourism agenda promotes ecologically sustained tourism, which focuses on the local culture, wilderness adventures, volunteering and personal growth of the local population. Efforts are taken to minimize the adverse effects of traditional tourism on the natural environment, and enhance the cultural integrity of local people. The tourism sector of Kerala responded with substantial efforts to reinforce promotions, creating innovative policy directions to diversify products and markets that could hedge future risks, and strengthen Kerala's renowned Public Private Partnership (PPP). Kerala has an active tourism industry and is accepted as one among the most suited industry for Kerala. Fortunately Kerala is ideally placed for offering the experiential vacations to the visitors by maintaining the unique identity. The vital factors that contributed to this unique identity may be articulated as;

1. Strong brand positioning
2. Product differentiation
3. Successful private-public partnership (e.g. KTM)
4. Non-arrival of manufacturing industries
5. Public acceptance
6. Vibrant Private sector
7. Achievements in the social sector – civil society and quality of life
8. Pristine and attractive nature with tremendous bio-diversity
9. Richness in heritage
10. Tremendous political support
11. Vibrant small and medium entrepreneurs who could offer products which are contemporary in outlook, unique in experience and of a scale and character which respects the environment and local sensitiveness.

Considering the above, Department of Tourism intends to promote 'Responsible Tourism' with focus on *indigenousness, environmental friendliness and community involvement.*

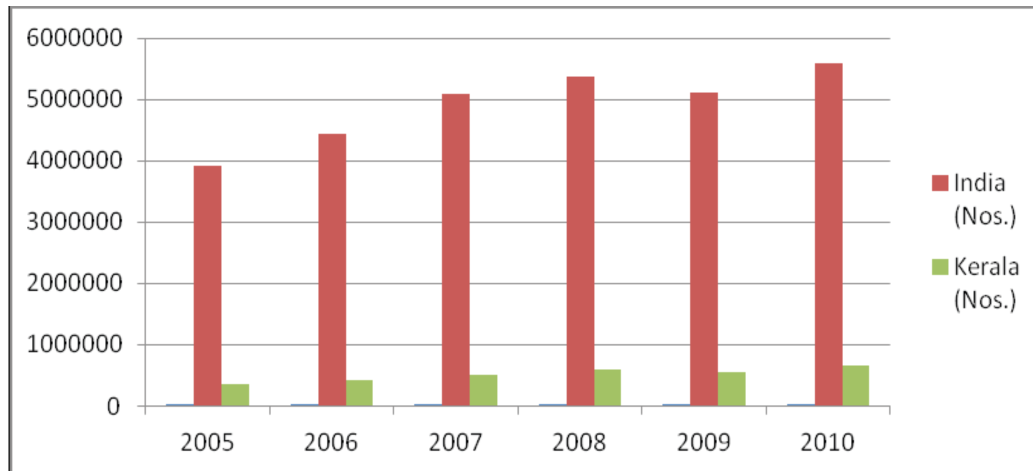
### 8.9.3 Priorities of the State

1. To position Kerala as a model state on Responsible Tourism with Community participation involvement of local self government, community groups and NGOs in tourism planning, implementation and operation of tourism products and creation of employment opportunities for the local population
2. To promote private investments in tourism
3. To Identify and promote new tourism destinations and circuits by utilizing the natural and cultural heritage of the state
4. To create quality infrastructure at waysides and tourist destinations
5. To focus on domestic market and identified international markets
6. To fully utilize the tourism potential of Malabar Region for the dispersal of tourism activity concentration in the South and Central Kerala
7. To conserve the natural and cultural heritage of the state
8. To revive and promote traditional industries and agricultural sectors through tourism
9. To promote innovations in tourism
10. To create new tourism products
11. To continue the focus on eco-tourism, backwater tourism, Ayurveda and other forms of wellness tourism
12. To Strengthen the Human Resource Development sector in tourism to take care on the large volume of capacity building needs of the local community and various stake holders in the tourism industry
13. To bring in innovative IT projects to promote Kerala Tourism
14. To bring in a quality control system
15. To create and develop a new brand image
16. To strengthen the organizational set up in tourism development and promotion to take care of the new challenges
17. To improve connectivity
18. To have clean and safe tourist destinations
19. To institutionalize the coordination between Government and the industry

### 8.9.4 Foreign Tourist Arrivals

The year 2010-11 has been recorded as a year of revival compared to the previous years. International Tourist arrival continued to decline due to the impact of Global Economic crisis in the previous years. But the year 2011 marked a significant improvement. The number of foreign tourists arrived in Kerala in the year 2010-11 is 659,265 against 557,258 in 2009-10. It shows an increase of 18.31 per cent over the previous year. During the last year Kerala has contributed 11.81 % of the total foreign tourist arrivals to India. Fig 8.2 gives a comparison of growth of foreign tourist arrivals in Kerala

**Fig 8.2**
**Comparison of Growth of Foreign Tourist Arrivals in Kerala and India**




*Source: Dept of Tourism*

### 8.9.5 Foreign Tourist Visits in Kerala over the Years

Foreign tourist visits in Kerala during 2010 were 659,265 as compared to 557,258 in the previous year and thus registered an increase of about 18.31 percent. Foreign tourist arrivals in Kerala since 1999 are given in the Table 8.10.

**Table 8.10**
**Foreign Tourist Arrivals in Kerala (1999-2010)**

| Year | No of Foreign Tourists | % of increase |
|---|---|---|
| 1999 | 202,173 | 6.44 |
| 2000 | 209,933 | 3.84 |
| 2001 | 208,830 | -0.53 |
| 2002 | 232,564 | 11.37 |
| 2003 | 294,621 | 26.68 |
| 2004 | 345,546 | 17.28 |
| 2005 | 346,499 | 0.25 |
| 2006 | 428,534 | 23.70 |
| 2007 | 515,808 | 20.37 |
| 2008 | 598,929 | 16.11 |
| 2009 | 557,258 | -6.96 |
| 2010 | 659,265 | 18.31 |

*Source: Dept of Tourism*

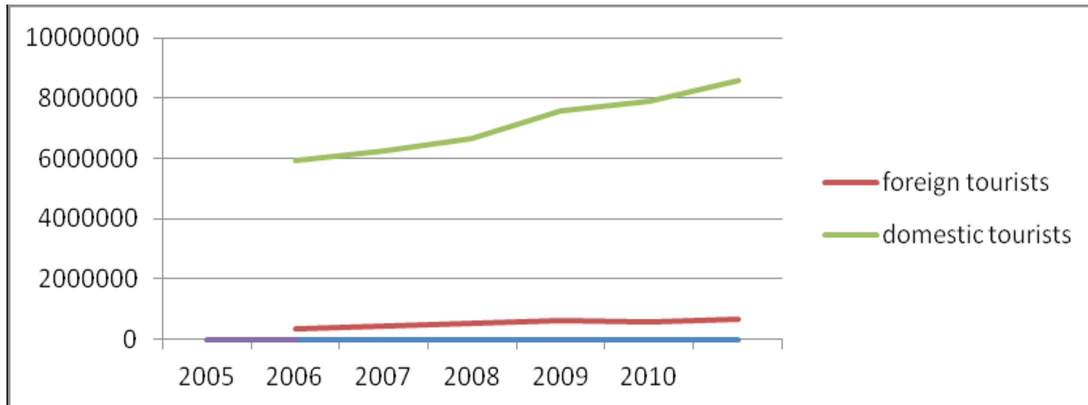
The single largest source market of Kerala for foreign tourist visits is United Kingdom, with a share of about 23.70 percent in 2010. In fact, United Kingdom has been continuing as the top tourist market of Kerala over the years. The second largest market was United States of America

(USA) with a share of 10.79 percent and it was followed by France with a share of about 9.79 percent domestic tourist arrivals.

The number of domestic tourists to Kerala in the year 2010-11 was 8,595,075 against 7,913,537 in 2009-10. It shows an increase of 8.61 per cent over the previous year. Appendix 8.12 gives the domestic tourist arrivals to Kerala from 2005 to 2010. The growth in foreign and domestic tourist arrivals to Kerala from 2005 to 2010 is given in fig 8.3.

**Fig 8.3**

**Growth in Foreign and Domestic Tourist Arrivals to Kerala from 2005 To 2010**




*Source: Dept of Tourism*

**8.9.6 Domestic Tourist Visits in Kerala over the Years**

Domestic tourist visits in Kerala during 2010 were about 8.59 million – as compared to 7.91 million during the previous year. The growth in domestic tourist visits during the year was 8.61 percent. There has been a moderate increase in domestic tourist visits in all the previous ten years except during 2005. The year wise domestic tourist visits and percentage changes since 1999 are given in Table 8.11.

**Table 8.11**

**Domestic tourist visits in Kerala during 1999 to 2010**

| Year | No of Domestic Tourist Visits | % of increase |
|---|---|---|
| 1999 | 4,888,287 | 9.07 |
| 2000 | 5,013,221 | 2.56 |
| 2001 | 5,239,692 | 4.52 |
| 2002 | 5,568,256 | 6.27 |
| 2003 | 5,871,228 | 5.44 |
| 2004 | 5,972,182 | 1.72 |
| 2005 | 5,946,423 | -0.43 |
| 2006 | 6,271,724 | 5.47 |
| 2007 | 6,642,941 | 5.92 |
| 2008 | 7,591,250 | 14.28 |
| 2009 | 7,913,537 | 4.25 |
| 2010 | 8,595,075 | 8.61 |

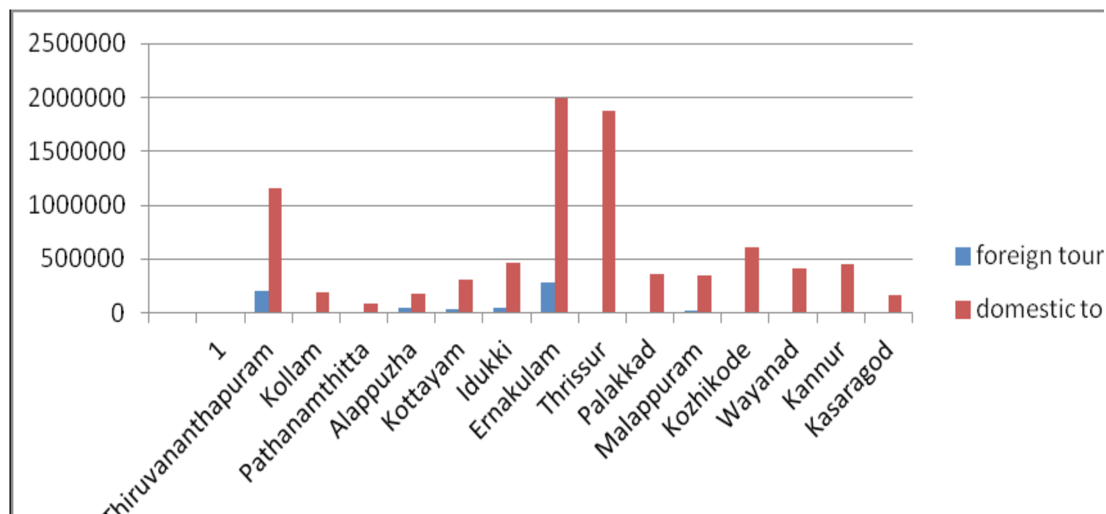
*Source: Dept of Tourism*

Out of 8.61 million domestic tourist visits, 6.10 million visits (71.03 percent) were made by the Keralites. Tamil Nadu contributed 13.02 percent of the domestic tourist visits. It was followed by Karnataka with a share of 6.46 percent and Maharashtra with a share of 3.38 percent. The other major source markets are Andhra Pradesh (1.99 percent), Delhi (1.46 percent), Gujarat (0.50 percent) and West Bengal (0.38 percent).

### 8.9.7 District Wise Arrival of Foreign and Domestic Tourists in Kerala.

Thiruvananthapuram and Ernakulam are the two leading districts recording the foreign tourists' arrivals to Kerala for the last few years. For the domestic tourist's arrival to Kerala, Ernakulam and Thrissur are the leading districts. Ernakulam is leading district in domestic and foreign tourist's arrival where as Pathanamthitta is the least. Figure 8.4 gives the comparison of District wise arrival of foreign and domestic tourists in Kerala (Fig 8.4)

**Fig 8.4**
**Comparison of District wise arrival of Foreign and Domestic Tourists in Kerala.**




*Source: Dept of Tourism*

### 8.9.8 Performance of Kerala Tourism during 2010-11

- Foreign Tourist arrival to Kerala during the year 2010-11 was 659,265. It shows an increase of 18.31% over the previous year.
- Domestic Tourist arrival to Kerala during the year 2010-11 was 8,595,075. It shows an increase of 8.61% over the previous year.
- Foreign exchange earnings for the year 2010-11 were Rs. 3797. 37 Crores which recorded an increase of 33.09 % over the previous year.
- Total Revenue (including direct & indirect) from Tourism during 2010 was Rs.17348 Crores, showing an increase of 31.12 % over the last year's figure.
- In India, Foreign Tourist Arrival during 2010 was 5.58 million with a growth rate of 8.1% as compared to the previous year.
- In India, Foreign exchange Earnings in Rupee terms during 2010 were Rs. 64,889 crores as compared to 54,960 crore in 2009 which shows an increase of 18.07%.

- The 8.1% growth rate in Foreign Tourists arrival in India for 2010 over 2009 is much better than UNWTO's projected growth rate of 5% to 6% for the world during the same period.
- Tourism's contribution to State's GDP is around 9%
- The average per day expenditure of a foreign tourist is Rs. 3,600 /-
- The average per day expenditure of a domestic tourist is Rs. 1,800/-
- The average length of stay of a foreign tourist is 16 days
- The average length of stay of a domestic tourist is 6 days

### 8.9.9 Economic Impact of Tourism

Tourism has an important role now in the Kerala economy. It helps to bring foreign exchange earnings and generate employment opportunities. Foreign exchange earnings from tourism from 2001 to 2010 are given in Table 8.12. It can be seen that the earnings are increasing steadily over the years. Only at 2009, the percentage of change became negative. The total revenue generated from tourism from 2001 to 2010 is also given in Table 8.12.

**Table 8.12**
**Earnings from Tourism in Kerala**

| Year | Foreign Exchange Earnings (Rs. in Crores) | % of Increase | Total Revenue Generated From Tourism (Direct & Indirect) | % of Increase |
|---|---|---|---|---|
| 2001 | 525.00 | 1.85 | 4500.00 | 9.58 |
| 2002 | 705.67 | 31.90 | 4931.00 | 20.42 |
| 2003 | 983.37 | 39.35 | 5938.00 | 12.83 |
| 2004 | 1266.77 | 28.82 | 6829.00 | 15.01 |
| 2005 | 1552.31 | 22.54 | 7738.00 | 13.31 |
| 2006 | 1988.40 | 28.09 | 9126.00 | 17.94 |
| 2007 | 2640.94 | 32.82 | 11433.00 | 25.28 |
| 2008 | 3066.52 | 16.11 | 13130.00 | 14.84 |
| 2009 | 2853.16 | -6.96 | 13231.00 | 0.77 |
| 2010 | 3797.37 | 33.09 | 17348.00 | 31.12 |

*Source: Dept of Tourism*

Tourism sector occupies a significant place in the foreign exchange earnings of the World, and has acquired tremendous progress in recent years. The sector is growing at a faster pace, especially in the developing countries. The tourism industry is a major contributor of foreign exchange earnings to the State's economy. It is found that the foreign exchange earnings during the year 2010-11 is Rs.3797.37 crore which recorded an increase of 33.09 % over the previous year. The total revenue generated from tourism comes to Rs 17348 crore, showing an increase of 31.12 per cent over the previous year and the tourism contribution to state's GDP is 9 per cent. From the graph shown below, it is clear that earnings from Tourism show an increasing trend over the years.

**Figure: 8.13**

*Source: Dept of Tourism*

### 8.9.10 Tourism as an upcoming Industry

• Kerala is aiming to attract more and more investment in the Tourism industry

• According to Kerala, Tourism is a high growth industry holding great potential and invited entrepreneurs to invest.

• Health Tourism, Kerala is leaping to the top destination of the world. Kerala has world class medical infrastructure and can provide quality health care at about 10 percent of the costs in the US or UK.

• A thrust was given to the Malabar area, waterways from Manjeswaram to Kovalam, cleanliness and safety of tourism destinations, tourism festivals etc.

• Effort has been taken to meet the additional room requirements by encouraging Home stays and private investments at different levels.

• The focus will be on the development of basic infrastructure in tourism. Destinations and make them clean and safe as per international standards.

### 8.9.11 Threats to the Tourism Industry in Kerala

With increasing threats posed by global warming and changing weather patterns, it is feared that much of Kerala's low lying areas might be susceptible to beach erosions and coastal flooding. The differing monsoon patterns also suggest possible tropical cyclones in the future.

- Global Warming and changing weather patterns
- Differing monsoon pattern.
- Global Economic Recession
- Opening of Sri Lanka as a safe destination.
- Slow development of tourist places.
- Insufficient facilities in the tourist spots.
- Negative attitudes of the local people.
- Lack of good accommodation facilities.
- Lack of proper information facilities.
- Lack of infrastructure facilities.

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