GATE DEGREE AND PG COLLEGE, CHIGURUWADA

BBA – THIRD SEMESTER

BUSINESS ENVIRONMENT

SEMESTER – III - BBA

COURSE 7: BUSINESS ENVIRONMENT

UNIT-I: INTRODUCTION

Business Environment-Concept, Significance and Nature of Business Environment; Elements of Environment- Internal and External. Salient features of Indian Economy.

UNIT-II: POLITICAL, LEGAL AND ECONOMIC ENVIRONMENT OF BUSINESS

Elements of Political Environment, Role of Government in Business facilitation. Competition Act ‘FEMA, Licensing Policies. Elements of Economic Environment. Industrial Policy1991.

UNIT-III: MANGEMENT OF MICRO, SMALL&MEDIUM ENTERPRISE (MSME)

Concepts and Definitions of MSME, The MSME Development Act, 2006. Government Policy Initiative, Current Schemes for MSME development. Problems faced by MSME Sector. Role of Clusters in Promoting MSME.

UNIT–IV: BALANCE OF PAYMENTS

International Trade, Components of BOP, Disequilibrium in BOP, Reasons for disequilibrium measures to bring back equilibrium in BOP –trade regulation, Exchange Control, Convertibility of currency, Current Account and Capital Account convertibility.

UNIT–V: INTERNATIONAL BUSINESS ENVIRONMENT

International economic institutions-Significance, Evolution and Functions - International Monetary Fund, Objectives and Evolution of GATT, Objectives and Functions of World Trade Organization.

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INTRODUCTION

BUSINESS ENVIRONMENT

MEANING

What is business:

Business is an economic activity which is related with continuous production of good and services for satisfying human wants.

- Exchange of goods/services
- Deals in numerous transactions.
- Profit is main objective.
- Risk and uncertainties.
- Buyer and seller.
- Marketing and distribution of goods/services.
- To satisfy human wants.
- Social obligation

Business does not function in isolation or in vacuum. It is affected by internal and external factors. These internal and external factors collectively constitute business environment. Internal environmental factors are within the control of business, whereas external factors are beyond the control of business.

'Environment' refers to the system in which human beings live and they have to adjust themselves according to it. So, it is surroundings, external agents, influences or circumstances under which something exists.

Business Environment can be defined as the aggregate of all those forces, factors and institutions which directly affect the working of a business organization.

Some of these constituents may be static, while others may be changing.

DEFINITION

1. "Business Environment is the aggregate of all conditions, events and influences that surround and affect the business." **Keith Davis**

2. "Business Environment encompasses the climate or set of conditions-economic, social, political or institutional in which business operations are conducted." **Prof. Weimer**
3. "The term Business Environment of a company is defined as the pattern of all external influences that affect its life and development." **Andrews**
4. "The total of all things external to firms and industries that affect the function of the organisation is called business environment." **Wheeler**
5. Business environment is the sum of all external and internal factors that impact a business and its business operations. Internal factors are those components that exist within the company, while external factors are outside causes that influence an organisation's functioning. The business environment indicates the totality of all the individuals, resources, stakeholders, institutions, regulations, and market forces that exist around the organisation.
6. The business environment refers to the combination of external and internal factors that influence a company's operations. These factors include economic conditions, government policies, market trends, competition, social and technological changes, and internal elements like company culture and resources. Businesses must understand and adapt to their environment to succeed.

IMPORTANCE (OR) SIGNIFICANCE OF BUSINESS ENVIRONMENT

Business and its environment are closely inter-related and mutually interdependent. Environment has its bearing on business and business has its bearing on environment. The success of business lies in understanding the environmental changes and adapting its business policies accordingly. The surroundings of business enterprise which are constantly changing, carry with them both opportunities and risks or uncertainties which can make or mar the future of business. Significance of the study of environment in business sector may be explained as follows:

1. **It Helps in Identifying Opportunities and Making First Mover Advantage:**
   - The environment provides numerous opportunities, and it is necessary to identify the opportunities to improve the performance of a business.
   - Early identification gives an opportunity to an enterprise be the first to identify opportunity instead of losing them to competitors.
   - **Example:** 'Airtel' identified the need for fast internet and took first-mover advantage by providing 4G speed to its users followed by Vodafone and Idea.

- Asian paints lost market share to Nerolac because it failed to match its technology.

2. **It Helps the Firm Identify Threats and Early Warning Signals:**
    - The business environment helps in understanding the threats which are likely to happen in the future.
    - Environmental awareness can help managers identify various threats on time and serve as an early warning signal.
    - **Example:** Patanjali products have become a warning signal to the rest of the FMCG
    - The sector to develop similar products. Similarly, if an Indian firm finds that a foreign multinational is entering the Indian market with new substitutes; it needs to prepare accordingly.
    - Chinese mobile phones have become a threat for Indian mobile phone manufacturers.
3. **It Helps in Tapping Useful Resources:**
    - Business and industry avail the resources (inputs) from the environment and convert them into usable products (outputs) and provide to society.
    - The environment provides various inputs (resources) the like finance, machines, raw materials, power and water, labour, etc.
    - The business enterprise provides outputs such as goods and services to the customers, payment of taxes to the government, to investors and so on.
    - **Example:** With the demand for the latest technology, manufacturers will tap the resources from the environment to manufacture LED TVs and Smart TVs rather than collecting resources for colour or Black & White TVs.
4. **It Helps in Coping with Rapid Changes:**
    - The business environment is changing very rapidly, and the industry is getting affected by changing market conditions.
    - Turbulent market environment, less brand loyalty, divisions of markets, changes in fashions, more demanding customers, and global competition are some examples of changing the business environment.
    - **Example:** Jack Ma started Alibaba as he could see the potential of interest in E-Commerce.
5. **It Helps in Assisting in Planning and Policy Formulation:**

- The business environment brings both threats and opportunities to a business.
- Awareness of business environment helps in deciding future planning or decision making.
- **Example:** Multiple entries of Chinese phones like VIVO, Gionee, OPPO, etc. have posed a threat to local players like Micromax, Karbonn, Lava etc. to think afresh how to deal with the situation.

6. **It Helps in Improving Performance:**
   - Environmental studies reveal that the success of any enterprise is closely bound with the changes in the environment.
   - The enterprises which monitor and adopt suitable business practices not only improve their performance but become leaders in the industry also.
   - **Example:** Apple has been successful in maintaining its market share due to its proper understanding of the environment and making suitable innovations in its products.

CHARACTERISTICS / NATURE OF BUSINESS ENVIRONMENT

Business Environment is very complicated, dynamic and multi-dimensional and affects different business institutions in different ways. It exhibits many characteristics like:

1. **The totality of External Forces:**
   - Business environment includes everything which is outside the organisation.
   - If we add all these forces, they will form a business environment.

   Example: When Pepsi and Coca-Cola got permission to set up their business in India, it was an opportunity for them and threat for local manufacturers like gold spot, camp-cola etc.
2. **Specific and General Forces:**
   - **Specific forces** are those forces which directly affect the operational activities of the business enterprise.
   - **Example:** Suppliers, Customers, Investors, Competitors, Financers etc.
   - **General forces** are those forces which indirectly affect the functioning of business enterprises.

   Example: Economic, Social, Political, Legal and Technological conditions.

3. **Inter-relatedness:**
    - Different forces of business environment are interrelated to each other.
    - One component of the business environment affects the functioning of other components.
    - **Example:** The increased life expectancy of people and awareness of health consciousness has increased the demand for many health products like diet coke, olive oil, and so many health products.
4. **Dynamic Nature:**

    The business environment is dynamic in nature and keeps on changing in terms of:
    - Technological improvement,
    - Shifts in consumer preferences,
    - The entry of new competition in the market.
    - **Example:** Many established companies in FMCG (Fast Moving Consumer goods) sector are focusing on producing the goods with natural ingredients with the entry of 'Patanjali Products'.
5. **Uncertainty:**
    - The changes in the business environment cannot be predicted accurately because of future uncertainties.
    - It is very difficult to predict the changes in the economic and social environment.
    - **Example**: There has been a sharp decline in the prices of Android smartphones due to the entry of many new companies.
6. **Complexity:**
    - All forces of the Business environment are interrelated and dynamic, which makes it difficult to understand.
    - Complex nature of Business environment can be understood if we study it in parts.
    - **Example**: Increase in goods and service tax to 15 % would increase the revenue of the government (economic), which would help the government to improve social being of people (social) and reduce the personal disposable income of rich people and thereby controlling inflation.
7. **Relativity:**

- Business Environment differs from place to place, region to region and country to country.
- **Example:** In China, the electricity to the industry is provided at cheaper rates as the consumption increases and hence, it leads to mass production whereas, in India, it is otherwise, higher consumption of electricity leads to costly electricity which results in lower production & higher cost of production.
- As is clear that environment is a mixture of many factors and changes in some or the other factors continue to take place. Therefore, it is said that business environment is dynamic.

8. **Multi-dimensional:**

   Business environment is related to the local conditions and this is the reason as to why the business environment happens to be different in different countries and different even in the same country at different places.

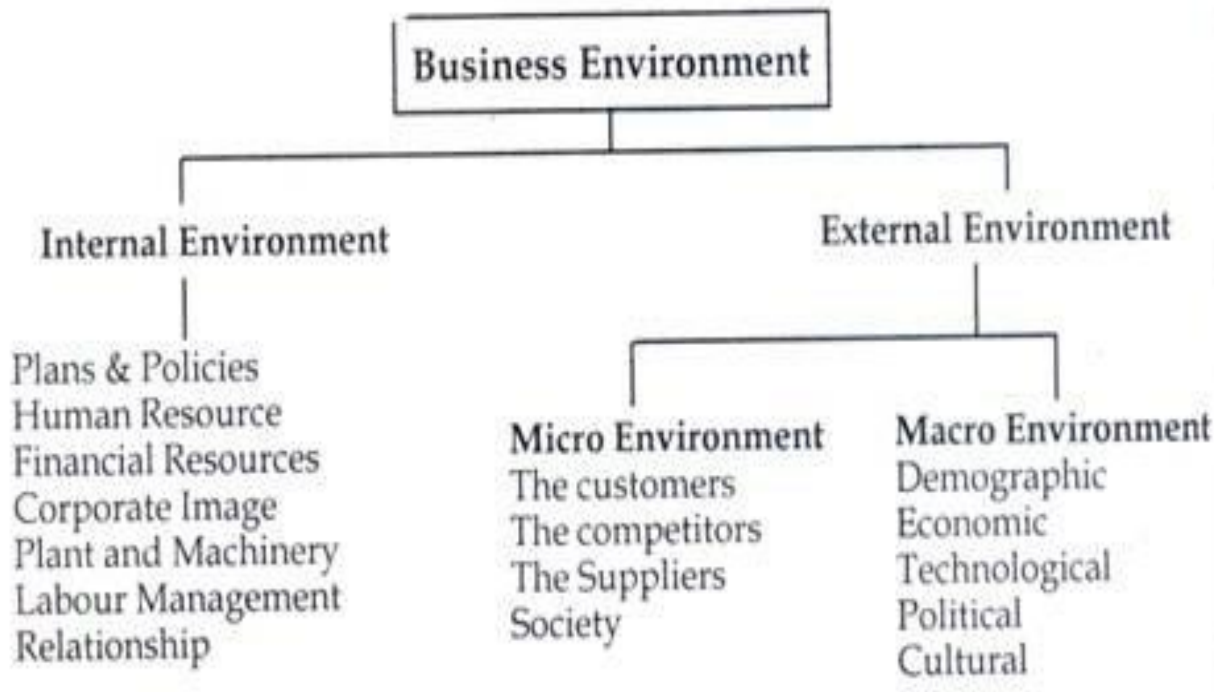
9. **Far-reaching Impact:**

   Decisions and changes in the business environment often affect not just one company but entire industries, communities, and even countries.

10. **Multi-faceted:**

    The environment includes various dimensions—economic, social, political, technological, and legal—each influencing business activities differently.

THE ELEMENTS OF BUSINESS ENVIRONMENT



The business environmental factors may be classified into different types. There are broadly two types of environment that affects the organisation, internal and external environment.

1. INTERNAL ENVIRONMENT

Environment which lies within the origin is known as internal environment. Internal factors are generally regarded as controllable factors.

Factors of Internal Environment:

Internal Environment includes the internal factors of the business. It includes plants and policies, human resources, financial resources, corporate image, plant and machinery, labour and management relationship, promoter's vision etc. The component of internal environment is controllable.

The following are the factors of internal environment:

i. **Plans & Policies:**

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

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

ii. **Human Resources**:

The survival and success of the firm largely depends on the quality of human resources. The social behaviour of the employees greatly affects the working of the business. The characteristics of human resource like skill, quality, morale, commitment can contribute to the success of the organisation.

If the employees of the organisation are skilled and committed, it can take the firm great height. Neglecting the human resource by the management can hamper the success of organisation.

iii. **Financial Resources**:

Capital is the lifeblood of every business. Finance relates to money. A firm needs inadequate funds to meet its working capital and fixed capital requirements. There is a need to have proper management of working capital and fixed capital.

Financial factors like financial policies, financial status (position) and capital structure also influence the internal environment of a firm affecting its performance. If the firm enjoys sufficient financial resources, it can spend on research and promotional activities.

iv. **Corporate Image**:

A firm should develop, maintain and enhance a good corporate image in the minds of employees, investors, customers etc., poor corporate image is a weakness of the firm.

Constant research and development activities should be undertaken by the firm to enhance the quality of the brand. This helps in creating a corporate image and strengthens the standard of the firm in the market.

v. **Plant and Machinery**:

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

vi. **Labour and Management Relationship**:

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

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

vii. **Promoters vision**:

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

2. EXTERNAL ENVIRONMENT

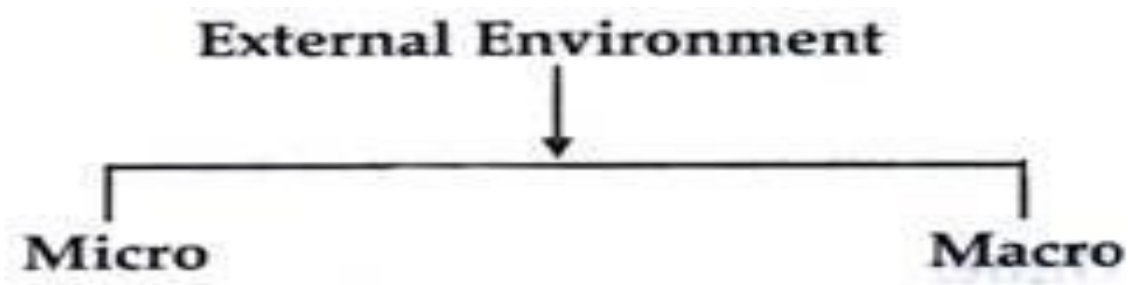
To run the business successfully, it is necessary to understand the environment with in which the business operates. Business environment is a set of external factors that are affecting the business decisions.

Definition of External Environment:

According to William Glueck and Jauck, "In environment there are several factors which constantly bring opportunities and threats to the business firm. It includes social, economic, technological and political conditions".

External Environment is further classified as:

I. Micro Environment
II. Macro Environment



I. Micro Environment:

Micro environment is also known as operating environment. It consists of company`s immediate environment that affect its performance. It includes customers, suppliers, intermediaries, competitors etc. The micro environment consists that directly affects the company.

According to Philip Kotler, "Micro environment consist of the factors in the company`s immediate environment which affects the performance of the business unit. These include suppliers, market intermediaries, competitors, customers and the public".

i. **The customers**:

Consumer is the king of the market. They are the centres of the business. They are one of the most important factors in the external environment. Customer satisfaction has become more challenging due to globalisation.

ii. **The competitors**:

The company has to identify its competitors' activities. Information must be collected about competitors in respect of their prices, products, and promotions and distribution strategies. World is becoming a global market.

Business firm has to face tremendous competition not only from Indian business firm but also from foreign firms. To achieve growth and success they have to monitor various activities of their competitors.

iii. **The Suppliers**:

Suppliers supply raw material, machines, equipment`s and other suppliers. The company has to keep a watch over prices and quality of materials and machines supplied. It also has to maintain good relations with the suppliers.

iv. Society:

Society affects company`s decisions. The expectation of the society from the business increasing. Therefore, the business firm maintains public relations departments to complaints, grievances and suggestions from general public. The members of the society included.

- Financial Institutions
- Shareholders
- Government
- Employees
- General public

v. **Marketing intermediaries**:

Market intermediaries include agents and brokers who help the business firm to find customers. They help the firm to promote and distribute the goods to the final consumers.

They are the link between the firms and the final consumers. Market intermediaries in wholesalers, retailers, advertising firm, media, transport agencies, banks, financial institutions etc., They assist the company in promoting and targeting its product to the right market.

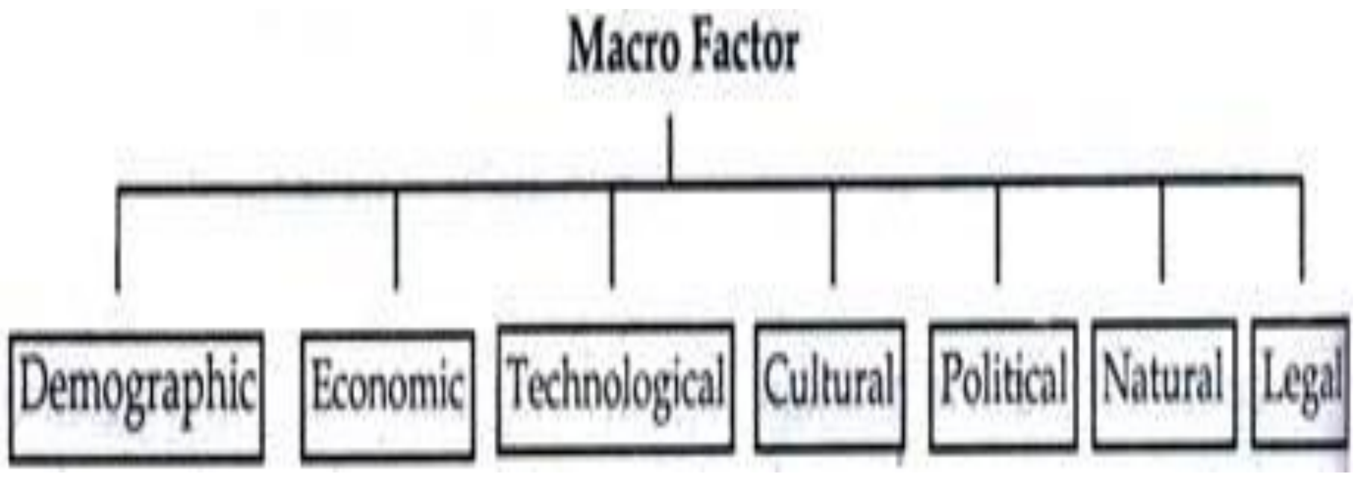
II. Macro Environment

The macro environment consists of the larger societal factors that affect the working of firm. Macro environment is also known as general environment. The macro factors are generally uncontrollable.

The macro environment factors are briefly discussed as follows:

Definition of Macro Environment:

According to Philip Kotler, "Macro environment create forces that creates opportunities and pose threats to the business unit, it includes economic, demographic, natural, technological, political, cultural environment."



i. **Demographic Environment**:

Demographic Environment relates to the human population with reference to its size, education, sex, ratio, age, occupation, income, status etc., Business deals with people so they have to study in detail the various components of demographic environment.

Demographic Environment differs from country to country. Demographic factors like size of population, age composition, density of population, rural-urban distribution, family size, income level, status etc., have significant implications of business.

ii. **Economic Environment**:

Economic environment consists of economic factors that influence the functioning of a business unit. These factors include economic system, policies, resources, trade cycles, gross national product, corporate profits, inflation rates, consumer income etc.

Economic environment is dynamic and complex in nature. A business firm closely interacts with economic environment that consists of:

- Economic conditions in the market i.e., demand and supply factors.
- Economic policies of the government monetary policy, fiscal policy, industrial policy, trade policy, foreign policy etc.
- Economic system prevailing in the country also affects the business growth. Every country different economic system. The economic system includes capitalism, socialism, and mixed economy. Business depends upon economic environment for their inputs and also for market. Changes in the economic factors can adversely affect the working of a business firm.

iii. **Technological Environment**:

Technology has brought about far reaching changes in the methods of production, quality of goods, productivity, and packaging. There is a constant technological development-taking place.

The business firm must constantly monitor the changes in the technological environment which may have a considerable impact on the working of a business. It also indicates the pace of research and development and progress made in introducing modern technology in production.

Technology provides capital intensive but cost-effective alternative to traditional labour-intensive methods. In a competitive business environment technology is the key to development of technology helps to run the business better and faster.

iv. **Cultural Environment**:

Culture involves knowledge, values, belief, morals, laws, customs, traditions etc. Cultural passes from one generation to another through institutions like family, schools, and college. Business is an integral part of the social system.

Society is largely influenced by the culture and in turn culture influence the business firm. Culture shapes the attitude and behaviour of the society. Any change in the cultural factor affects the business in large. Business should be organised and governed, taking into consideration various values and norms of the society.

v. **Political Environment**:

The Political environment in a country influences the legislations and government rules and regulations under which a firm operates. Political environment means influences exerted by:

- **Legislature**: This includes parliament, legislative assemblies. They are the law-making bodies that frame rules and regulations.
- **Executives**: They include government beurocracy who implements the decisions.
- **The Judiciary**: It includes Supreme Court, High Court who sees whether the decisions taken and implemented by the executive are within the constitutional framework. They are also known as dispute settlement bodies.

vi. **Natural Environment**:

Resources availability like land, water and mineral is the fundamental factor in the development of business organisation. It includes natural resources, weather, climatic conditions, transport facilities, topographical factors such as soil, sea, rivers, rainfall etc.

Every business unit must look for these factors before choosing the location for their business. The natural environment largely determines the functioning of a business firm. Natural environment has a great influence on the working of a business. The business organisation should consider the natural factors before starting their operations.

Natural calamities like flood, drought, cyclone, Tsunami etc., can also affect the business environment.

vii. **Legal Environment**:

The state sets the formal rules, laws and regulations for the country's operational system. It creates a framework of rules and regulations within which a business has to operate. The business should have complete knowledge of laws and policies to run the business effectively. Some of the laws are:

- Consumer protection Act 1986
- Factories Act – 1948
- Workers compensation Act 1923
- FEMA Act 1999
- The Companies Act 1956
- The Environment Protection Act 1986

SALIENT FEATURES OF INDIAN ECONOMY

Indian economy is termed as the developing economy of the world. Some features like low per capita income, higher population below poverty line, poor infrastructure, agriculture based economy and lower rate of capital formation, tagged it as a developing economy in the world.

Features of Indian Economy:

I. Strengths of Indian Economy

1. **Mixed Nature of Economy:**
   India's economy is a blend of socialism and capitalism, integrating the efficiency and innovation of the private sector with the social welfare objectives of the public sector. This system has evolved significantly since the economic liberalization of the 1990s, which reduced government controls over the private sector, attracting foreign investments, and encouraging free-market principles. The synergy between private enterprise and public governance aims to foster economic growth while ensuring equitable access to resources and opportunities.
2. **Pre-dominance of Agriculture:**
   Agriculture is a cornerstone of the Indian economy, supporting a majority of the rural population. It's not just the source of food security but also a significant contributor to India's GDP. However, the sector faces challenges such as limited technological advancement, reliance on monsoon rains, and small landholdings that hinder productivity. Addressing these issues while capitalizing on the sector's potential is crucial for sustainable development.
3. **Emerging Economy:**
   India's status as an emerging economy is underscored by its rapid growth rates, increasing influence in global trade, and an expanding role in international affairs. Its large market, democratic governance, and strategic location make it an attractive destination for foreign direct investment (FDI). The challenge lies in maintaining this growth momentum while ensuring it translates into broad-based improvements in living standards.
4. **Demographic Dividend:**
   India's demographic profile, with a large proportion of young people, presents a potential economic boon. This demographic dividend can drive growth if the workforce is well-educated, skilled, and employed in productive sectors. The challenge is to create enough quality jobs and enhance skill development to fully leverage this advantage.

5. **Rapid Urban Growth:**
   Urbanization in India is propelled by migration from rural areas seeking better employment and living conditions. Cities are hubs of economic activity, innovation, and entrepreneurship. However, rapid urban growth also strains infrastructure, housing, and public services. Balancing urban development with sustainable resource management is key.
6. **Fast Growing Service Sector:**
   The service sector's dynamism has positioned India as a global leader in areas like IT, telecommunications, and financial services. This sector's growth has been instrumental in driving economic expansion and job creation. The challenge is to ensure that this growth is inclusive and benefits other sectors of the economy as well.
   - **Tourism** contributes to economic diversification, foreign exchange earnings, and job creation, showcasing India's rich cultural heritage and natural beauty.
   - **IT Industry** is a global powerhouse, providing software and services worldwide, highlighting the need for continuous skill development and innovation.
   - **Space Sector** demonstrates India's technological capabilities and ambitions, with implications for national security, global positioning, and scientific advancement.
   - **Port Services** are critical for trade and economic integration, requiring investments in infrastructure and efficiency improvements.

II.Weaknesses of Indian Economy:

1. **Low per Capita Income:** India's per capita income is very less as compare to developed countries. As per the estimates of the Central Statistics Office (CSO), the per capita net national income of the country at current prices for the year 2015-16 is estimated to attain the level of Rs. 93231/-. The per capita net national income at constant prices (2011-12) for the year 2015-16 is estimated to attain the level of Rs. 77, 431/-. As per the CSO's estimates, the per capital net national income at **current prices is**

   2012-13 ……Rs. 71050/-
   2013-14 …… Rs. 79412/

2014-15 …….Rs. 86,879/-

The per capita net national income at **constant prices** (base year 2011-12)

2012-13……. Rs. 65,664/-

2013-14……. Rs. 68867/-

2014-15. ……Rs. 72889/-

2. **Agriculture Based Economy:** Agriculture and allied sectors provide around 14.2% of Indian GDP while 53% of total Indian population is based on the agriculture sector.
3. **Over population:** in every decade Indian population get increased by about 20% . During the 2001-11 population increased by 17.6%. Currently India is adding the total population of Australia every year. India is the possessor of around 17.5% population of the whole world.
4. **Income Disparities:** a report released by Credit Suisse revealed that the richest 1% Indians owned 53% of the country's wealth, while the share of the top 10% was 76.30%. To put it differently, in a manner that conveys the political economy of this stunning statistic, 90% of India owns less than a quarter of the country's wealth.
5. **Lack of Capital Formation:** Rate of capital formation is low because of lower level of income. Gross domestic capital formation was 23.3% in 1993-94 increased up to the level os 38.1% in 2007-08 but declined up to 34.8% in 2012-13.
6. **Backwardness of Infrastructural Development:** As per an recent study, 25% of Indian families don't have reach of electricity and 97 million peoples don't have reach of safe drinking water and 840 million people in India don't have sanitation services. India needs 100 million dollars for infrastructural development upto 2025.
7. **Market Imperfections:** Indian economy doesn't have good mobility from one place to other which hinders the optimum utilization of resources. These market imperfections create the fluctuations in the price of commodities every year.
8. **Economy is Trapped in the Vicious Circle of Poverty:** Prof. Ragner Nurkes says that 'a country is poor because it is poor'. It means poor countries are trapped in the vicious circle of poverty.
9. **Use of Outdated Technology:** It is very clear that Indian production technique is more labour oriented in nature. So it increases the cost of production of the products made in these countries.

10. **Traditional Set Up of Society:** Indian societies are trapped in the menace like casteism, communalist, male dominated society, superstitions, lack of entrepreneurship, and '*chalta hai attitude' of the peoples*. These all factors hindered the growth of the country as a whole.

UNIT-II

POLITICAL, LEGAL AND ECONOMIC ENVIRONMENT OF BUSINESS

ELEMENTS OF POLITICAL ENVIRONMENT

Definition:

The **political environment** refers to the **influence of government and political factors** on business activities. It includes laws, government policies, political stability, and international relations, all of which can affect how businesses operate, grow, or face risks.

Elements of Political Environment:

1. Government Policies

- These are rules and regulations set by the government that directly affect businesses.
- Includes taxation policy, industrial policy, licensing policy, trade policy, etc.
- **Example:** The introduction of GST in India unified indirect taxes, affecting pricing and business processes.

2. **Political Stability**

- Political stability means a consistent and reliable government without frequent changes or unrest.
- Stable governments attract investment; unstable ones create risk and uncertainty.
- **Example:** Foreign companies prefer to invest in politically stable countries like Singapore or the UAE.

3. Legal and Regulatory Framework

- Refers to the system of laws governing business conduct.
- Includes:
    - ✓ Labour laws
    - ✓ Environmental laws
    - ✓ Consumer protection laws
    - ✓ Industrial safety rules
- **Example:** Strict labour laws may increase the cost of hiring workers.

4. Taxation and Trade Policies

- These are financial and trade-related rules made by the government.
- Includes:

- ✓ Income tax
- ✓ Corporate tax
- ✓ Customs duties
- ✓ Export/import restrictions

- **Example:** High import duties may discourage businesses from importing foreign goods.

5. Government Support and Incentives

- Government may provide support to promote certain industries.
- Includes:
  - ✓ Subsidies
  - ✓ Financial aid
  - ✓ Tax exemptions
  - ✓ Startup support schemes
- **Example:** The Indian government's "Make in India" initiative gives incentives to local manufacturers.

6. Bureaucracy and Corruption

- Bureaucracy refers to government officials and departments handling business processes.
- A complex and corrupt bureaucracy can slow down approvals and increase costs.
- **Example:** Businesses prefer states/countries with transparent systems and fast approvals.

7. International Relations and Political Alliances

- The relationship between a country and other nations can impact foreign investment and trade.
- Good diplomatic ties encourage business growth; hostile relations can lead to trade bans or sanctions.
- **Example:** Sanctions on Russia affected many global businesses operating there.

8. Political Pressure and Public Opinion

- Businesses are influenced by political parties, interest groups, NGOs, and public expectations.
- This pressure can shape company policies, especially related to environmental and social responsibility.

- **Example:** Due to public concern, many companies are reducing plastic usage and adopting green practices.

The political environment is a **critical external factor** for any business. A company must stay updated on political developments, laws, and policies to plan its strategies effectively and reduce risks.

Examples of Political Environment in Business:

1. **India – GST Implementation (2017):**
   - **Element involved:** Government Policy
   - **Impact:** Businesses had to change their accounting and billing systems to comply with the new tax structure. It simplified indirect taxes but required adaptation.
2. **Russia-Ukraine War (2022–Present):**
   - **Element involved:** Political Stability and International Relations
   - **Impact:** Many global companies like McDonald's and Apple stopped operations in Russia due to sanctions and political pressure.
3. **Brexit – UK Leaving the European Union (2020):**
   - **Element involved:** Trade and Political Alliances
   - **Impact:** UK-based businesses had to adjust to new trade regulations, customs checks, and tariffs when dealing with EU countries.
4. **Make in India Campaign (Launched in 2014):**
   - **Element involved:** Government Support
   - **Impact:** Encouraged foreign and domestic companies to manufacture in India by offering incentives and reducing restrictions.
5. **COVID-19 Lockdowns and Restrictions (2020):**
   - **Element involved:** Government Policy and Regulatory Framework
   - **Impact:** Government-mandated lockdowns forced many businesses to shut down temporarily or shift to online operations.
6. **Ban on Chinese Apps in India (2020):**
   - **Element involved:** National Security & International Relations
   - **Impact:** Popular apps like TikTok and PUBG were banned in India, affecting companies' user base and advertising revenues.
7. **US Corporate Tax Cuts (2017 – Trump Administration):**
   - **Element involved:** Tax Policy

- **Impact:** Lowered the corporate tax rate, leading to increased investment and profit margins for businesses in the US.

These examples show how changes in the political environment—whether domestic or international—can influence business decisions, operations, and profitability.

ROLE OF GOVERNMENT IN BUSINESS FACILITATION

The government plays a vital role in supporting, regulating, and promoting businesses. It creates a favorable environment for entrepreneurs and investors by providing policies, infrastructure, and support systems necessary for business growth.

1.Regulatory Role:

The government creates and enforces laws and regulations to maintain order and fairness in business operations.

- **Business Registration** – Helps businesses operate legally.
- **Licenses and Permits** – To ensure legal and ethical operations.
- **Consumer Protection Laws** – Safeguard customers from frauds.
- **Labour Laws** – To protect employees' rights.

2. Infrastructure Development:

Businesses need strong infrastructure to function smoothly.

- **Transport** – Roads, railways, airports, etc.
- **Power and Water Supply** – Essential utilities.
- **Digital Infrastructure** – Internet, e-governance portals.

3. Financial Assistance and Incentives

The government provides monetary and non-monetary support to help businesses thrive.

- **Subsidies and Tax Benefits**
- **Loans at low interest rates**
- **Start-up India Scheme** – Support for new entrepreneurs.
- **Make in India Initiative** – Promotes manufacturing.

4. Promoting Ease of Doing Business

To reduce red tape and make processes simpler for entrepreneurs:

- Online registration and approval systems.
- GST for simplified tax structure.
- Single-window clearance systems.

5. Encouraging Foreign Trade and Investment

The government promotes global trade relations and investments.

- **Trade Agreements** – e.g., Free Trade Agreements (FTA).
- **FDI Policies** – Attract foreign companies to invest.
- Export promotion councils and incentives.

6. Education and Skill Development

A skilled workforce is crucial for business success.

- Government-run training centers.
- Industry-academia partnerships.
- National Skill Development Mission.

7. Legal Framework and Dispute Resolution

The government ensures quick and fair legal processes for business conflicts.

- Commercial Courts and Tribunals
- Arbitration and Mediation Centers
- Protection of Intellectual Property Rights (IPR)

8. Promoting Research and Innovation

The government funds and encourages innovation in business.

- **R&D Grants and Tax Benefits**
- **Incubation Centers** and **Startup Hubs**
- Digital India initiative for tech innovation.

9. Environmental and Social Responsibility

Ensures that businesses grow sustainably and ethically.

- **Environmental Laws** (like pollution control norms)
- **Corporate Social Responsibility (CSR)** regulations.
- Promotion of eco-friendly industries.

The government's role in business facilitation is multi-dimensional. It acts as a **regulator, promoter, facilitator, and partner**, ensuring that businesses grow in a stable, fair, and sustainable environment.

Role of Government in Business: A Four-Dimensional Perspective

1. Regulator

The government regulates business activities through laws and rules to ensure fairness, ethics, and safety.

- Enforces **legal compliance** (e.g., Companies Act, Labour Laws, Environmental Laws).

- Maintains **market discipline** and prevents monopolies.
- Protects **consumer rights**, **employee welfare**, and **investor interest**.
- Example: The Competition Commission of India (CCI) prevents unfair trade practices.

2. Promoter

The government promotes business and industrial development, especially in backward or priority sectors.

- Sets up **industrial estates**, **SEZs**, and **PSUs** (Public Sector Units).
- Launches **schemes for MSMEs and Startups**.
- Promotes specific sectors like **renewable energy**, **textiles**, **IT**, etc.
- Example: Startup India, Digital India, and Make in India programs.

3. Facilitator

The government creates a **supportive environment** for businesses to operate smoothly.

- Provides **infrastructure**, **skilled labor**, and **financial services**.
- Ensures **ease of doing business** through simplified procedures.
- Encourages **innovation and entrepreneurship**.
- Example: One-window clearance system, GST for a unified tax system.

4. Partner:

The government collaborates directly with private businesses through **Public-Private Partnerships (PPP)** or investments.

- Works jointly in sectors like **infrastructure**, **transport**, **health**, and **education**.
- Shares **resources, risks, and responsibilities**.
- Encourages **private sector participation** in nation-building.
- **Example:** PPP models in metro rail, highways, and airports.

The government does not merely control businesses; it plays an **active and collaborative role** by **regulating**, **supporting**, **enabling**, and **partnering** with them to foster sustainable economic growth.

Role	Description	Example
Regulator	Sets rules and laws to ensure ethical, legal business practices	Companies Act, Labour Laws

Promoter	Launches schemes and supports industries with subsidies and infrastructure	Startup India, Make in India
Facilitator	Provides services, training, infrastructure, and a business-friendly system	GST, Skill India Mission
Partner	Works with private sector in Public-Private Partnerships (PPP)	Metro Rail, Roads under PPP

COMPITITION

Healthy completion is often a great way for organizations to motivate themselves and their employees to strive for excellence. There are several types of business competition, and each has an important part in increasing customer satisfaction, promoting innovation and revealing marketplace advantages. As a marketing, sales or advertising professional, understanding competition in business may help you improve your efforts and maximize your success. In this article, we define business competition, discuss the types and benefits of business competition and offer a list of tips to help you promote healthy business competition.

What is competition?

Competition is the contest between organizations that provide similar products or services or that target the same audience of consumers. Businesses compete to convert and retain customers, increase revenue and gain more market share.A high amount of business competition may be a sign of a healthy, profitable marketplace and often enhances the overall quality of available products and services by encouraging organizations to improve their operations, fulfill the needs of their customers and develop their client relationships.

Types of competition in business:

1. **Direct competition**

   Direct competitors are brands or businesses that sell the same products or services to the same target audience. You can tell if two businesses are in direct competition with each other if:

   - They operate within the same industry
   - They provide the same or similar products or services

- They target the same audience of consumers
- They satisfy the same customer need
- They use the same channel of distribution

2. **Indirect competition:**

   Indirect competitors provide products or services that are not the same but that satisfy the same consumer needs. A great example of indirect competitors would be two different styles of restaurants. For example, a fast-food restaurant and a buffet restaurant do not provide the same type of product, but they satisfy the same customer need of hunger. You can tell if two businesses are indirect competitors if:

   - They operate in the same industry
   - They satisfy the same need
   - They target the same audience

3. **Replacement competition:**

   Replacement competitors are brands and businesses that have the ability to completely replace existing organizations by producing new products or services that better satisfy the needs of their target audience. For example, mobile phone manufactures eventually replaced manufacturers of landline phones because they fulfilled the same need in an improved, more convenient way. You can tell if an organization is a replacement competition if it offers an existing product or service in a new, innovative way the more successfully satisfies the needs of consumers.

Benefits of competition in business:

Competition in business often provides opportunities for brands and businesses to improve the performance of their products and services. Additional benefits of business competition may include:

- **Addressing the needs of customers**

  Often, business competition motivates brands and businesses to fulfill their customer's needs more effectively than their competitors. This promotes organizations to develop their understanding of the needs of their target audience and tailor their offerings to fulfill satisfy their needs. The results of brands and businesses that focus on fulfilling customer needs include higher quality products, the increased value of services and enhanced customer satisfaction.

- **Analyzing strengths and weaknesses**

Business competition may encourage organizations to evaluate their strengths and weaknesses and optimize their strategies based on these findings. This may allow brands and businesses to maximize the talents of their teams and departments, make informed decisions about their marketing and sales strategies and tailor their offerings according to their strengths.

- **Increasing demand**
  Business competition is an effective way to increase the demand for a product or service. As more companies invest in their marketing and advertising efforts, consumer demand for their products and services may increase as brand awareness continues to grow. This is beneficial to each competitor involved and may result in increased revenue, higher customer acquisition and retention.

- **Encouraging innovation**
  In order to gain an advantage in the marketplace, business competition may encourage organizations to innovate their strategies and improve their products or services in creative, revolutionary ways. This is an important contribution to the continued improvement of goods and services, the advancement of technology products and services and adapting to the changing needs of consumers.

- **Revealing competitive advantages**
  Brands and businesses often track and analyze their competitors' performances to gain insight into their business strategy. By studying their competitors' tactics, brands and businesses may be able to reveal their own advantages in the market. This may help organizations better understand the aspects of their business that differentiate them from the competition, and using this information, they may develop strategies that contribute to their success.

- **Promoting business development**
  Continued business development may be an important factor in long-term success. Business competition often challenges brands and businesses to continually improve their procedures, analyze the success of their efforts and develop new methods of achieving their objectives. This may help organizations seek continued business development and could contribute to their long-term success.

Tips for promoting healthy business competition

Promoting healthy business competition may help you stimulate the growth and development of your organization, increase the health of the market and promote the success of your products and services. Consider following these tips to promote healthy business competition:

- **Understand your competition**
  Conducting market research is a great way to understand your competitor's strategies and success. Understanding the effectiveness of their techniques may help you make informed decisions about your own strategies. This may result in competitors adjusting their methods in order to be most effective, increasing healthy market competition and promoting continuous business development.

- **Make positive connections**
  Partnerships are a great way to maximize the benefits of business competition. Similar brands or businesses may enter into partnerships to strengthen their customer outreach, connect with each other's target audiences and better fulfill the needs of their customers. Mutually beneficial partnerships may help organizations more successfully fulfill the needs of their customers, expand their audience bases and enhance positive brand perception.

- **Demonstrate your uniqueness**
  Highlighting the ways your products or services differ from your competitors is an effective way to promote business competition. Consider integrating messaging about how your products or services exceed the expectations of competitor offerings into your marketing and advertising campaigns. Demonstrating how your offerings more successfully fulfill the needs of your target audience may encourage competing businesses to improve their offerings and promote continuous improvement in the marketplace.

ACT FEMA FOREIGN EXCHANGE MANAGEMENT ACT (FEMA), 1999

Introduction

- FEMA stands for **Foreign Exchange Management Act**.
- Enacted in **1999**, effective from **June 1, 2000**.
- Replaced **FERA (Foreign Exchange Regulation Act), 1973**.
- Aims to **facilitate external trade and payments** and ensure the **orderly development of the forex market**.

Objectives of FEMA

- To consolidate and amend laws related to foreign exchange.
- To facilitate external trade and payments.
- To promote the orderly development of the foreign exchange market in India.
- To simplify procedures and promote transparent transactions.

Features of FEMA

- Civil law in nature, not criminal.
- Applicable throughout India and to Indian citizens abroad.
- Regulates foreign exchange through the **RBI** and **Central Government**.
- Monetary penalties for violations, no imprisonment in most cases.
- Frees current account transactions unless restricted.
- Capital account transactions are regulated by the RBI.

Important Definitions

- **Authorized Person**: Entity (like a bank or money changer) approved by RBI to deal in foreign exchange.
- **Current Account Transaction**: Day-to-day foreign exchange transactions (e.g., travel, education, medical expenses).
- **Capital Account Transaction**: Alters assets/liabilities outside India (e.g., buying property or investing abroad).
- **Foreign Security**: Financial instrument issued by a foreign company.

Authorities under FEMA

- **RBI** – Central regulatory authority for forex.
- **Enforcement Directorate (ED)** – Investigates and penalizes violations.
- **Central Government** – Makes rules and notifications under FEMA.

Major Provisions

- Only authorized persons can deal in foreign exchange.
- Foreign exchange and foreign asset holdings must follow FEMA rules.
- Export proceeds must be repatriated to India within the specified time.
- Capital account transactions require RBI permission or are governed by rules.

Penalties under FEMA

- Fine up to 3 times the amount involved or Rs. 2,00,000 (if not quantifiable).
- Additional fine of Rs. 5,000 per day for continuing violations.
- Civil penalty – no jail term, unlike FERA.

Difference Between FERA and FEMA

Aspect	FERA	FEMA
Year	1973	1999
Nature	Criminal	Civil
Objective	Control foreign exchange	Manage foreign exchange
Penalty	Imprisonment	Monetary fine only
Approach	Restrictive	Liberal and facilitative

Importance of FEMA for Business

- Encourages foreign trade and investment.
- Provides legal clarity for international transactions.
- Boosts investor confidence.

- Controls illegal forex transactions and black money.
- Aligns with global economic practices.

FEMA regulates foreign exchange in India by allowing current account transactions freely and capital account transactions under RBI supervision. It’s business-friendly, promotes global trade, and ensures smooth and legal forex operations.

LICENSING POLICIES

The Indian Government established a licensing system in Order to maintain control over industries according to the Industries development and Regulation Act 1951. A license is a written permission granted to an enterprise by the government, according to which the product mentioned therein can be manufactured by the enterprise. The license also includes many other particulars such as:

1. The name of the product to be produced
2. The place where the factory is to be established
3. Expansion of the enterprise
4. The limit of the production capacity

Objectives of Licensing:

The main aim of the licensing policy is to regulate the industrial sector. The main aims of the licensing system are:

1. Encouraging small scale industry
2. Encouraging new entrepreneurs for setting industries
3. Regulating location of industrial units
4. To ensuring balanced regional development
5. Promoting technological advancements in industries
6. Development and control of Industrial Investment and production.

Compulsion for Licensing:

As per the licensing policy, it is necessary to obtain license in the following circumstances:

1. **For setting up New Industrial Units:** If any industrial unit is to be set up in the category of licensing industries it has to obtain license under Industries Development and Regulation Act,1951.
2. **For Expansion:** Under Industrial Licensing Policy, if any industrial unit which is covered under licensing wants to expand its production capacity then it will have to obtain prior approval under this act.

3. **Location of Industrial Units:** Any Industrial Unit wants to change it location then it will have to take prior approval. An Industrial License is required for projects which are to be located in large cities with a population of more than 10 lakhs. Only after obtaining approval, the location can be changed.
4. **For producing Articles Reserved for Small Scale Industries:** An industrial undertaking wants to manufacture an item reserved for small scale sector it is required to obtain industrial license. The list of items reserved for small scale industries is reviewed from time to time. At this time 239 items were reserved for small scale sector.
5. **Registration of Existing Industrial Units:** An existing Industrial Units which were existing before enforcement of this act and are covered under industrial licensing will have to obtain registration under this act.

Present Position of Licensing Policy:

Present position of licensing policy explain are as follows:

1. **Compulsory Licensing:** According to the New Industrial Policy of 1991, it is necessary to obtain license only in case of 15 industries which are engaged in the field of defence-equipment's, luxury goods and hazardous commodities. In the wake of liberalisation this number has been reduced to 5. The five industries for which licensing is compulsory are
   - Alcoholic Products
   - Industrial Explosives
   - Aerospace and defence equipment
   - Hazardous Chemicals
   - Tobacco products
2. **Protection to Small Industries:** In order to protect the small-scale industries and save them from competition with large industries, the production of certain products was reserved for the small industries. Only 239 items are reserved for small scale industries.
3. **Industries Reserved for Public Sector:** Some industries had been reserved for the public sector. These industries could be established in the public sector only and the private sector was not granted licenses for the establishment of these industries. Only 3 industries reserve for the public sector such atomic minerals, atomic energy and railway.
4. **Definition of Large Industrial Houses**: In the new industrial policy of 1991, the limit on holding assets was completely abolished and there is no restrictions on size of large

business houses. The new policy lays greater stress on preventing unfair trade practices rather than on the size of business houses. In 2002 the government abolished MRTP Act

5. **Licensing for the Expansion of Production Capacity**: According to the new policy of 1991, No license is required for the expansion of production capacity of MRTD companies. In the present situation, there is no restriction on expansion of production-capacity except five licensed industries.

Criticism of Licensing Policy:

- **Discourages the Entrepreneurs:** Under Industrial Licensing Policy, industries have to obtain licenses for setting up new unit, change location etc. So excessive control discourages the entrepreneurs.
- **Conflicting Objectives Licensing involves conflicting objectives**: Like on one hand government wants to increase industrial production in the economy on the other hand government is restricting the activities of industrial units like substantial expansion, production of new articles etc.
- **Lengthy Procedure**: For obtaining industrial license the entrepreneur has to take approval from various government departments. So, all this involves lengthy procedure and many formalities
- **Corruption while Granting Licenses**: Licenses are given to such entrepreneurs who have either political links or who can bribe the corrupt officials. Licenses are not granted on merit basis. Efficient entrepreneurs are ignored.
- **Poor Follow-up:** After granting license, authorities do not check whether the business unit is following the provisions of licensing or not. So the basic objective of licensing policy is defeated.

ELEMENTS OF ECONOMIC ENVIRONMENT

Economic environment Definition:

The Economic Environment consists of external factors in a business market and the broader economy that can influence a business. Economic environment is divided into the Microeconomic environment, which affects business decision making - such as individual actions of firms and consumers –and the macroeconomic environment, which affects an entire economy and all of its participants.

Macroeconomic influences are broad economic factors that either directly or indirectly affect the entire economy and all of its participants, including your business. These factors include thing as:

- Interest rates
- Taxes
- Inflation
- Currency Exchange rates
- Consumer discretionary income
- Savings rates
- Consumer confidence levels
- Unemployment rates
- Recession
- Depression

Microeconomic factors influence how your business will make decisions. Unlike macroeconomic factors, these factors are less broad in scope and do not necessarily affect the entire economy as a whole. Microeconomic factors influencing a business include:

- Market size
- Demand
- Supply
- Competitors
- Suppliers
- Distribution chain, such as retailer stores

ELEMENTS OF ECONOMIC ENVIRONMENT

Economics environment refers all economics surroundings that influence organisation activities. It consists of economic parameters. It concerned with the nature and direction of economy in which the organisations operate. Important elements of economic development are:

1. Economic systems: Economic system determines the scope of private sec tore ownership of the factors of production and market forces. The models of economic system are:

- **Free market economic system/ capitalism**: This system is based on private ownership of the factors of production. Profit serves as the driver of economic engine. The competitive market mechanism guides business decisions. There is freedom of choice. Individual initiative encouraged.
- **Socialism/ Centrally planned economy:** A socialist economy is an economic organisation in which that means of production and owned and regulated by the state. The production and distribution of goods and factors of production are done by the state under the direction of the planning commission. The economy is centrally planned. Controlled and regulated by the government. There is no consumer sovereignty.
- **Mixed economy:** This system is a mix of free market and centrally planned economics. Both public and private sectors coexist. The public sector has ownership and control of basic industries including utilities. The sector owns agriculture and other industries but is regulated by the state.

2. Economic policies: Policies are guidelines for decision-making and action. Economic policies of the government significantly influence and guide organisations. Key economic policies influencing organisation are:

- **Monetary policy**: It is concerned with money supply, inflation rates, interest rates and credit availability. It influences the level of spending through interest rates. Cheap money reduces cost, dear money increases cost. Interest rates cost of capital. Foreign exchange rates affect imports and exports.
- **Fiscal Policy**: It is concerned with the use of taxation and government expenditure to regulate economic activity. Tax on income, expenditure and capital influence business decisions.

- **Industrial policy**: It is considered with the industrial licencing location, incentives, facilities, foreign investment, technology transfer and nationalization.

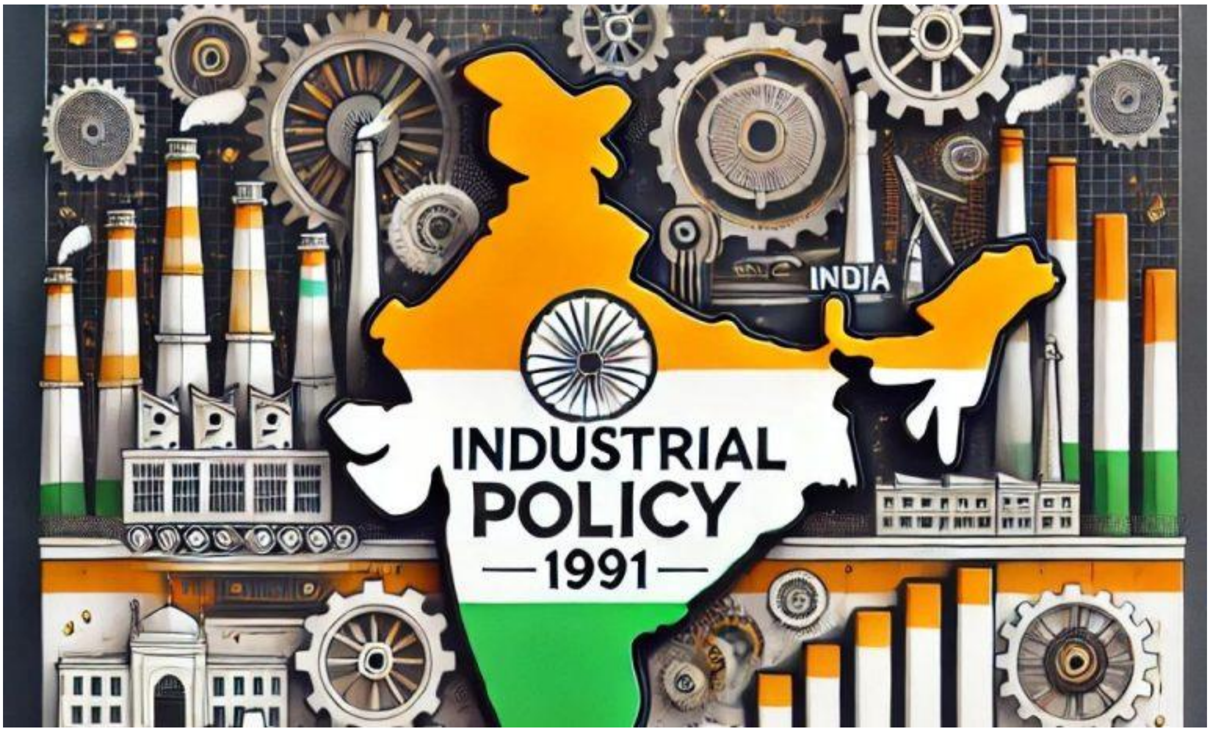
3. Economic conditions: They indicate the health of the economy in which the organisation operates. The factors affecting economic conditions are :

- **State of economic development**: An economy can be least developed, developing and developed. Organizational activities are influence by the stage of economic development.
- **Income**: The level of employment affect expenditure, saving and investment. They together influence the economic conditions of organization.
- **Employment:** The level of employment affects organization. It determines availability and of a labour.
- **Business Cycle:** The stages of business cycle can prosperity, rescission and recovery. They affect the health organisation.
- **Influence:** It is rise in price level, influences costs, price and profit of organization.

4. Regional economic groups: They promote cooperation and free trade among members by removing tariff and other restrictions. They provide opportunities to member countries and threats to non-member countries. Example –

SAARC: South Asian Association for Regional Cooperation.
ASIAN: Association of South East Asian Nations.
EU: European Union.

INDUSTRIAL POLICY 19991/ NEW INDUSTRIAL POLICY/OPEN INDUSTRIAL POLICY



Industrial Policy is a statement, which defines the role of government in industrial development. The place of the public and private sectors in industrialisation of the country. The relative role of large and small industries.

Objectives:

- Rapid Industrial Development
- Balanced industrial structure
- Prevention of concentration of economic power
- Balanced regional growth

INDUSTRIAL POLICY OF 1991 IN INDIA

The **1991 Industrial Policy of India** marks a major milestone in the country's economic history, ushering in **economic liberalization and market reforms**. Announced on **July 24, 1991**, by then-Prime Minister **P.V. Narasimha Rao** and Finance Minister **Dr. Manmohan Singh**, this policy marked a shift from the long-standing focus on state-led development to a new era prioritizing **economic openness, private sector growth, and global integration**. The 1991 policy is widely regarded as a transformative step in making India's economy more efficient, competitive, and globally connected.

The Industrial Policy 1991 was introduced by the Government of India in response to the economic challenges faced by the country. India, at that time, was dealing with a foreign exchange crisis, high inflation, and slow industrial growth. The policy sought to liberalize the industrial sector, encourage private and foreign investment, reduce bureaucratic red tape, and make India more competitive in the global market. This policy marked the beginning of economic reforms, which paved the way for India's growth in the coming decades.

Key Features of the Industrial Policy 1991

- **Liberalization:** The policy focused on reducing government control over industries. It aimed to relax licensing requirements and remove restrictions on the expansion of industries.
- **Privatization:** The policy encouraged the private sector to take a larger role in industrial growth, reducing the dominance of public sector enterprises.
- **Foreign Direct Investment (FDI):** It allowed increased foreign investment in the country, which helped modernize industries and bring in new technology.
- **Deregulation:** The policy sought to reduce regulations and allow market forces to determine industrial growth.
- **Abolition of Industrial Licensing**: The policy removed licensing requirements for most industries except for a few that had implications for **public health, security, and environmental safety**. This marked a significant move toward **deregulation** and allowed businesses to expand without prior government approval.
- **Disinvestment in Public Sector Units (PSUs)**: To address inefficiencies and reduce the financial burden, the policy introduced the concept of **disinvestment** in non-

strategic PSUs. This was intended to increase productivity and enable the government to reduce its fiscal deficit.

- **Policy on Monopolies and Restrictive Trade Practices (MRTP)**: The policy diluted the **MRTP Act**, which had imposed significant restrictions on business expansion to prevent monopolies. Large corporations were now permitted to grow without requiring prior government approval, encouraging the growth of large-scale industries.
- **Promotion of Export-Oriented and Technology-Driven Enterprises**: The policy recognized the importance of global markets and encouraged **export-oriented units** (EOUs) by providing incentives and easing regulations for those investing in high-technology sectors, thereby supporting India's integration into the global economy.
- **Focus on Small-Scale Industries (SSIs)**: Although the policy promoted large-scale industries and foreign investment, it also recognized the importance of SSIs. Certain products were reserved exclusively for small-scale units, and SSIs were provided with incentives for technological upgrades and productivity enhancement.

Objectives of Industrial Policy 1991

The Industrial Policy 1991 aimed at addressing the challenges faced by India's industrial sector, promoting industrial growth, and making India more competitive globally. Its key objectives included:

Liberalization of the Economy

The primary objective of the policy was to liberalize the economy by reducing the role of the government in industrial activities. This was achieved by:

- **Deregulating industries**: Allowing industries to grow without unnecessary government control.
- **Reducing licensing requirements**: Industries no longer needed a license to operate in most cases, which led to faster growth.

Encouraging Foreign Investment:

The policy aimed to attract foreign capital and technology to India. It allowed increased foreign direct investment (FDI) in several sectors, which brought in:

- **Advanced technology**: Foreign firms introduced new manufacturing technologies that enhanced productivity.
- **Capital for growth**: Foreign investments led to an infusion of capital that boosted industrial output.

Promoting Private Sector Participation:

The policy sought to reduce the dominance of the public sector and encourage the private sector to play a more significant role. This included:

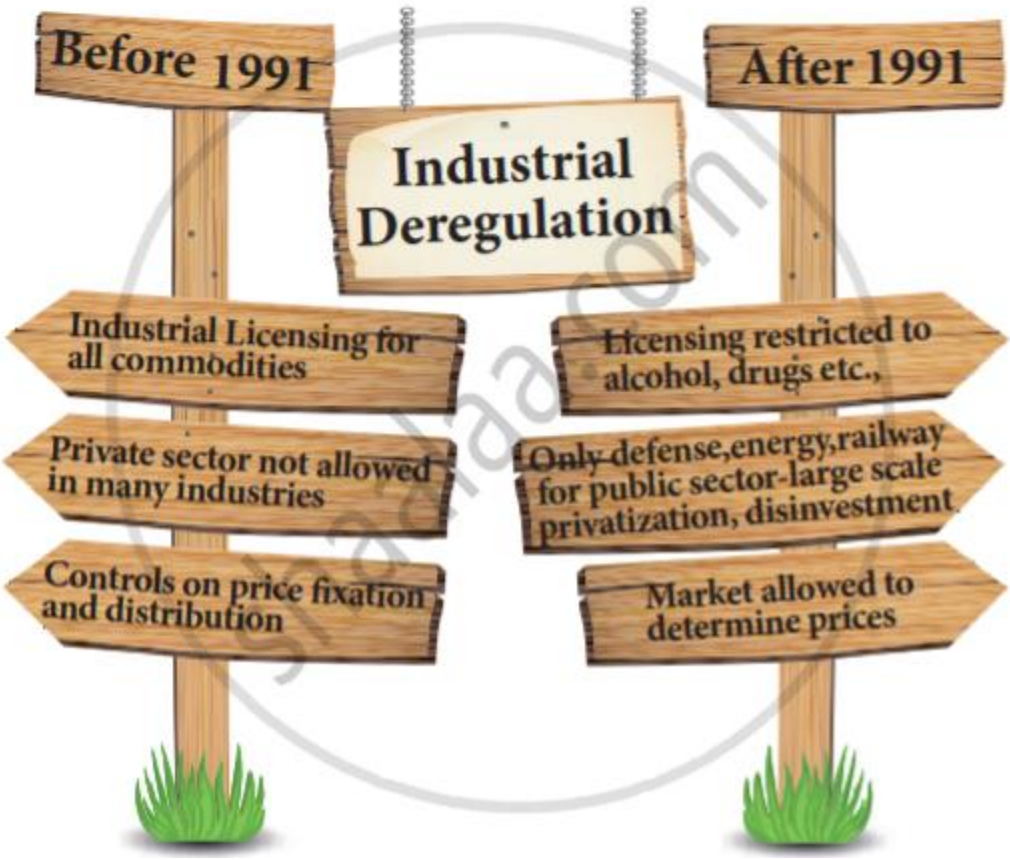
- **Privatization of public sector enterprises**: The policy pushed for the disinvestment and privatization of several state-owned enterprises.
- **Fostering competition**: Allowing more private players increased competition and encouraged innovation.

Enhancing Export Potential

The Industrial Policy 1991 aimed to make Indian industries more competitive globally. It focused on:

- **Increased focus on exports**: Industrial growth was directed toward boosting exports to earn foreign exchange.
- **Improved competitiveness**: Encouraging industries to adopt modern technology made Indian goods competitive in international markets.

Outcomes of Industrial Policy 1991



The Industrial Policy 1991 had several significant outcomes that shaped India's industrial landscape. It laid the groundwork for India's transition into a more open and competitive economy. Let's explore the key outcomes of this landmark policy.

Economic Growth and Industrial Expansion

- **Faster Growth in Manufacturing**: After the policy was implemented, India witnessed an increase in industrial growth. Manufacturing sectors like automobiles, electronics, and telecommunications grew rapidly due to the liberalization and privatization initiatives.
- **Rise in Foreign Investment**: The policy led to a substantial increase in foreign direct investment (FDI), which played a key role in the modernization of industries.

Technological Advancements

- **Access to Modern Technology**: Increased foreign investments brought in modern technologies, helping Indian industries improve their productivity. The advent of new machinery and technology helped industries compete with global standards.

Improved Competitiveness

- **Globalization of Indian Industries**: As India opened up its economy, Indian companies started competing in global markets. Companies such as Tata, Infosys, and Bharti Airtel became global players, and India became an important player in global trade.
- **Exports Boosted**: India's exports rose significantly due to the focus on making industries globally competitive. This helped strengthen the economy and improve the country's foreign exchange reserves.

Shift in Government Role

- **Reduction in Bureaucracy**: The government's control over industries was reduced, and more industries were allowed to function with less interference. The removal of licensing requirements meant industries could focus on growth rather than getting through bureaucratic hurdles.

Creation of Jobs

- **Increase In Employment:** The policy contributed to the creation of millions of jobs, particularly in sectors such as information technology (IT), manufacturing, and telecommunications. These sectors helped absorb the growing workforce in urban areas.

Limitations and Challenges of the 1991 Industrial Policy

- **Challenges in the Public Sector**: While the policy aimed to improve public sector efficiency through disinvestment, some public sector enterprises continued to struggle due to persistent inefficiencies, underutilized capacities, and lack of market orientation.
- **Regional Imbalances**: Economic liberalization led to significant growth in urban and industrialized regions, while some rural and less-developed areas lagged behind, exacerbating regional inequalities.
- **Dependence on Foreign Investment**: The increased focus on FDI raised concerns about dependency on foreign capital and potential vulnerability to external economic shocks. This reliance also raised questions about the stability and sustainability of certain sectors.
- **Limited Benefits to Small-Scale Industries**: While SSIs were supported in the policy, the increased competition from large and multinational companies often limited the ability of small industries to expand and modernize effectively.
- **Socioeconomic Disparities**: The shift to a market-driven economy contributed to income disparities as certain sectors and regions grew rapidly, leaving behind those without access to modern infrastructure, education, or employment opportunities in emerging industries.

Legacy and Long-Term Impact

The 1991 Industrial Policy has had a profound impact on India's economic trajectory, transforming it from a **closed, state-led economy** to an **open, market-oriented economy**. It laid the foundation for India's **IT boom**, increased its **global trade**, and integrated India into the **global economy** as a competitive player. This policy is widely regarded as the catalyst for India's economic transformation, leading to rapid GDP growth, urbanization, and a booming middle class.

The policy's emphasis on liberalization, privatization, and globalization—often summarized as **LPG**—continues to influence India's economic policies today. Future policies in the 2000s and beyond have built upon the 1991 reforms, further opening sectors to private investment, encouraging startups, and emphasizing technology-driven growth.

However, the policy's legacy also includes challenges such as rising income inequality, regional disparities, and ongoing debates about the role of foreign investment in strategic sectors. Despite these challenges, the 1991 Industrial Policy is recognized as a turning point in

India’s economic history and a foundational reform that laid the groundwork for the country’s future economic growth and development.

UNIT-III

MANGEMENT OF MICRO, SMALL&MEDIUM ENTERPRISE (MSME)

CONCEPTS AND DEFINITIONS OF MSME

As per the **Micro, Small and Medium Enterprises Development (MSMED) Act, 2006**, and the **latest government notification (S.O. 1364(E), dated March 21, 2025)**, As per the new guidelines issued by the Government of India, effective from **April 1, 2025**, the classification of Micro, Small, and Medium Enterprises (MSMEs) is based on their **investment in plant and machinery or equipment** and their **annual turnover**.

1. An **enterprise will be classified as a Micro Enterprise** if it has an investment up to **₹2.5 crore** and an annual turnover up to **₹10 crore**.
2. An **enterprise will be classified as a Small Enterprise** if the investment is up to **₹25 crore** and the annual turnover is up to **₹100 crore**.
3. An **enterprise will be classified as a Medium Enterprise** if the investment does not exceed **₹125 crore** and the annual turnover does not exceed **₹500 crore**.

This updated classification replaces the earlier limits set in 2020, and it is intended to allow growing businesses to continue receiving MSME benefits such as subsidies, credit support, and easier compliance procedures.

Classification	Micro	Small	Medium
Manufacturing Enterprises and Enterprises rendering Services	Investment in Plant and Machinery or Equipment: Not more than Rs. 2.5 crore and Annual Turnover not more than Rs. 10 crores	Investment in Plant and Machinery or Equipment: Not more than Rs. 25 crore and Annual Turnover not more than Rs. 100 crores	Investment in Plant and Machinery or Equipment: Not more than Rs. 125 crore and Annual Turnover not more than Rs. 500 crores

Category	Investment not exceeding (₹ in Crore)	(Revised) Investment not exceeding (₹ in Crore)	Turnover not exceeding (₹ in Crore)	(Revised) Turnover not exceeding (₹ in Crore)
Micro	1	2.5	5	10
Small	10	25	50	100
Medium	50	125	250	500

<u>THE MSMED DEVELOPMENT ACT, 2006</u>

Introduction

- Enacted on **June 16, 2006**.
- Came into effect from **October 2, 2006**.
- Objective: To **facilitate the promotion, development and enhancement of competitiveness** of Micro, Small and Medium Enterprises (MSMEs).
- Replaced the earlier **Industries (Development and Regulation) Act, 1951** for small-scale industries.

Objectives of the MSMED Act

1. Classify enterprises into **micro, small, and medium**.
2. Set norms for **investment and turnover**.
3. Provide for **delayed payment protection** to MSMEs.
4. Promote **technological upgradation and skill development**.
5. Create a **legal framework** for policy support.

Classification of Enterprises

Revised MSME Categories (Effective April 1, 2025)

Enterprise Type	Investment in Plant & Machinery/Equipment	Annual Turnover
Micro	≤ ₹2.5 crore	≤ ₹10 crore
Small	≤ ₹25 crore	≤ ₹100 crore
Medium	≤ ₹125 crore	≤ ₹500 crore

Key Features of the Act

Enterprise Classification

- Applies to **manufacturing** and **service sectors**.
- Ensures equal support to both types.

Advisory Bodies

- **National Board for MSMEs**: Advises central government on MSME-related policies.
- Includes representatives from Central/State Governments, industry associations, banks, etc.

Promotion and Development:

- Focus on:
  - Technology upgrade
  - Infrastructure development
  - Cluster development
  - Skill training and capacity building

Delayed Payments to MSMEs

- Buyers must make payment **within 45 days**.
- Beyond 45 days: Interest at **3 times the RBI bank rate** is payable.
- MSMEs can file complaints with **MSE Facilitation Council (MSEFC)** for dispute resolution.

Benefits under MSMED Act

- **Collateral-free loans** under CGTMSE.
- **Subsidies** for patent registration, ISO certification.
- **Ease of registration** through Udyam portal.
- **Reservation policy** for certain products.
- **Market access assistance** and public procurement policy (25% of purchases reserved for MSMEs by government bodies).

Role of State Governments

- Create supportive policies and institutional mechanisms.
- Set up **District Industries Centres (DICs)** to facilitate MSMEs at local levels.
- Monitor and support delayed payment redressal through MSEFC.

Amendments & Developments

- **Udyog Aadhaar Memorandum (2015)** – simplified MSME registration.
- **Udyam Registration (2020)** – replaces Udyog Aadhaar.
- **Integration with Income Tax & GST systems** for real-time verification.
- Inclusion of **retail and wholesale traders** under MSME (2021) for priority sector lending.

Importance of MSMED Act in Indian Economy

- Provides **legal backing** and structure to MSME policies.
- Encourages **entrepreneurship** and employment generation.
- Enhances **credit flow** to small businesses.
- Strengthens **industrial growth** in rural and semi-urban areas.

Challenges

- Lack of awareness among entrepreneurs.
- Delayed payments still a major issue.
- Limited access to modern technology.
- Insufficient infrastructure in remote areas.

The MSMED Act, 2006, plays a **vital role in shaping the MSME ecosystem** in India by offering a clear legal framework, financial support mechanisms, and institutional support. It continues to evolve through reforms to match the changing needs of businesses.

GOVERNMENT POLICY INITIATIVE

The Union Budget 2025-26 introduces a series of measures aimed at strengthening the Micro, Small, and Medium Enterprises (MSME) sector, recognising its role as one of the key engines in India's journey of development, alongside agriculture, investment, and exports. To help businesses expand and improve efficiency, the investment and turnover limits for MSME classification have been raised. Access to credit is set to improve with an increase in the credit guarantee cover for micro and small enterprises, startups, and export-focused MSMEs. A new scheme will provide financial support to first-time entrepreneurs from disadvantaged backgrounds, while sector-specific initiatives will enhance productivity in areas such as footwear, leather, and toy manufacturing.

As a vital contributor to India's industrial landscape, the MSME sector plays a crucial role in manufacturing, exports, and employment. With 5.93 crore registered MSMEs employing more than 25 crore people, these enterprises generate a significant share of the country's economic output. In 2023-24, MSME-related products accounted for 45.73% of India's total exports, reinforcing their role in positioning the country as a global manufacturing hub. The new budgetary provisions aim to build on this strong foundation by fostering innovation, enhancing competitiveness, and ensuring better access to resources. Through these steps, the government seeks to equip MSMEs with the tools needed to expand their reach and strengthen their contribution to India's economic growth.

Key Measures for MSMEs in Union Budget 2025-26

The Union Budget 2025-26 introduces a series of measures aimed at strengthening the MSME sector by enhancing credit access, supporting first-time entrepreneurs, and promoting labour-intensive industries.

Revised Classification Criteria

To help MSMEs scale operations and access better resources, the investment and turnover limits for classification have been increased by **2.5 times and 2 times**, respectively. This is expected to improve efficiency, technological adoption, and employment generation.

Rs. in Crore	Investment		Turnover	
	Current	Revised	Current	Revised
Micro Enterprises	1	2.5	5	10
Small Enterprises	10	25	50	100
Medium Enterprises	50	125	250	500

Enhanced Credit Availability

- The credit guarantee cover for micro and small enterprises has been increased from ₹5 crore to ₹10 crore, enabling additional credit of ₹1.5 lakh crore over five years.
- Startups will see their guarantee cover double from ₹10 crore to ₹20 crore, with a reduced fee of 1% for loans in 27 priority sectors.
- Exporter MSMEs will benefit from term loans up to ₹20 crore with enhanced guarantee cover.

Credit Cards for Micro Enterprises

- A new customised Credit Card scheme will provide ₹5 lakh in credit to micro enterprises registered on the Udyam portal, with 10 lakh cards set to be issued in the first year.

Support for Startups and First-Time Entrepreneurs

- A new Fund of Funds with ₹10,000 crore will be established to expand support for startups.
- A scheme for 5 lakh first-time women, Scheduled Caste, and Scheduled Tribe entrepreneurs will provide term loans up to ₹2 crore over five years, incorporating lessons from the Stand-Up India scheme.

Focus on Labour-Intensive Sectors

- A Focus Product Scheme for the footwear and leather sector will support design, component manufacturing, and non-leather footwear production, expected to create 22 lakh jobs and generate a turnover of ₹4 lakh crore.
- A new scheme for the toy sector will promote cluster development and skill-building, positioning India as a global toy manufacturing hub.
- A National Institute of Food Technology, Entrepreneurship and Management will be established in Bihar to boost food processing industries in the eastern region.

Manufacturing and Clean Tech Initiatives

- A National Manufacturing Mission will provide policy support and roadmaps f or small, medium, and large industries under the Make in India initiative.
- Special emphasis will be given to clean tech manufacturing, fostering domestic production of solar PV cells, EV batteries, wind turbines, and high-voltage transmission equipment.

Budgetary outlay of Ministry of MSME

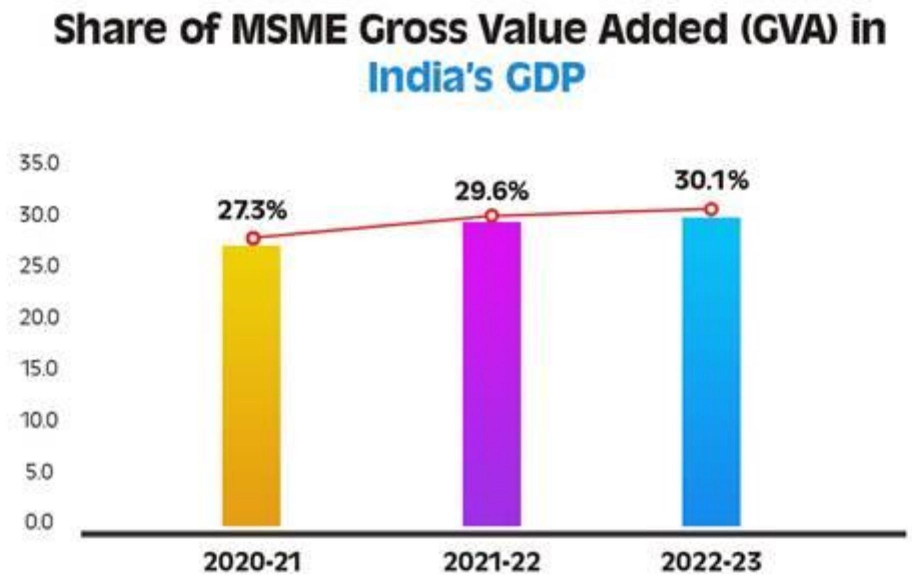
(In Rs. Crore)

Financial Year	Budget Estimates	Revised Estimates
2019-20	7,011.29	7,011.29
2020-21	7,572.20	5,664.22
2021-22	15,699.65	15,699.65
2022-23	21,422.00	23,628.73
2023-24	22,137.95	22,138.01

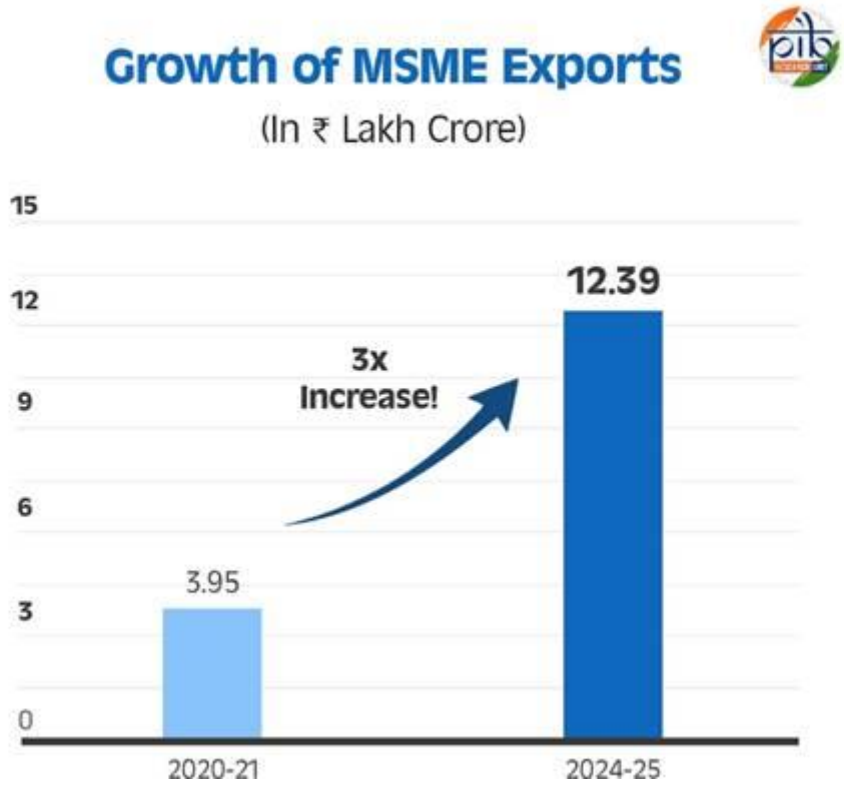
2024-25	**22,137.95**	**17,306.70**
2025-26	**23,168.15**	**-**

Current Landscape of MSMEs in India

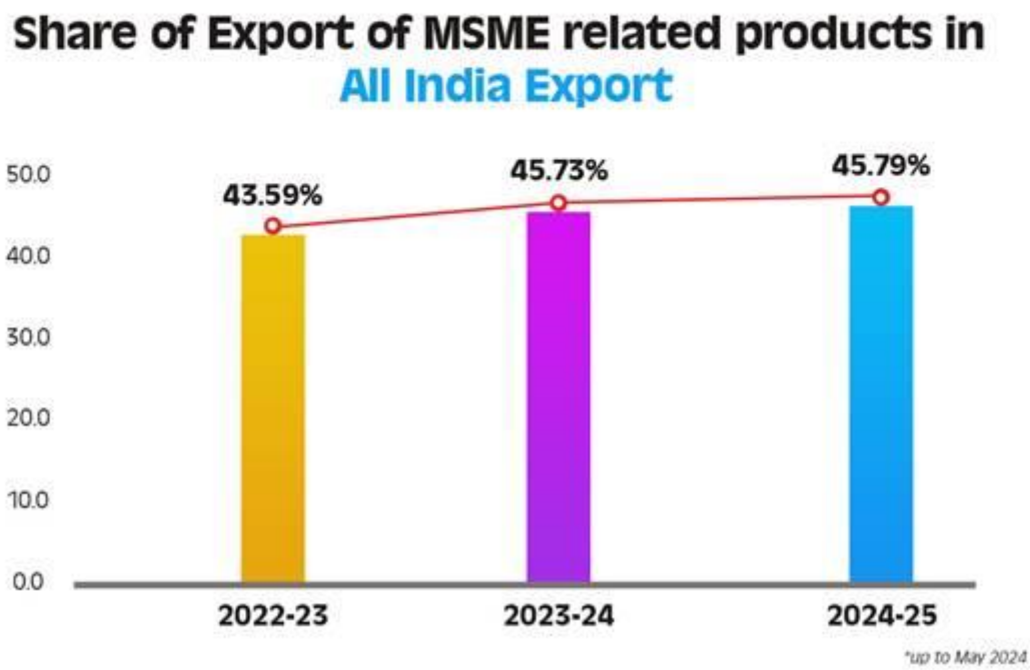
The MSME sector continues to be a cornerstone of India's economic growth, contributing significantly to employment, manufacturing, and exports. In recent years, the sector has displayed remarkable resilience, with its share in the country's Gross Value Added (GVA) increasing from **27.3% in 2020-21 to 29.6% in 2021-22 and 30.1% in 2022-23**, highlighting its growing role in national economic output.



Exports from MSMEs have seen substantial growth, rising from **₹3.95 lakh crore in 2020-21 to ₹12.39 lakh crore in 2024-25**. The number of exporting MSMEs has also surged, increasing from **52,849 in 2020-21 to 1,73,350 in 2024-25**.



Their contribution to India's total exports has steadily grown, reaching **43.59% in 2022-23, 45.73% in 2023-24, and 45.79% in 2024-25 (up to May 2024)**. These trends underscore the sector's increasing integration into global trade and its potential to drive India's position as a manufacturing and export hub.



GOVERNMENT INITIATIVES FOR MSMEs

The Government of India has implemented a robust array of initiatives aimed at bolstering the Micro, Small, and Medium Enterprises (MSME) sector, recognizing its pivotal role in the economy. These efforts range from financial support and procurement policies to capacity building and market integration. Key initiatives include the Udyam Registration Portal, PM Vishwakarma scheme, PMEGP, SFURTI, and the Public Procurement Policy for MSEs, all aimed at fostering entrepreneurship, enhancing employment, and integrating informal sectors into the formal economy. These initiatives reflect the government's commitment to supporting MSMEs and driving inclusive economic growth nationwide.

PM Vishwakarma

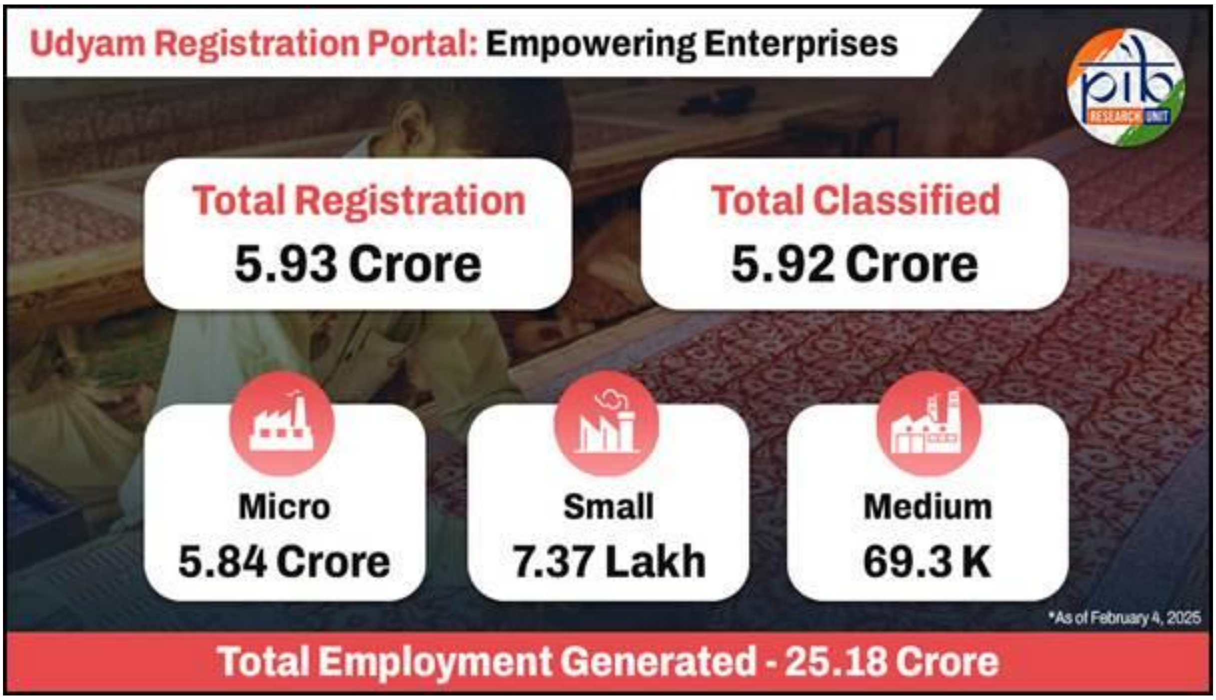
The 'PM Vishwakarma' scheme, launched by the Government of India, aims to enhance the quality and reach of products and services by artisans and craftspeople, integrating them into domestic and global value chains. Announced in the 2023-24 Budget and launched on September 17, 2023, this scheme seeks to provide comprehensive support to Vishwakarmas, improving their socio-economic status and quality of life.

PM Vishwakarma is fully funded by the Government of India with an initial outlay of Rs. 13,000 crores for 2023-24 to 2027-28.

Since its launch, the PM Vishwakarma scheme has achieved significant milestones, with over 2.65 crore applications submitted and 27.13 lakh applications successfully registered. Registered applicants will undergo a 5-day 'Basic Training' program, and those opting for credit support will receive collateral-free credit. These accomplishments highlight the scheme's early success in empowering artisans and craftspeople nationwide.

Udyam Registration Portal

Launched on July 1, 2020, the Udyam Registration Portal serves as a pivotal platform for facilitating the registration of enterprises across India. The portal encourages enterprises previously registered under the Udyog Aadhaar Memorandum and Entrepreneurship Memorandum-II to migrate to this new system. It offers a free, paperless, and self-declaration-based registration process, eliminating the need for document uploads, thus simplifying the formalization of businesses.



In a significant step towards integrating informal micro-enterprises into the formal economy, the Government introduced the Udyam Assist Platform on November 11, 2023. This initiative aims to bring these micro-enterprises under the formal sector, enabling them to access benefits such as Priority Sector Lending, which is essential for their growth and sustainability.

As of February 4, 2025, the Udyam Portal boasts an impressive total of 5,93,38,604 registered MSMEs, with the vast majority classified as micro-enterprises. Beyond their economic contributions, these MSMEs have generated substantial employment opportunities, providing jobs to over 25.18 crore individuals. This extensive employment generation underscores the sector's crucial role in driving economic development and enhancing social stability by offering livelihoods to millions across the country.

Prime Minister's Employment Generation Programme (PMEGP)

Prime Minister's Employment Generation Programme (PMEGP) is a credit linked subsidy scheme for providing employment opportunities through establishment of micro-enterprises in the non-farm sector. Under the Scheme, Margin Money (Subsidy) is provided to beneficiaries availing loan from banks for setting up new enterprises. The maximum project cost admissible for setting up of new project is Rs. 50 lakhs in manufacturing sector and Rs. 20 lakhs in Service Sector

Subsidies under PMEGP vary by category:

- Special Categories, including SC, ST, OBC, Minorities, Women, Ex-Servicemen, Transgenders, Differently-abled individuals, NER, Aspirational Districts, and Hill and Border areas, are eligible for a subsidy of 25% in urban areas and 35% in rural areas
- General Category applicants are eligible for a subsidy of 15% in urban areas and 25% in rural areas.

In a notable development, units in Aspirational Districts and Transgenders have been included in the Special Category. Additionally, geo-tagging of PMEGP units has been initiated to capture details of the products and services offered by these units and to create market linkages for them. Furthermore, prospective entrepreneurs receive free 2-day Entrepreneurship Development Programme (EDP) training to equip them with the necessary skills and knowledge to succeed.

In 2023-24, the Prime Minister's Employment Generation Programme (PMEGP) supported 89,118 enterprises, facilitating entrepreneurship across various sectors. The scheme disbursed ₹3,093.87 crore as margin money subsidy, enabling small businesses to scale operations and sustain growth. As a result, an estimated 7,12,944 employment opportunities were generated, reinforcing PMEGP's role in strengthening self-employment and job creation nationwide.

Scheme of Fund for Regeneration of Traditional Industries (SFURTI)

Launched in 2005-06, the Scheme of Fund for Regeneration of Traditional Industries (SFURTI) aims to organize traditional artisans into collectives or clusters, facilitating product development, diversification, and value addition. The scheme promotes traditional sectors and seeks to sustainably increase the income of artisans. SFURTI was revamped in 2014-15 to further enhance its impact and reach.

The primary objective of SFURTI is to organize artisans and traditional industries into clusters to improve competitiveness, create employment opportunities, and enhance the marketability of their products. By bringing artisans together, the scheme helps them leverage collective resources and skills, leading to better income prospects and sustained growth.

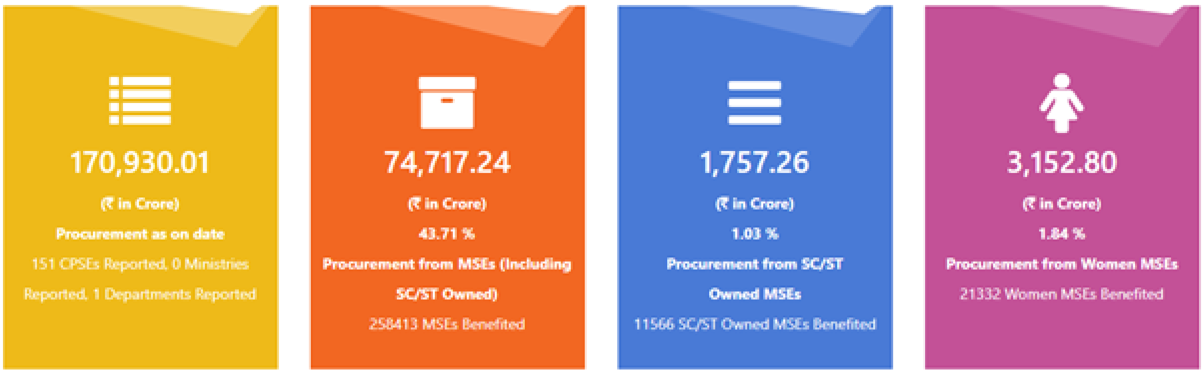
Achievements:

- Since 2014-15, SFURTI has approved the formation of 513 clusters and 376 clusters have successfully become functional.
- A total grant of ₹1,336 crore has been extended to support these clusters.

- Sustainable employment opportunities have been generated for around 2,20,800 artisans in 376 functional clusters (as on 12 Dec 2024).

Public Procurement Policy for Micro and Small Enterprises

The Ministry of MSME, Government of India, notified the Public Procurement Policy for Micro and Small Enterprises (MSEs) in 2012. This policy mandates that 25% of annual procurement by Central Ministries, Departments, and Central Public Sector Enterprises (CPSEs) must be sourced from MSEs. Within this 25%, 4% is reserved for MSEs owned by Scheduled Castes/Scheduled Tribes (SC/ST), and 3% is reserved for MSEs owned by women entrepreneurs. Additionally, 358 items are exclusively reserved for procurement from MSEs.



(Year: 2023-24)

Achievements:

- In 2023-24, Central Ministries, Departments, and CPSEs procured a total of ₹74,717 crore worth of goods and services from MSEs, which constituted 43.71% of their total procurement.
- This policy benefitted 2,58,413 MSEs, ensuring they had access to significant business opportunities and support through government procurement.

Conclusion:

In conclusion, the Union Budget 2025-26 outlines a strategic approach to bolster the MSME sector in India, emphasizing increased credit access, entrepreneurial support, and sector-specific initiatives. The significant revisions in classification criteria, coupled with enhanced credit guarantees and customised financial products like credit cards for micro-enterprises, are poised to catalyze growth and innovation. The focus on sectors like footwear, leather, and toys not only aims to boost employment but also positions India as a competitive player in global markets. Furthermore, the government's ongoing initiatives like Udyam Registration, PM Vishwakarma, PMEGP, SFURTI, and the Public Procurement Policy continue to demonstrate a committed effort towards integrating and empowering MSMEs. These measures, combined with the establishment of new institutions and missions for manufacturing and clean technology, reflect a holistic strategy to not only sustain but significantly amplify the role of MSMEs in driving economic growth, employment, and inclusive development in India.

CURRENT SCHEMES FOR MSME DEVELOPMENT

1. **A Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship (ASPIRE)**

   Objective:

   - To set up a network of Livelihood Business Incubators (LBIs), predominantly in the rural and underserved areas, to promote innovation and accelerate entrepreneurship for the following:
     - Generate employment opportunities by facilitating formal, scalable micro-enterprise creation in the agro-rural sector.
     - Skill, up-skill, re-skill unemployed, self-employed/ wage earners in new technologies in the agro-rural sector.
     - Provide skilled human capital to nearby industrial clusters and promote innovations for strengthening the competitiveness in the MSME sector.

   KeyBenefits:

   - Maximum of INR 1 crore. to Government agencies & INR 75 lakh to Private agencies for procuring plant and machinery.
   - Maximum of INR 1 crore. to Government and Private agencies as operational expenditure support towards manpower cost, running incubation and skill development programmers, etc.

2. **Assistance to Training Institutions (ATI) Scheme**

   Description:

- The assistance is provided to National level training institutions operating under the Ministry of MSME, namely, NI-MSME, KVIC, Coir Board, Tool Rooms, NSIC & MGIRI in the form of capital grant for the purpose of creation and strengthening of infrastructure and support for entrepreneurship development and skill development training programmes. Assistance is also provided to existing State level EDIs i.e. owned and controlled by a State Government/UT for creation or strengthening/ expansion of their training infrastructure

Nature of Assistance:

- Amount of assistance will not exceed the actual amount for strengthening/ expansion of the infrastructure required by the training institutions of this Ministry. Scale of maximum assistance to the State level EDIs will be restricted to Rs.3.00 crore in each case. Assistance for skill development programmes will be provided as per the prescribed rates.

How to apply:

- Organizations wishing to apply for assistance for creation or strengthening of infrastructure may send their applications to the Director/Deputy Secretary (EDI), Ministry of Micro, Small and Medium Enterprises, Udyog Bhawan, Rafi Marg, New Delhi – 110 011.

3. **Coir Vikas Yojana- Umbrella Scheme:**
   Objective:

- To enhance utilization of the raw material abundantly available in the country at economic levels of production. Coir Vikas Yojana (CVY) is an Umbrella Scheme being implemented by Coir Board for the Development of Coir Industry all over the country.
- To increase income/returns to workers, entrepreneurs, exporters and other stake-holders of the industry.

- Full utilization of the market potential of the products within the country and abroad and Industry related functional support services.
- Development of improved equipments machinery, processes and new products.
- Promoting large scale investment in Coir Industry. •Development of skilled manpower for Coir industry, empowerment of rural women and Employment Generation.
- Welfare measures for coir workers.
- To upgrade the coir industry through technological interventions and integration of various Digital Platforms.

4. **Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE)**

Availability of bank credit without the hassles of collaterals / third party guarantees would be a major source of support to the first generation entrepreneurs to realise their dream of setting up a unit of their own Micro and Small Enterprise (MSE). Keeping this objective in view, Ministry of Micro, Small & Medium Enterprises (MSME), Government of India launched Credit Guarantee Scheme (CGS) so as to strengthen credit delivery system and facilitate flow of credit to the MSE sector. To operationalise the scheme, Government of India and SIDBI set up the Credit Guarantee Fund Trust for Micro and Small Enterprises(CGTMSE).

CGTMSE has introduced a new "Hybrid Security" product allowing guarantee cover for the portion of credit facility not covered by collateral security. In the partial collateral security model, the MLIs will be allowed to obtain collateral security for a part of the credit facility, whereas the remaining part of the credit facility, up to a maximum of 200 lakh, can be covered under Credit Guarantee Scheme of CGTMSE. CGTMSE will, however, have pari-passu charge on the primary security as well as on the collateral security provided by the borrower for the credit facility.

The main objective is that the lender should give importance to project viability and secure the credit facility purely on the primary security of the assets financed. The other objective is that the lender availing guarantee facility should endeavor to give composite credit to the borrowers so that the borrowers obtain both term loan and working capital facilities from a single agency. The Credit Guarantee scheme (CGS) seeks to reassure the lender that, in the event of a MSE unit, which availed collateral free credit facilities, fails to discharge its liabilities to the lender, the Guarantee Trust would make good the loss incurred by the lender up to 50/75/80/85 per cent of the credit facility.

5. **Credit Guarantee Scheme for Subordinate Debt (CGSSD) for Stressed MSMEs**

   Objective:

   - Subordinate debt will provide a substantial help in sustaining and reviving the MSMEs which have either become NPA or are on the brink of becoming NPA.
   - Promoter(s) may infuse this amount in MSME unit as equity and thereby enhance the liquidity and maintain debt-equity ratio.
   - In a situation, where an outright loan is difficult, sub-debt with guarantee will provide the requisite financing to the MSME Units.

   Key Benefits:

   - Promoter(s) of the MSMEs are given credit equal to 50% of their stake (equity plus debt) or Rs. 75 lakh whichever is lower.

6. **Credit Linked Capital Subsidy Scheme for Technology Upgradation:**

   The objective of the Scheme is to facilitate technology up-gradation in MSEs by providing an upfront capital subsidy of 15 per cent (on institutional finance of upto Rs 1 crore availed by them) for induction of well-established and improved technology in the specified 51 sub-sectors/products approved. In other words the major objective is to upgrade their plant & machinery with state-of-the-art technology, with or without expansion and also for new MSEs which have set up their facilities with appropriate eligible and proven technology duly approved under scheme guidelines.

7. **Entrepreneurship and Skill Development Programme(ESDP) Scheme:**

   Objective:

   - To promote new enterprises, capacity building of existing MSMEs and inculcating entrepreneurial culture in the country.

Key benefits:

- Widen the base of entrepreneurship by development, achievement, motivation and entrepreneurial skill to the different sections of the society.

8. **International Cooperation (IC) Scheme:**

   Objective:

   The scheme aims to build Capacity of MSMEs for entering export market by facilitating their participation in international exhibitions/ fairs/conferences/ seminar/ buyer-seller meets abroad as well as providing them with actionable market-intelligence and reimbursement of various costs involved in export of goods and services. The Scheme provides opportunities to MSMEs to continuously update themselves to meet the challenges emerging out of changes in technology, changes in demand, emergence of new markets, etc.

9. **KHADI GRAMODYOG VIKAS YOJANA - Umbrella Scheme**

   Objective:

   - To increase productivity and wages of Khadi Artisans and secure livelihood
   - To improve Infrastructure for Khadi Production •Increased Khadi Production, Sales and Employment •Development of Village Industries and increase number of rural artisans
   - To revive the traditional and inherent skills of rural artisans
   - To renovate and Modernize Sales Outlets
   - To promote Marketing and Exports

10. **Micro & Small Enterprises Cluster Development Programme(MSE-CDP) Scheme**

    Objective:

    - To support the sustainability and growth of MSEs by addressing common issues such as improvement of technology, skills & amp; quality, market access, etc.

- To create/upgrade infrastructural facilities in the new/ existing Industrial Areas/Clusters of MSEs.
- To set up Common Facility Centres (for testing, training, raw material depot, effluent treatment, complementing production processes, etc).
- Promotion of green & sustainable manufacturing technology for the clusters.

Key Benefits:

- Creation of Common Facility Centers including Plug & Play Facilities.
- Support for Infrastructure Development Projects including Flatted Factory Complexes.

11. MSME Champions Scheme

Ministry of MSME has been implementing Credit Linked Capital Subsidy and Technology Upgradation Scheme (CLCS-TUS) for promoting competitiveness amongst Micro, Small and Medium Enterprises (MSMEs) by the way of wastage reduction through Lean Manufacturing, support for Design improvement, building awareness on Intellectual Property Rights, Zero Defect Zero Effect (ZED) Scheme, digitally empowerment of MSME through Digital MSME and to promote & support untapped creativity of individual and to promote adoption of latest technologies in manufacturing as well as knowledge based innovation MSMEs through Incubation across India.

MSME Champions scheme has been formulated through Standing Finance Committee (SFC) by merging all 6 components of erstwhile Technology Upgradation Scheme (TUS) for a period of 5 years i.e. 2021-22 to 2025-26. It is a Holistic Approach to unify, synergize and converge various schemes and Interventions with a single purpose. The end objective is to pick up clusters and enterprises and modernize their processes, reduce wastages, sharpen business competitiveness and facilitate their National and Global reach and excellence. There are 3 components under the new MSME Champions scheme, the details of which are as below:

- MSME-Sustainable (ZED)
- MSME-Innovative(for Incubation, IPR, Design)

- MSME-Competitive (Lean) Yet to be launched
  Digital MSME Yet to be launched
  (The Digital MSME will be interlinked with all the other components of the MSME Champions Scheme.)

12. **National SC-ST Hub Scheme**

    Objective:

    To provide professional support to Scheduled Caste and Scheduled Tribe Entrepreneurs to fulfill the obligations under the Central Government Public Procurement Policy for Micro and Small Enterprises Order 2012, adopt applicable business practices and leverage the Stand-Up India initiatives.

13. **Prime Minister Employment Generation Programme (PMEGP)**

The scheme is implemented by Khadi and Village Industries Commission (KVIC) as the nodal agency at the national level. At the state level, the scheme is implemented through State KVIC Directorates, State Khadi and Village Industries Boards (KVIBs) and District Industries Centres (DICs) and banks. The Government subsidy under the scheme is routed by KVIC through the identified banks for eventual distribution to the beneficiaries/entrepreneurs into their bank accounts.

14. **Procurement and Marketing Support (PMS) Scheme**

Objective:

The scheme aims to promote new market access initiatives like organizing / participation in National / International Trade Fairs / Exhibitions / MSME Expo, etc. held across the country and to create awareness and educate the MSMEs about the importance / methods/ process of packaging in marketing, latest packaging technology, import-export policy and procedure, GeM portal, MSME Conclave, latest developments in international / national trade and other subjects / topics relevant for market access developments.

15. **Promotion of MSMEs in - NER & Sikkim**

Objective:

- The scheme envisaged for providing financial support mainly for augmenting Infrastructure development for enhancing the productivity, sustainability, competitiveness and growth by addressing common issues such as improvement of technology, skills & quality, market access etc. of Micro, Small and Medium Enterprises (MSMEs).

- Creation of common facilities to supplement manufacturing, testing, packaging, R&D, product and process innovations and training for natural resources such as fruits, spices, agri, forestry, sericulture and bamboo etc. available in NER and Sikkim.
- Development of tourism sector in NER and Sikkim by creation of common services such as kitchen, bakery, laundry & dry cleaning, refrigeration and cold storage, IT infra, potable water, display center for local products, center for cultural activities etc. in a cluster of home stays
- To create/ upgrade infrastructural facilities in the new/existing Industrial Areas for MSMEs.

Key Benefits:

- Common facilities for MSMEs to develop new products & processes including toolings.
- Developed infrastructure for entrepreneurs for establishing new units or expanding their units.
- Support for creation of common infrastructures to boost tourism in NER & Sikkim.

16. Raising and Accelerating MSME Performance (RAMP)

About the scheme:

- RAMP is a World Bank supported Central Sector Scheme aimed at improving access of MSMEs to market, finance and technology upgradation by enhancing the outreach of existing MoMSME schemes. The programme also aims at strengthening institutions at the Central and State level, and enhancing Centre- State collaboration

Objective:

- Accelerating Centre- State collaboration in MSME promotion and development
- Enhancing effectiveness of existing MoMSME schemes for technology upgradation

- Strengthening Receivable Financing Market for MSMEs Enhancing effectiveness of Credit Guarantee Trust for Micro & Small Enterprises (CGTMSE), and promoting guarantee for greening initiatives of MSEs, and women owned MSEs
- Reducing incidence of delayed payments to MSEs

Key Benefits:

- RAMP scheme would enhance the performance of MSMEs by promoting technology upgradation, innovation, digitization, market access, credit, greening initiatives, etc through active participation of the State Governments.

17. **Scheme of Fund for Regeneration of Traditional Industries (SFURTI)**

Objective:

- To organize traditional industries and artisans into collectives by increasing production and value addition to make products competitive
- To promote traditional sectors and increase income of artisans providing sustainable employment.

Key Benefits:

- GoI support:
- Upto Rs. 2.5 cr. for upto 500 artisans
- Rs. 5 cr for more than 500 artisans.
- A production facility is set up with latest machineries
- Raw material support
- Soft Interventions – upto Rs. 25 lakhs
- Skill Development
- Exposure Visits
- Buyer Seller Meets
- Marketing connect, e-commerce
- Design support

18. **SELF RELIANT INDIA (SRI) FUND Empowering MSMEs for Aatmanirbhar Bharat**

About the scheme:

- India has embarked upon the path of self reliant economic growth for achieving its aspiration of becoming an economic superpower. Towards this end, one of the initiatives taken by the Government of India is the launch of the Self Reliant India (SRI) Fund.
- The Fund structure is designed in a manner that it will leverage the strength of the private sector in providing growth capital to viable MSMEs having a definite growth plan.

Fund Objective:

The Fund aims to provide capital support to the Daughter Funds for onward provision to MSMEs as growth capital, through equity, quasi-equity and debt to achieve the following:

- Supporting faster growth of MSME businesses, thereby igniting the economy & creating several employment opportunities.
- Supporting enterprises which have the potential to graduate beyond the MSME bracket and become National/International champions.
- Supporting MSMEs which will help make India self-reliant by producing relevant technologies, goods and services.

19. Tool Rooms and Technical Institutions - A Component of Infrastructure Development & Capacity Building

Objective:

- Tool Room & Technical Institutions are concentrated on an integrated Development of the relevant sector of industries to help MSME. Total 18 MSME Tool Rooms & Technical institutions established PAN India serving in the relevant sector like General Engineering, foundry & forging, electronics, fragrance, glass, sports good and footwear etc.

Key Benefits:

- Improves access of MSMEs to tooling facilities for enhancement of their efficiency and providing industry ready manpower by conducting training programme.
- Process and Product development in relevant sector.
- Consultancy and job works in relevant sector.

PROBLEMS FACED BY MSME SECTOR

1. **Problem of Finance:**
   Scarcity of finance and credit is the main obstacle in the development of small scale units. The artisans and craftsmen have little capital. They take credit from money lenders who charge a very high exploitative rate of interest. Due to their weak creditworthiness and poor economic base, they find it difficult to take loans from the commercial banks. Also, it is partly due to scarcity of capital in the country as a whole. Besides, SSIs are also unable to generate resources as they lack knowledge to communicate their work to the capital markets. Due to poor financial image, small entrepreneurs fail to get credit facility at reasonable costs.
2. **Problem of Raw Materials:**
   SSIs are facing the problem of short supply of raw materials. They cannot use the services of middlemen to get raw materials due to their weak financial position. In some areas there is an absolute scarcity of raw materials or it has a poor quality and high cost. For instance, the handloom industry depends on the condition that the weavers will sell the cloth only to them when it is ready. Thus, the weavers are subjected to double exploitation. Thus, small units fail to use their full production capacity. It also increases their production cost which adversely affects their competitive strength in the market.
3. **Inadequate infrastructure:**
   In a survey of 1063 small units, Keshar Das and Morris found that 716 units faced significant infrastructural problems. SSTs are being constrained by inadequate physical facilities like electricity, water, roads, transportation, communication, banks and other basic services particularly in backward areas. This results in underutilisation of capacity and wastages.
4. **Outdated Technology:**
   Most of the small units depend upon old techniques of production. They use outdated machinery and equipment. Many are using second-hand tools and machines. Due to limited capital,. They find it difficult to modernise their workshop and machinery. Thus, the quality of their products and productivity tend to be low and cost of production per unit remains high.
5. **Problem of Under-utilised capacity:**

Many studies have made it clear that there is the gross under-utilisation of installed capacity in small scale industries. After looking at findings of various surveys, it can be inferred that on an average 50 to 40% of capacity is not utilised in small scale units.

6. **Problem of Power and Water:**
   Related to the under-utilisation of capacity are power and water problems faced by small scale units. Power supply is not always available in rural areas. Besides, small entrepreneurs cannot afford to go in for power alternatives. Water supply is also not regular in villages. This affects their productivity adversely.
7. **Unskilled labour:**
   Labour has an active part in small scale units. But, workers lack training facilities in small scale sector. Most of the workers are unskilled, inefficient, untrained and having low level of education. Hence, they fail to cope up with the challenges of modern production system. Professionals and trained technicians also do not join small scale units. Due to this constraint of labour force, SSIs face difficulty in improving their productivity.
8. **Unsuitable location:**
   Selection of proper location of workshops and plant is also a major problem before the SS1s. The choice of location depends on various factors like availability of infrastructural facility, cost of location, availability of skilled labour , markets and raw materials. But, small entrepreneurs are governed by different considerations such as cheap land, their traditional work place, family business, measures of local markets, sentimental attachment to their traditional ancestral property or business-place etc. Thus, small entrepreneurs are not properly skilled in deciding about suitable location.
9. **Problems of Marketing:**
   One of the problems faced by SS1s is in the field of marketing. These units do not have any 'marketing organisation'. They lack transport, storage and warehousing facilities. They do not have sale organisation. They do not make use of advertising and publicity methods. Therefore, these units suffer from a competitive disadvantage vis-a-vis large scale units. These, units also lack 'bargaining skill' and 'staying capacity' in the market. Thus, they are forced to sell their products at very low prices. To save small scale units from competition with large scale units, the government has reserved certain items for the small scale sector.

10. **Poor Project Planning:**
    Due to the low level of education and experience, small entrepreneurs often depend upon consultants and hired experts for project formulation. They do not fully understand project details. Thus, poor planning of projects increase the cost and expenses. Due to dependence on others, project and programmes tend to over-run which leads to further difficulties.
11. **Problem for Ancillary Units:**
    Ancillary units face the problems of their own types. One of these problems relate to delayed payments. Small entrepreneurs go through financial hardships on account of delayed payments by large firms and government departments. The other problems include-inadequacy of technological support by parent units, non-adherence to quality and delivery schedules. SSIs lack bargaining power in dictating their terms for their products. It, frequently happens that buyers do not pay their dues to SSIs for more than 12 months. Thus, it creates working capital problems before the SSIs.

CLUSTERS IN MSME

In terms of employment generation, exports, and contributions to gross domestic product, **Micro, Small and Medium Enterprises (MSMEs)** are the backbone of the Indian economy. With the abundant potential of MSMEs and also the specialisation of issues faced by the sector, the government has come up with specific initiatives to promote and help them. One of the schemes is the Micro and Small Enterprises Cluster Development Programme (MSE-CDP).

The **MSME Cluster Development Scheme** is the flagship scheme of the Ministry of MSME that encourages the collective growth of micro and small enterprises so that productivity, competitiveness, and capacity are enhanced further, entirely based on the cluster-based development approach.

An overview of the MSME Cluster Development Scheme:

The Micro and Small Enterprises - Cluster Development Programme (MSE-CDP) is being implemented nationwide, by the Ministry of MSME. Through financial assistance such as a grant from the Government of India (GoI) for the establishment of Common Facility Centers (CFCs) in existing clusters and the establishment of new or upgraded Industrial Areas, Estates, or Flatted Factory Complexes, the scheme aims to increase the productivity and competitiveness of Micro and Small Enterprises (MSEs) for their holistic development using a cluster approach.

What Is a Cluster?

According to Ministry of MSMEs, "A cluster is a group of enterprises located within an identifiable and as far as practicable, contiguous area or a value chain that goes beyond a geographical area and producing same/similar products/complementary products/services, which can be linked together by common physical infrastructure facilities that help address their common challenges."

The ministry has further defined the characteristics of a cluster too. Here are the characteristics of a cluster.

- Units in the cluster must use similar of complimentary production methods, quality checks and testing. They should have similar energy consumption and pollution control methods.
- Units in the cluster should have similar kinds of technology in use and similar marketing practices for their products.
- Units should have common markets and skill requirements.
- Units should have similar market challenges and opportunities.

This creates an environment that enables cooperation among stakeholders, competitiveness, and the sharing of resources on a low-cost basis.

Objectives Under the MSME Cluster Development Scheme:

- **Support Growth and Sustainability:** Here, the MSME sector faces many common challenges such as outdated technology, skill gaps, weak market access, limited availability of capital, etc.
- **Build Collective Capacity:** The scheme encourages the formation of self-help groups, consortia, and trade associations so that collective action and knowledge can be shared among the MSMEs.
- **Upgrade Infrastructure:** It assists in the development and improvement of infrastructure in new or existing industrial clusters to make them better comparable and investment-ready.
- **Establish Common Facility Centers (CFCs):** CFCs provide shared access to critical resources like testing laboratories, training sessions, and machinery.

- **Promote Green Technology:** The scheme promotes environment-friendly or sustainable manufacturing practices in MSME clusters.

ROLE OF CLUSTERS IN PROMOTING MSME

Cluster Development Programs (CDPs) play a vital role in promoting Micro, Small, and Medium Enterprises (MSMEs) by fostering growth, enhancing competitiveness, and creating a conducive ecosystem for their development. These programs focus on improving productivity, innovation, and market access for MSMEs within geographically concentrated areas.

- **Economic Growth and Employment:**
  CDPs stimulate economic growth by supporting the expansion of MSMEs, leading to increased production, sales, and job creation within the cluster and the surrounding region.
- **Enhanced Competitiveness:**
  By addressing common challenges like technology adoption, skill development, and access to markets, CDPs help MSMEs become more competitive in both domestic and international markets.
- **Improved Productivity and Innovation:**
  CDPs facilitate the adoption of modern technologies, best practices, and improved production processes, leading to increased productivity and innovation within the cluster.
- **Skill Development and Training:**
  These programs offer targeted training and skill development initiatives to enhance the capabilities of the workforce, enabling MSMEs to meet the demands of a changing market.
- **Infrastructure Development:**
  CDPs support the development of common infrastructure facilities like testing centers, training centers, and effluent treatment plants, which are crucial for the efficient functioning of MSMEs.
- **Access to Finance and Marketing Support:**
  CDPs provide access to financial resources and marketing assistance, enabling MSMEs to overcome barriers to growth and expand their market reach.
- **Sustainability and Green Practices:**

By promoting the adoption of green technologies and sustainable manufacturing practices, CDPs contribute to the environmental sustainability of MSMEs and their clusters.

- **Strengthened Collaboration and Networking:**
  CDPs foster collaboration and networking among MSMEs, leading to increased bargaining power, knowledge sharing, and economies of scale.

Examples of Initiatives:

- **Micro & Small Enterprises Cluster Development Programme (MSE-CDP):**
  The Ministry of MSME supports the sustainability and growth of MSEs by addressing common issues like technology, skills, quality, and market access.
- **SFURTI (Scheme of Fund for Regeneration of Traditional Industries):**
  SFURTI aims to develop and upgrade the competitiveness of traditional industries and artisans.
- **SIDBI Cluster Development Fund:**
  SIDBI (Small Industries Development Bank Of India) provides support for diagnostics, skilling, technology, marketing, and credit facilitation for MSME clusters.

UNIT-IV

BALANCE OF PAYMENTS

INTERNATIONAL TRADE

Meaning of International Trade:

International trade is referred to as the exchange or trade of goods and services between different nations. This kind of trade contributes and increases the world economy. The most commonly traded commodities are television sets, clothes, machinery, capital goods, food, raw material, etc.

International trade has exceptionally increased, which includes services such as foreign transportation, travel and tourism, banking, warehousing, communication, distribution, and advertising. Other equally important developments are the increase in foreign investments and production of foreign goods and services in an international country.

These foreign investments and productions help companies to come closer to their international customers, thus serving them with goods and services at a very low rate.

All the mentioned activities are parts of international business. It can be concluded by saying that international trade and production are two aspects of international business, which is growing day by day across the globe.

Reasons for International Trade:

1. **Production**
   - ✓ It is not possible for every single country to produce equally at a cheap cost.
   - ✓ That is why international trade is taken into account.
2. **Factors of production**
   - ✓ Factors of production include labour, capital, and raw material for producing goods and services that are available at different rates in different countries.
3. **Cost of production**
   - ✓ Each country finds it advantageous to produce only those goods and services that can be produced efficiently.
   - ✓ The rest of the activities are assigned to other countries at a lower cost.
4. **Resource distribution**
   - ✓ Many times, companies face problems due to the limitation of natural resources.
   - ✓ There is an unequal distribution of the resources in the country.
   - ✓ **Examples:** Different countries are specialised in different sectors like in India, Maharashtra is involved in textiles, West Bengal in jute products, Haryana and Punjab in food products, Kerala in spices, etc. Same is categorised for other countries.

Importance of International Trade:

International trade between various nations is an essential factor that is responsible for the increase in the standard of living, creating employment, and empowering consumers to enjoy different kinds of goods. Few other important factors that are influenced by international trade are:

1. **Utilisation of raw materials:** Some countries are naturally blessed with an abundance of raw materials, like Qatar is for oil, Iceland for metals and fish, etc. Without international trade, these countries would never benefit from their natural resources or raw materials.
2. **Greater choice for consumers:** More international trade results in more choices of products.
3. **Specialisation and economies of scale – greater efficiency:** This means that it does not matter what a country is specialised in, and the essential thing is to pursue a specialisation that allows companies to make a profit that outweighs most of the other factors.

4. **Global growth and economic development:** International trade influences the economic growth of a country. This increase also leads to the reduction of poverty levels.

Scope of International Business

1. **Exports and Imports**
   - ✓ They include merchandise (tangible or having physical existence) of goods.
   - ✓ Export merchandise means sending goods to other nations.
   - ✓ Import merchandise means receiving goods from other nations.
   - ✓ They include the trade of services.
2. **Service trade**
   - ✓ It is also known as invisible trade.
   - ✓ It includes the trade of services (intangible or no physical existence).
   - ✓ There is both export and import of services.
   - ✓ It includes services like tourism, hotel, transportation, training, research, etc.
3. **Licensing and Franchising**
   - ✓ Under this, permission is given to the organisations of other countries.
   - ✓ It includes selling the product of a particular company.
   - ✓ Under its trademark, patents are given in return of some fees. *Example: Pepsi and Coca Cola are produced and sold through different sellers abroad.*
   - ✓ Franchising is similar to licensing, but franchising is associated with services. *Example:* Dominos, Burger King, etc.
4. **Foreign investment**

   It includes the investment of available funds in foreign companies to get returns. It can be of two types:

   i. **Direct investment** means investing funds in plant and machinery for marketing and production, also known as a foreign direct investment (FDI). Sometimes, these investments are done jointly and are known as joint ventures.

   ii. **Portfolio investment** means one company invests in another company by way of investing in its securities and earning income in the form of interests and dividends.

Advantages of International Business

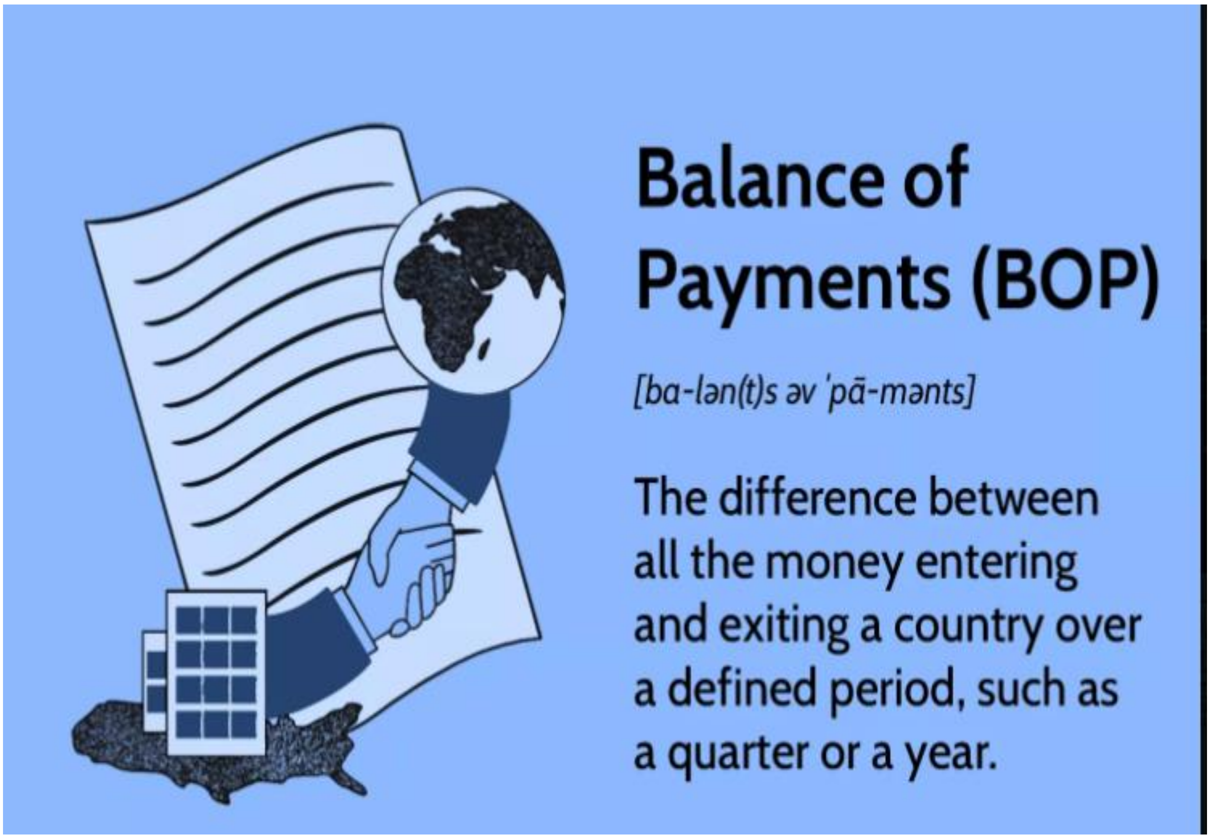
1. **Income**
   - ✓ It helps in earning foreign exchange to the organisations.
   - ✓ Forex helps in paying off the cost of imports of capital goods, technologies, fertilisers, etc., from abroad.
2. **Efficient resources**
   - ✓ Under international trade, countries produce what they can produce efficiently and leave the other activities to nations in which they can work efficiently.
   - ✓ This helps different nations to distribute the activities and work efficiently in their areas.
3. **Growth and employment potentials**
   - ✓ International trade helps in faster growth of organisations as well as countries.
   - ✓ Sometimes, organisations are not able to create employment in the market as they produce on a small scale.
   - ✓ Initially, countries like China, Japan, and South Korea took the whole world as a single market for trade.
   - ✓ This helped them in employment generation across the world.
4. **Standard of living**
   - ✓ People in one country are able to enjoy goods and services of other nations.
   - ✓ This helps them in improving the standard of living.

Difference between Domestic and International Trade

Parameters	Domestic trade	International trade
Nationality of buyers and sellers	Under this, people of one nation work in their respective domestic market.	Under this, people from different nations work in the international market.
Nationality of other stakeholders	Stakeholders like suppliers, producers, employees, middlemen, etc., are of the same nation.	Stakeholders like suppliers, producers, employees, middlemen, etc., are of different nations.

Mobility of factors of production	Factors of production like capital and labour are mobile across one nation.	Factors of production like capital and labour are mobile across the different nations.
Heterogeneous customers	Usually, customers are homogeneous in the domestic market.	Customers are not homogeneous in the international market due to different religion, caste, language, etc.
Risks	Under this, a nation is subjected to the political risks within the nation.	This may be a barrier to international trade as different nations have different political risks.
Policies	It is subjected to different policies and regulations, and laws of a single nation.	It is subjected to different policies and regulations, and laws of multiple nations.
Currency	Only one currency is involved.	There is involvement of more than one currency.

BALANCE OF PAYMENTS



Meaning of Balance of Payments (BOP)?

The Balance of Payments (BOP), also known as the balance of international payments, provides a complete overview of all transactions between entities inside a country and the rest of the world within a certain period. This can be a quarter or a year.

It outlines the various interactions within a nation, encompassing exchanges between people, businesses, and governments. Additionally, it encompasses the interactions involving individuals, businesses, and governments beyond

The balance of payment for a nation indicates whether the country has more financial inflows or outflows. It reflects whether the country's exports surpass its imports or vice versa.

The balance of payments (BOP) is the method countries use to monitor all international monetary transactions in a specific period. The BOP is usually calculated every quarter and every calendar year.

All trades conducted by both the private and public sectors are accounted for in the BOP to determine how much money is going in and out of a country. If a country has received money, this is known as a credit, and if a country has paid or given money, the transaction is counted as a debit.

Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance, but in practice, this is rarely the case. Thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming.

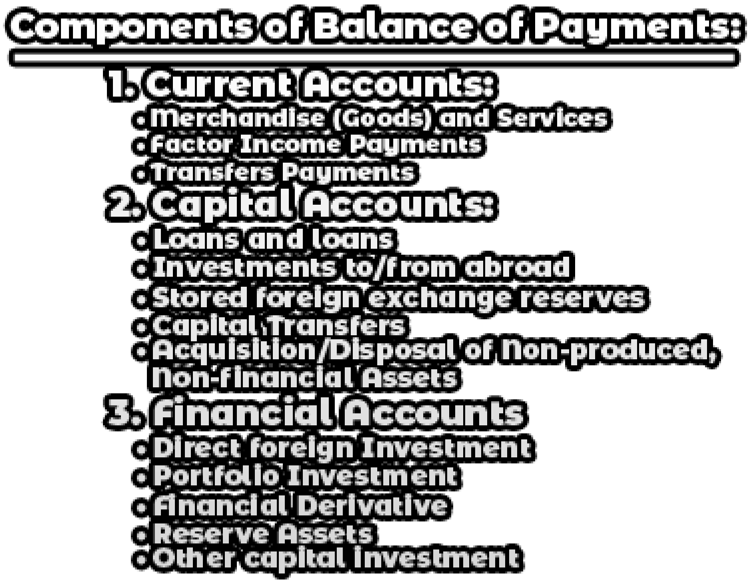
Key Takeaways

- The balance of payments (BOP) is the record of all international financial transactions made by the residents of a country.
- There are three main categories of the BOP: the current account, the capital account, and the financial account.
- The current account is used to mark the inflow and outflow of goods and services into a country.
- The capital account is where all international capital transfers are recorded.
- In the financial account, international monetary flows related to investment in business, real estate, bonds, and stocks are documented.

What Is the Balance of Payment?

- Balance of Payments is a detailed account of a country’s economic transactions with the whole world during a specific period like a year or quarter. It acts as an accounting ledger, recording all money flowing into and out of a country. This balance of payments is key to a country’s economic health and its relationship with the world.
- In simpler terms, think of a Balance of Payments as a nation's financial report card. It tells us whether a country is earning more from its international dealings than it's spending or vice versa.

COMPONENTS OF BALANCE OF PAYMENTS



The BOP is divided into three primary components, each offering insights into different aspects of a country's economic transactions on the global stage:

1. **Current Account:**
   The Current Account is like a ledger of a country's day-to-day economic activities with the rest of the world. It encompasses several key elements:
   Trade in Goods records the value of physical products (like machinery, automobiles, and agricultural goods) that a country exports to and imports from other nations.
   Trade in Services: This includes exchanging intangible services, such as tourism, consulting, and financial services, between a country and its international partners.
   Transfers: The Current Account also accounts for unilateral transfers of money or assets between countries, including remittances sent by individuals working abroad and foreign aid and grants.
2. **Capital Account:**
   The Capital Account focuses on long-term financial transactions, such as investments and loans, that a country engages in with foreign entities. It involves:
   Foreign Direct Investment (FDI): This reflects investment made by individuals, organizations, or governments from one nation into assets or enterprises in another, typically with the purpose of exerting considerable influence or control.

Portfolio Investment: This consists of the buying and selling of financial assets like stocks and bonds issued by foreign firms, demonstrating the extent of international investment in a country's financial markets.

Loans and Borrowings: The Capital Account also records loans extended to and borrowed from other countries, shedding light on a nation's debt obligations and financing sources.

3. **Financial Account:**

The Financial Account is concerned with international financial asset transactions. It helps track a country's holdings of assets abroad and foreign holdings within its borders. It involves:

Foreign Exchange Reserves: This element accounts for a country's accumulation or depletion of foreign currency reserves, which play a critical role in controlling exchange rates and guaranteeing economic stability.

Financial Derivatives: The Financial Account contains financial contracts, such as options and futures, that derive their value from underlying assets and may be utilized for hedging or speculative reasons.

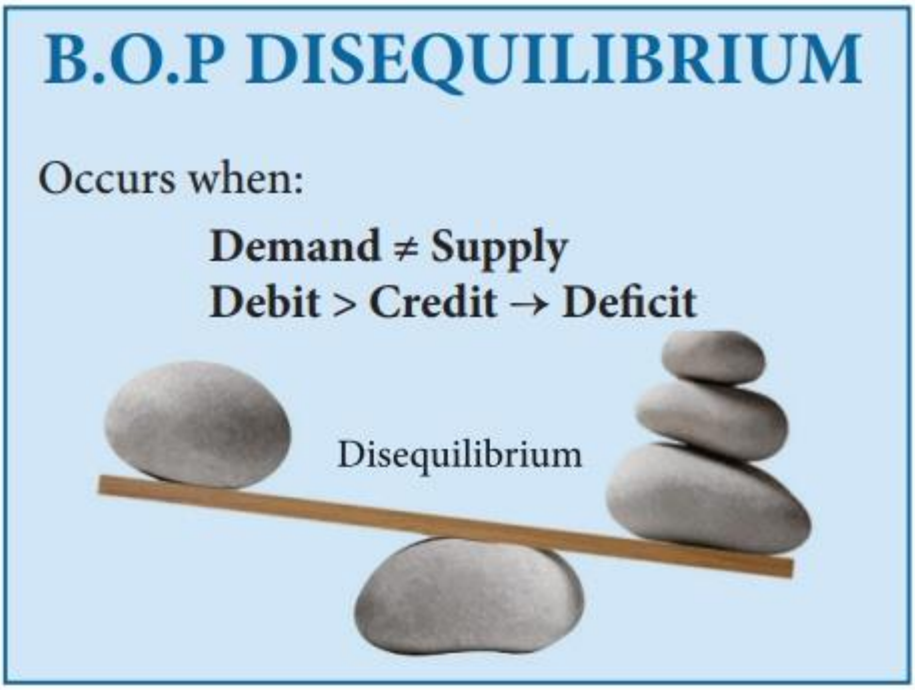
Other Investment: This category comprises numerous financial transactions, such as trade credits, loans, and deposits, demonstrating the short-term financial exchanges between a nation and the rest of the world.

IMPORTANCE OF BALANCE OF PAYMENT

- **Economic Health:** BOP helps gauge a country's financial health, identifying trends that could impact its economic stability.
- **Trade Policy:** It informs trade policies and strategies, helping governments make informed decisions.
- **Currency Stability:** BOP data aids in managing exchange rates and ensuring currency stability.
- **Investment Insights:** It provides insights into a nation's attractiveness for foreign investment.
- **Domestic Industry:** BOP can reveal how imports affect domestic industries and employment.
- **Foreign Aid:** It tracks foreign aid and grants, assisting in managing international assistance programs.

- **Global Competitiveness:** BOP data can indicate a nation's competitiveness in the global market.
- **Risk Assessment:** It helps assess a country's exposure to financial risks and vulnerabilities.
- **Monetary Policies:** Central banks use BOP information to formulate effective monetary policies.
- **Economic Planning:** BOP supports long-term economic planning and development strategies.

DIS EQUILIBRIUM IN BALANCE OF PAYMENT



Equilibrium and Disequilibrium in BOP

Equilibrium in the Balance of Payments (BOP) occurs when the inflow of money into a country matches the outflow. Disequilibrium arises when there is an imbalance, with either more money leaving or entering than the country is earning or spending.

Equilibrium in the Balance of Payments

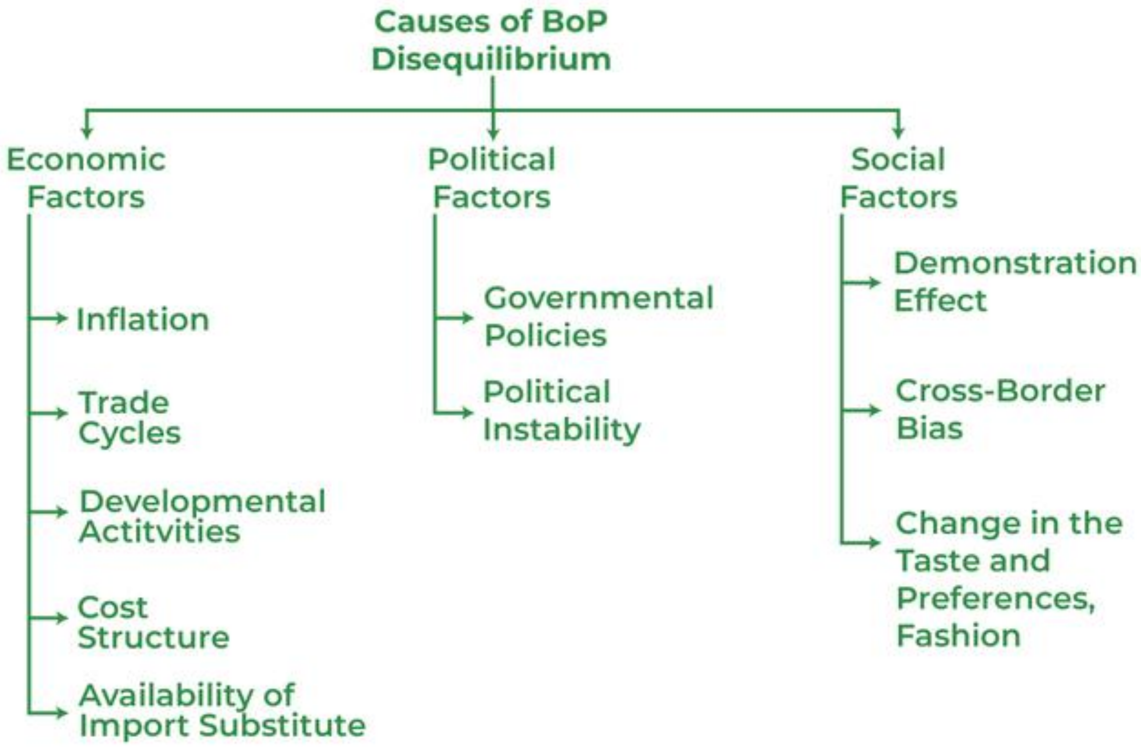
The term equilibrium in the Balance of Payments means that the entry of coins is equal to those emerging from a country. This balance signals that a country is, at least, trading and spending in a stable manner. When there is equilibrium, the economy is balanced. The exports and imports are in harmony, and no major changes occur in the economy. This enables the government to make better choices. There is strength in the country's call, that is, the economy is performed well. The limitations should be that the country can go on with continuous smooth growth. This stable growth gives enough room for planning for the future. This balance of trade keeps the economy stable. Equilibrium in BOP shows stable development.

Disequilibrium in the Balance of Payments

Disequilibrium in the Balance of Payments occurs when there is no equality between the entry and exit of money. This can arise if a country spends more on imports than it earns from exports. On the contrary, when it is disequilibrium, it can cause problems for the economy. The deficit shows that the country spends more than it receives. The surplus shows that the country earns more than it spends. Disequilibrium can lead to financial problems such as debts or inflation. It may alter the economy and put pressure on businesses and jobs in the country. **Disequilibrium** serves as a good warning for the economy when there is a need to pay more attention to crisis management.

- If we add the current account and the capital account excluding the central bank's reserve account imbalances (Disequilibrium) is possible, for example, more imports than exports (and hence demand of foreign currency exceeds its supply) or vice–versa.
- This deficit or surplus needs to be counterbalanced from the Foreign Reserve of the country in order to make net zero Balance of Payments.
- Hence, a Balance of Payments (excluding forex) surplus (or deficit) is accompanied by an accumulation (or de-accumulation) of foreign exchange reserves.
- A disequilibrium in the balance of payment means its condition of Surplus Or deficit.
- A Surplus in the BOP occurs when Total Receipts exceeds Total Payments. Thus, BOP= CREDIT>DEBIT.
- A Deficit in the BOP occurs when Total Payments exceeds Total Receipts. Thus, BOP= CREDIT<DEBIT

REASONS FOR DIS EQUILIBRIUM IN BALANCE OF PAYMENT



1. **Economic Factors:**
    - Imbalance between exports and imports.
    - Large scale development expenditure which causes large imports,
    - High domestic prices which lead to imports,
    - Cyclical fluctuations (like recession or depression) in general business activity,
    - New sources of supply and new substitutes.
2. **Political Factors:**
    - The political instability and disturbances cause large capital outflows and hinder Inflows of foreign capital.
3. **Social Factors:**
    - Changes in fashions, tastes and preferences of the people bring disequilibrium in BOP by influencing imports and exports
    - High population growth in poor countries adversely affects their BOP because it increases the needs of the countries for imports and decreases their capacity to export.

MEASURES TO BRING BACK EQUILIBRIUM IN BOP

1. **Monetary Measures:**

   - **Monetary Policy** The monetary policy is concerned with money supply and credit in the economy. The Central Bank may expand or contract the money supply in the economy through appropriate measures which will affect the prices.
   - **Fiscal Policy** Fiscal policy is government's policy on income and expenditure. Government incurs development and non - development expenditure, It gets income through taxation and non - tax sources. Depending upon the situation governments expenditure may be increased or decreased.
   - **Exchange Rate Depreciation** By reducing the value of the domestic currency, government can correct the disequilibrium in the BOP in the economy. Exchange rate depreciation reduces the value of home currency in relation to foreign currency. As a result, import becomes costlier and export become cheaper. It also leads to inflationary trends in the country
   - **Devaluation** devaluation is lowering the exchange value of the official currency. When a country devalues its currency, exports becomes cheaper and imports become expensive which causes a reduction in the BOP deficit.
   - **Deflation** Deflation is the reduction in the quantity of money to reduce prices and incomes. In the domestic market, when the currency is deflated, there is a decrease in the income of the people. This puts curb on consumption and government can increase exports and earn more foreign exchange.
   - **Exchange Control** All exporters are directed by the monetary authority to surrender their foreign exchange earnings, and the total available foreign exchange is rationed among the licensed importers. The license-holder can import any good but amount if fixed by monetary authority.

2. Non- Monetary measures:

- **Export Promotion** To control export promotions the country may adopt measures to stimulate exports like: export duties may be reduced to boost exports, cash assistance, subsidies can be given to exporters to increase exports ;goods meant for exports can be exempted from all types of taxes.

- **Import Substitutes** Steps may be taken to encourage the production of import substitutes. This will save foreign exchange in the short run by replacing the use of imports by these import substitutes
- **Import Control** Import may be kept in check through the adoption of a wide variety of measures like quotas and tariffs. Under the quota system, the government fixes the maximum quantity of goods and services that can be imported during a particular time period.
    - ✓ **Quotas –** Under the quota system, the government may fix and permit the maximum quantity or value of a commodity to be imported during a given period. By restricting imports through the quota system, the deficit is reduced and the balance of payments position is improved.
    - ✓ **Tariffs –** Tariffs are duties (taxes) imposed on imports. When tariffs are imposed, the prices of imports would increase to the extent of tariff. The increased prices will reduced the demand for imported goods and at the same time induce domestic producers to produce more of import substitute

<u>TYPES OF DISEQUILIBRIUM OF BALANCE OF PAYMENTS (BOP)</u>

1. **Temporary Disequilibrium**
    - Temporary disequilibrium in the form of deficits or surpluses tend to last for a short period of time.
    - They are the result of temporary changes in the economy like – crop failure, seasonal fluctuations, effect of weather on agricultural production, etc.
    - Such a disequilibrium may occur once a while and gets automatically corrected. It does not pose a serious problem for a country.

2. **Fundamental Disequilibrium**
    - There is no precise definition of the term fundamental disequilibrium. Economists generally define fundamental disequilibrium as – “a deep rooted persistent deficit or surplus in the BOP of a country.”
    - It is a chronic BOP deficit, according to IMF. It is of long term nature and a matter of serious concern for the country.
3. **Cyclical Disequilibrium**

- Cyclical fluctuations in the business activity also lead to Balance of Payments disequilibrium.
- Cyclical disequilibrium occurs because of the following reasons:
    - Trade cycles follow different paths and patterns in different countries.
    - Different countries follow different stabilization programmes.
    - Difference in the price and income elasticity of demands for imports.

4. **Structural Disequilibrium**
    - Structural disequilibrium occurs due to structural changes in the economy.
    - Some of the structural changes would include changes in technology, changes in tastes and preferences, changes in long term capital movements, etc.

SURPLUSES AND DEFICITS IN THE BALANCE OF PAYMENTS

A country's Balance of Payments (BOP) can result in either a surplus or a deficit:

BOP Surplus

- **Definition:** A BOP surplus occurs when a country's exports, income from investments, and capital inflows exceed its imports, debt repayments, and capital outflows.
- **Implications:** A surplus generally indicates a strong economic position, with potential benefits such as increased foreign exchange reserves, currency appreciation, and increased investor confidence.

BOP Deficit

- **Definition:** A BOP deficit arises when a country's imports, debt repayments, and capital outflows exceed its exports, income from investments, and capital inflows.
- **Implications:** A deficit can signal economic challenges, including potential currency depreciation, depletion of foreign exchange reserves, and increased reliance on foreign borrowing.

It's essential to note that both surpluses and deficits can have positive or negative consequences depending on the underlying factors and the country's economic situation.

TRADE REGULATION

Meaning of Trade Regulation:

Trade regulation refers to laws, rules, and policies formulated by the government or international bodies to control and promote fair practices in domestic and international trade.

Objectives of Trade Regulation:

- To ensure fair competition among businesses.
- To protect consumers from fraud or unfair trade practices.
- To promote exports and regulate imports.
- To encourage domestic industries through protective policies.
- To maintain economic stability and protect national interests.

Types of Trade Regulation:

1. **Domestic Trade Regulations:**
   - Govern trade within the country.
   - Include licensing, taxation, price controls, consumer protection, etc.
2. **International Trade Regulations:**
   - Regulate trade between countries.
   - Include import/export duties, trade agreements, tariffs, quotas, etc.

Key Trade Regulatory Authorities in India:

1. **Directorate General of Foreign Trade (DGFT)** – formulates foreign trade policy.
2. **Competition Commission of India (CCI)** – ensures fair competition.
3. **Bureau of Indian Standards (BIS)** – regulates product quality standards.
4. **Ministry of Commerce and Industry** – oversees trade and industrial development.

Major Trade Regulatory Instruments:

Instrument	Description
Tariffs	Taxes on imported goods to protect local industries.
Quotas	Limits on the quantity of goods that can be imported/exported.
Subsidies	Financial aid to domestic producers to enhance competitiveness.

Anti-dumping duties	Taxes on foreign goods sold below fair market value.
Import Licensing	Permission needed to import specific goods.
Export Promotion Schemes	Incentives for companies to export goods.

International Trade Regulations:

Institution	**Role**
WTO (World Trade Organization)	Promotes free trade, resolves disputes, sets global trade rules.
IMF (International Monetary Fund)	Assists with global financial stability and trade balance.
UNCTAD (United Nations Conference on Trade and Development)	Helps developing countries access trade opportunities.

India's Foreign Trade Policy (FTP):

- Managed by DGFT under Ministry of Commerce.
- Promotes Make in India, Ease of Doing Business, export promotion.
- Includes SEZs (Special Economic Zones), Duty Drawback Schemes, etc.

Importance of Trade Regulation:

- Protects domestic businesses and employment.
- Ensures consumer safety and quality.
- Maintains trade balance and foreign exchange.
- Controls illegal or unethical business practices.
- Facilitates smooth international trade relationships.

Challenges in Trade Regulation:

- Balancing free trade with protectionism.
- Trade wars and geopolitical tensions.
- Compliance with international norms.
- Digital trade and evolving technologies.

EXCHANGE CONTROL

What is Exchange Control?

Exchange control refers to the regulatory measures imposed by a government to manage and control the movement of foreign currency within its borders. It is a set of rules and policies designed to ensure stability in the foreign exchange market and safeguard a nation's economic interests.

This regulatory framework ensures stability in the foreign exchange market, controls inflation and protects a nation's economic interests. In simpler terms, exchange control involves monitoring and regulating foreign currency buying and selling, aiming to maintain a balanced and stable economic environment.

Governments may employ various methods to enact exchange control, such as fixed exchange rates, capital controls, and trade restrictions. Fixed exchange rates peg a nation's currency to another, fostering stability in international transactions. Capital controls restrict the movement of funds across borders, mitigating risks associated with excessive capital flight or speculative activities. Trade restrictions, on the other hand, involve regulating imports and exports to sustain a balanced payment system.

Understanding Exchange Control

Exchange control involves monitoring and regulating the buying and selling of foreign currencies, restricting the flow of capital across borders. Governments implement these controls to stabilise their currency, manage inflation, and safeguard their foreign exchange reserves.

This financial regulatory mechanism refers to the measures adopted by governments to monitor and manage the movement of foreign currency within their jurisdictions. The primary goal is fostering economic stability, controlling inflation, and safeguarding national financial interests.

Understanding exchange control is crucial for businesses and individuals in international trade and finance. This comprehension empowers them to navigate the intricacies of foreign exchange regulations, ensuring compliance and facilitating seamless financial transactions in an increasingly interconnected global economy.

Methods of Exchange Control

Various methods are employed to implement exchange control, including fixed exchange rates, capital controls, and trade restrictions.

1. **Fixed exchange rates**: Under this method, a country pegs its currency to another, ensuring a stable and predictable exchange rate. This approach provides businesses and individuals with a sense of certainty when engaging in international transactions, reducing currency-related risks
2. **Capital controls**: Capital controls involve regulations that restrict the movement of funds across borders, preventing excessive capital flight or speculative activities. These measures are implemented to maintain economic stability, manage inflation, and safeguard a nation's financial interests.
3. **Trade restrictions**: Exchange control can be exerted through trade restrictions, which involve regulating imports and exports to achieve a balance of payments. Governments may impose tariffs, quotas, or other barriers to control the outflow and inflow of goods and services.
4. **Foreign Exchange Reserves Management:** Central banks may indirectly use interest rate policies to influence exchange rates. By adjusting interest rates, governments can attract or discourage foreign capital, impacting the demand for their currency in the foreign exchange market.

Objective of Exchange Control

- The primary objective of exchange control is to uphold economic stability and safeguard a nation's financial well-being. This regulatory mechanism is implemented by governments to manage the movement of foreign currency within borders, aiming to achieve a delicate balance in economic factors. By meticulously overseeing the buying and selling of foreign currencies, exchange control contributes to controlling inflation rates, stabilising interest rates, and ensuring the availability of foreign exchange reserves.
- Exchange control acts as a safeguard, protecting these nations from potential economic volatility and external threats. By monitoring the flow of foreign currency, authorities can prevent excessive fluctuations in exchange rates and maintain a competitive trade environment. Additionally, exchange control plays a crucial role in supporting economic growth, fostering a climate conducive to international trade, and attracting foreign investment.
- Ultimately, the objective of exchange control is rooted in the broader goals of economic prosperity and financial security. It serves as a strategic tool that empowers

governments to navigate the complexities of the global financial landscape, ensuring resilience and sustainability for the benefit of businesses and individual

CONVERTIBILITY OF CURRENCY

Currency Convertibility is a vital aspect of a nation's economic framework, determining the ease with which its currency can be exchanged for foreign currencies. This mechanism plays a crucial role in international trade, investment, and economic stability.

What is Currency Convertibility?

- **Currency convertibility** means that a country's currency can be freely exchanged for foreign currency at an exchange rate, which is determined by the market forces i.e. demand for and supply of the currency.
- **For example**, convertibility of Rupee means that those having foreign currency (e.g. US dollars, Pound Sterling etc.) can get them converted into rupees and vice-versa at the market determined rate of exchange.

Advantages of Currency Convertibility:

1. Encouragement to exports:

An important advantage of currency convertibility is that it encourages exports by increasing their profitability. With convertibility profitability of exports increases because market foreign exchange rate is higher than the previous officially fixed exchange rate. This implies that from given exports, exporters can get more rupees against foreign exchange (e.g. US dollars) earned from exports. Currency convertibility especially encourages those exports which have low import-intensity.

2. Encouragement to import substitution:

Since free or market determined exchange rate is higher than the previous officially fixed exchange rate, imports become more expensive after convertibility of a currency. This discourages imports and gives boost to import substitution.

3. Incentive to send remittances from abroad:

Thirdly, rupee convertibility provided greater incentives to send remittances of foreign exchange by Indian workers living abroad and by NRI. further, it makes illegal remittance such 'hawala money' and smuggling of gold less attractive.

4. A self – balancing mechanism:

Another important merit of currency convertibility lies in its self-balancing mechanism. When balance of payments is in deficit due to over-valued exchange rate, under currency convertibility, the currency of the country depreciates which gives boost to exports by lowering their prices on the one hand and discourages imports by raising their prices on the other.

In this way, deficit in balance of payments get automatically corrected without intervention by the Government or its Central bank. The opposite happens when balance of payments is in surplus due to the under-valued exchange rate.

5. Specialisation in accordance with comparative advantage:

Another merit of currency convertibility ensures production pattern of different trading countries in accordance with their comparative advantage and resource endowment. It is only when there is currency convertibility that market exchange rate truly reflects the purchasing powers of their currencies which is based on the prices and costs of goods found in different countries.

Since prices in competitive environment reflect that prices of those goods are lower in which the country has a comparative advantage, this will encourages exports. On the other hand, a country will tend to import those goods in the production of which it has a comparative disadvantage. Thus, currency convertibility ensures specialisation and international trade on the basis of comparative advantage from which all countries derive benefit.

6. Integration of World Economy:

Finally, currency convertibility gives boost to the integration of the world economy. As under currency convertibility there is easy access to foreign exchange, it greatly helps the growth of trade and capital flows between the countries. The expansion in trade and capital flows between countries will ensure rapid economic growth in the economies of the world. In fact, currency convertibility is said to be a prerequisite for the success of globalisation.

COMPONENTS OF CURRENCY CONVERTIBILITY

It has two components**:**

1. **Current Account Convertibility**
2. **Capital Account Convertibility**

CURRENT ACCOUNT CONVERTIBILITY

Current Account Convertibility refers to the degree of freedom to convert your rupees into other internationally accepted currencies and vice versa without any restrictions whenever payments are made.

Current Account Convertibility in India

- ❖ In India, Current Account is today fully convertible since August 19, 1994.
  - Prior to this date, India had partial Current Account Convertibility.

- Accordingly, several provisions like remittances for service, education, basic travel, gift remittances, donation, and provisions of the Exchange Earners' Foreign Currency Account (EEFCA) were relaxed.
- It means that the full amount of foreign exchange required for current purposes will be available at the official exchange rate, allowing for an unrestricted outflow of foreign exchange.
- India was required to comply with Article VIII of the IMF, which puts prohibition on any exchange restrictions on current international transactions.
- Notwithstanding the above, the government still retains many controls on current account, such as:
  - Repatriation of export proceeds within six months;
  - Caps on the amounts spent on the purchase of services abroad;
  - Restrictions on the repatriation of interest on rupee debt;
  - Dividend-balancing for FDI in some consumer goods industries;
  - Restrictions on the repatriation of interest on NRI deposits;
  - The rupee is not allowed to be officially used as international means of payment. Indian banks are not permitted to offer two – way quotes to NRIs or-non-resident banks.

Note: With the help of these controls, the governments can significantly alter the flow of foreign exchange and the exchange rate of rupee. Additionally, the RBI can influence the exchange rate through direct purchase and sale of foreign exchange in the market.

Capital Account Convertibility

CAPITAL ACCOUNT CONVERTIBILITY (CAC)

- **Capital Account Convertibility (CAC)** refers to the degree of freedom to convert foreign financial assets into domestic financial assets and vice versa at market-determined exchange rate.
- Thus, it allows anyone to move freely from local currency into foreign currency and back.
- Capital Account Convertibility is usually introduced after a certain period of introducing the Current Account Convertibility.

- The most important effect of introducing the convertibility in capital account is that it encourages the inflow of the foreign capital, because under certain conditions, the foreign investors are enabled to repatriate their investments, wherever they want.
- But the risk is that it may accelerate the flight of the capital from the country if things are unfavourable.
- **For example,** an Indian can sell property here and take the Capital outside. India, at present, has partial convertibility in capital account.

Capital Account Convertibility in India

- Following the recommendations of the S.S. Tarapore Committee on Capital Account Convertibility (1997), India has been progressing towards full convertibility in this account, while taking necessary precautions.
- India still maintains partial convertibility (40:60) in the capital account.
    - However, within this policy framework, significant reforms have been implemented, and for certain levels of foreign exchange requirements, the economy allows full convertibility in capital account.

Steps taken for Capital Account Convertibility in India

- Indian corporates are allowed full capital account convertibility for upto $ 500 million overseas ventures through automatic route.
- Indian corporates are allowed to prepay their External Commercial Borrowings (ECBs) of amount above $ 500 millions via automatic route.
- Individuals are allowed to invest in foreign shares, and other assets up to $ 2,50,000 per annum.
- Unlimited amount of gold is allowed to be imported (this is equal to allowing full convertibility in the capital account via current account route, but not feasible for everybody) which is not allowed now.
- The priority has been to liberalise inflows relative to outflows, but all outflows associated with inflows have been made completely free of restrictions.
- Among the type of inflows, FDI is preferred for its stability, while short-term external debt is avoided.
- A differentiation is made between individuals, banks and corporates.

Advantages of Capital Account Convertibility

- Improved access to international financial markets, thus leading to availability of large funds.
- Reduction in cost of capital.
- Incentivises Indians to acquire and hold international securities and assets.
- Greater financial competitiveness.
- Will help Indian corporations to use External commercial borrowing routes without RBI or Govt approval.
- Indian residents can hold and transact foreign currency-denominated deposits with Indian banks.
- Allowing access to the global financial market for certain class of financial institutions.
- Financial institutions such as banks can trade in Gold globally and issue loans.

Disadvantages of Capital Account Convertibility

- Market determined exchange rates are usually higher than the officially fixed exchange rates. Thus, it can raise import prices and cause Cost-push inflation.
- Improper management of convertibility in Capital Account can cause currency depreciation and hence affect trade and capital flows.
- The advantages have been found to be short lived as per studies.
- Post-2008 crisis, the international financial institutions are skeptical about CAC.
- Speculative activities can lead to capital flight from the country. For example, the case of South East Asian economies during 1997-98.
- Imposing controls would become challenging in a globalized environment once convertibility in Capital Account is introduced.

Capital Account Convertibility Vs Current Account Convertibility

Though Current Account Convertibility and Capital Account Convertibility both are components of Currency Convertibility, there are some differences between the two as depicted below:

	Capital Account Convertibility	Current Account Convertibility
Definition	Capital Account Convertibility implies freedom of currency conversion related to capital inflows and outflows.	Current Account Convertibility means freedom to convert domestic currency into foreign currency and vice-versa to execute trade in goods and visible.
Features	Provides right to firms and residents to freely buy oversees assets such as equity, bonds, properties, ownership of oversees firms besides free repatriation of proceeds by foreign investors	It allows residents to make and receive trade-related payments - any foreign currency for export and import of goods and services, make sundry remittances, access foreign currency for travel, study abroad, medical treatment and gifts, etc.
Nature	Complex	Relatively Easy
State in India	Full Capital Account Convertibility still not permitted.	Full Current Account Convertibility.
Benefits	• Availability of a larger capital stock at international prices to supplement domestic resources. • Increases the confidence of Foreign Investors. • Incentivizes to acquire and hold international assets and securities. • Improved access to international financial market. • Reduction in cost of capital.	• Facilitates and promotes international trade. • Helps in integrating the world economy • Ensures that production pattern of different trading countries are in accordance with their comparative advantage and resource endowment.

Conclusion

Currency Convertibility, encompassing both current and capital account aspects, is crucial for integrating a country's economy with the global financial system. While current account convertibility has been fully achieved in India, capital account convertibility remains a work in progress, balancing the benefits of increased financial access with the risks of economic instability. By carefully managing these components, countries can optimise their economic interactions on the international stage, fostering growth, competitiveness, and resilience in an interconnected world.

UNIT-V

INTERNATIONAL BUSINESS ENVIRONMENT

INTERNATIONAL ECONOMIC INSTITUTIONS

Meaning

International Economic Institutions are global or regional organizations established by countries to promote international economic stability, growth, trade, and development. They support cooperation in finance, trade, investment, and development policies.

Objectives

- Promote global economic stability
- Encourage international trade and investment
- Assist in economic development of poor and developing nations
- Provide financial support during crises
- Ensure cooperation between countries on monetary and fiscal matters

Importance

- Reduces economic disparities among nations
- Solves balance of payments crises
- Encourages economic reforms and development projects
- Promotes sustainable development goals (SDGs)
- Helps in dispute settlement related to trade and finance

Major International Economic Institutions & Their Functions

1. **International Monetary Fund (IMF)**

- Established: 1945
- Headquarters: Washington, D.C., USA
- Functions:
    - Maintain global monetary cooperation
    - Provide short-term loans to countries with balance of payment issues
    - Monitor global economic and financial trends
    - Offer technical assistance and policy advice

2. **World Bank Group**

- Established: 1944
- Main Organizations: IBRD, IDA, IFC, MIGA, ICSID
- Functions:

    - Fund long-term infrastructure and development projects
    - Provide low-interest loans, grants, and technical expertise
    - Focus on poverty reduction, education, health, etc.

3. **World Trade Organization (WTO)**
    - Established: 1995 (Replaced GATT)
    - Headquarters: Geneva, Switzerland
    - Functions:
        - Facilitate global trade negotiations
        - Set and enforce rules for international trade
        - Settle trade disputes among nations
        - Monitor trade policies
4. **United Nations Conference on Trade and Development (UNCTAD)**
    - Established: 1964
    - Functions:
        - Promote development-friendly trade, investment, and technology
        - Help developing countries integrate into the global economy
        - Conduct research and policy analysis
5. **Asian Development Bank (ADB)**
    - Established: 1966
    - Headquarters: Manila, Philippines
    - Functions:
        - Provide loans, grants, and technical assistance to Asian countries
        - Support infrastructure development, poverty reduction, and economic growth
6. **New Development Bank (NDB)**
    - Established: 2015 by BRICS nations (Brazil, Russia, India, China, South Africa)
    - Headquarters: Shanghai, China
    - Functions:
        - Finance infrastructure and sustainable development projects
        - Offer an alternative to IMF and World Bank for BRICS countries
7. **OECD (Organisation for Economic Co-operation and Development)**
    - Established: 1961
    - Functions:
        - Promote economic growth, financial stability, and trade liberalization

- o Conduct research and develop policy recommendations

Comparison Table

Institution	Founded	Focus Area	Key Role
IMF	1945	Finance	Monetary cooperation, short-term loans
World Bank	1944	Development	Long-term development projects
WTO	1995	Trade	Trade rules and dispute resolution
UNCTAD	1964	Trade & Dev	Policy support to developing nations
ADB	1966	Regional Dev	Aid to Asian countries
NDB	2015	Emerging Econ	BRICS infrastructure support

Conclusion

International Economic Institutions are crucial for global financial stability, trade regulation, and development financing. They help in reducing global poverty, solving economic crises, and building partnerships for a better economic future.

INTERNATIONAL MONETARY FUND (IMF)

The International Monetary Fund (IMF) is a key institution in the global financial system. It plays a vital role in stabilising international monetary affairs and facilitating global economic growth.

What is International Monetary Fund (IMF)?

- The International Monetary Fund (IMF) is an international organisation of 189 countries, which works to secure financial stability, foster global monetary cooperation, facilitate international trade, promote sustainable growth and high employment, and reduce poverty across the world.
- The International Monetary Fund (IMF) is an **organization of 190-member countries**, each of which has representation on the IMF's executive board in proportion to its financial importance, so that the most powerful countries in the global economy have the most voting power.
- International Monetary Fund formally came into existence on 27 December 1945.
- It is one of the Bretton Woods Institutions.

What are Bretton Woods Institutions?

- The Bretton Woods institutions were established in 1944 at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire.
- After the Second World War, delegates from 43 countries met to help rebuild the shattered post-war economy and promote international economic cooperation, create a

new international monetary system to ensure a foreign exchange rate system, prevent competitive devaluations, and promote economic growth.

- One of the major outcomes of the Bretton Woods Agreement was the creation of the institutions like International Monetary Fund (IMF) and the World Bank (with its first group institution IBRD).
- International Monetary Fund and World Bank, together, are popularly called as Bretton Woods Institutions or Bretton Woods Twins.
- John Maynard Keynes was one of the founding fathers of the two institutes.

Objectives of International Monetary Fund:

- To foster global monetary cooperation,
- To secure financial stability,
- To facilitate international trade,
- To promote high employment and sustainable economic growth, and
- To reduce poverty around the world.
- Macro-economic growth
- Policy advise & financing for developing countries,
- Promotion of exchange rate stability, and an international payment system

Functions of International Monetary Fund

- **Provides Financial Assistance:** To provide **financial assistance to member countries** with balance of payments problems, the IMF lends money to replenish international reserves, stabilize currencies and strengthen conditions for economic growth. Countries must embark on structural adjustment policies monitored by the IMF.
- **IMF Surveillance:** It oversees the international monetary system and monitors the economic and financial policies of its 190-member countries.
  - As part of this process, which takes place both at the global level and in individual countries, the IMF **highlights possible risks to stability** and advises on needed policy adjustments.
- **Capacity Development:** It provides technical assistance and training to central banks, finance ministries, tax authorities, and other economic institutions.
  - This helps countries raise public revenues, modernize banking systems, develop strong legal frameworks, improve governance, and enhance the

reporting of macroeconomic and financial data. It also helps countries to make progress towards the **Sustainable Development Goals (SDGs)**.

What Does the IMF Do?

It has three critical missions:

- Furthering international monetary cooperation, encouraging the expansion of trade and economic growth,
- Discouraging policies that would harm prosperity.
- To fulfill these missions, IMF member countries work collaboratively with each other and with other international bodies.

History of IMF

- The IMF, also known as the Fund, was conceived at a **UN conference in Bretton Woods,** New Hampshire, United States, in July **1944.**
- The 44 countries at that conference sought to build a framework for economic cooperation to avoid a repetition of the competitive devaluations that had contributed to the Great Depression of the 1930s.
- **Countries were not eligible for membership** in the International Bank for Reconstruction and Development (IBRD) **unless they were members of the IMF**.
- IMF, as per **Bretton Woods agreement** to encourage international financial cooperation, introduced a system of convertible currencies at fixed exchange rates, and replaced gold with the U.S. dollar (gold at $35 per ounce) for official reserve.
  - After the **Bretton Woods system** (system of fixed exchange rates) **collapsed in the 1971,** the IMF has promoted the **system of floating exchange rates**. Countries are free to choose their exchange arrangement, meaning that market forces determine the value of currencies relative to one another. **This system continues to be in place today.**
- During **1973 oil crisis,** IMF estimated that the foreign debts of 100 oil-importing developing countries increased by 150% between 1973 and 1977, complicated further by a worldwide shift to floating exchange rates. IMF administered a new lending program during 1974–1976 called the **Oil Facility**. Funded by oil-exporting nations and other lenders, it was available to nations suffering from acute problems with their balance of trade due to the rise in oil prices.
- IMF was one of the key organisations of the international economic system; its design **allowed the system to balance the rebuilding of international capitalism** with

the maximisation of national economic sovereignty and human welfare, also known as **embedded liberalism**.

- The IMF played a central role in helping the countries of the former Soviet bloc transition from central planning to market-driven economies.
- **In 1997,** a wave of **financial crises swept over East Asia,** from Thailand to Indonesia to Korea and beyond.
    - The International Monetary Fund created **a series of bailouts (rescue packages)** for the most-affected economies to enable them to avoid default, tying the packages to currency, banking and financial system reforms.
- **Global Economic Crisis (2008)**: IMF undertook major initiatives to strengthen surveillance to respond to a more globalized and interconnected world.
    - These initiatives included revamping the legal framework for surveillance to cover spill-overs (when economic policies in one country can affect others), deepening analysis of risks and financial systems, stepping up assessments of members' external positions, and responding more promptly to concerns of the members.

Governance Structure of IMF

- The International Monetary Fund is governed by and accountable to 189-member countries.
- Various components of its Governance Structure are explained in the sections that follow.

1. **Board of Governors**

- The Board of Governors (BOGs) is the topmost decision-making body of the organization.
- It consists of one governor along with one alternate governor from each member country.
- The governor is appointed by the member country, who is usually the Minister of Finance or the Governor of the Central Bank.
- The Union Finance Minister is the ex-officio Governor of India in the IMF and the RBI Governor is the alternative governor.
- All powers of the International Monetary Fund are vested in the Board of Governors, which performs the following functions:
    - Approval of quota increases;
    - Special drawing right allocations;

  - The admittance of new members;
  - Compulsory withdrawal of members etc.
  - Amendments to the agreements a by-laws of the MOUs signed among nations.
- The Board of Governors normally meets once a year.
- Unlike the General Assembly of the United Nations, where each country has one vote, decision-making at the IMF has been designed in a way so as to reflect the relative positions of its member countries in the global economy.

2. **Ministerial Committees**

The Board of Governors is advised by two Ministerial Committees:

- International Monetary and Financial Committee (IMFC)
- Development Committee

International Monetary and Financial Committee (IMFC)

- The International Monetary and Financial Committee comprises 24 members selected from the 190 governors, and represent all member countries.
- It discusses and deliberates on the management of the international monetary and financial system.
- It also discusses proposals by the Executive Board to amend the Articles of Agreement.
- It can also discuss any other matters of common concern affecting the global economy.

Development Committee

- It is a joint committee, consisting of 25 members from the Board of Governors of the International Monetary Fund & World Bank.
- It main task is to advise the Boards of Governors of the International Monetary Fund and the World Bank on the issues related to economic development in developing countries and emerging markets.
- It serves as a forum for building inter-governmental consensus on critical development issues.

3. **Executive Board**

- The Executive Board of the International Monetary Fund comprises of 24 Executive Directors.
- The Executive Directors represent all the 189 member countries through a geographically based roster.

4. **Managing Director**

- The International Monetary Fund has a Managing Director (MD), who serves as the head of the staff and Chairperson of the Executive Board.
- The Managing Director (MD) is appointed by the Executive Board for a renewable five-years term.
- The employees of the organization come from across the world.
    - They are responsible to the IMF, not to the authorities of their home countries.

IMF Quota System

- The IMF's quota system was created to raise funds for providing loans.
- Each member country is assigned a quota (i.e. contribution) that reflects the country's relative size in the global economy.
- Higher quota is directly related to high voting rights and greater borrowing permissions.
- Quota defines the amount of assistance a country will get out of the contingency fund of the International Monetary Fund, as well as the power of a country to influence the lending decisions and tap into the funds themselves.
- Quotas are denominated in Special Drawing Rights (SDRs) – the IMF's unit of account.

How IMF Quota is Determined?

- Upon joining the International Monetary Fund, each member country contributes a specified amount of money, known as a quota subscription.
- The quota subscription of a member country is determined according to the Quota Formula, which is based on the country's economic performance and wealth.
- It is a weighted average of:
    - GDP (weight of 50 percent),
    - Openness (30 percent),
    - Economic variability (15 percent),
    - International reserves (5 percent).

Note: The GDP of a member country is measured through a blend of GDP based on market exchange rates (weight of 60 per cent) and GDP based on PPP exchange rates (40 per cent).

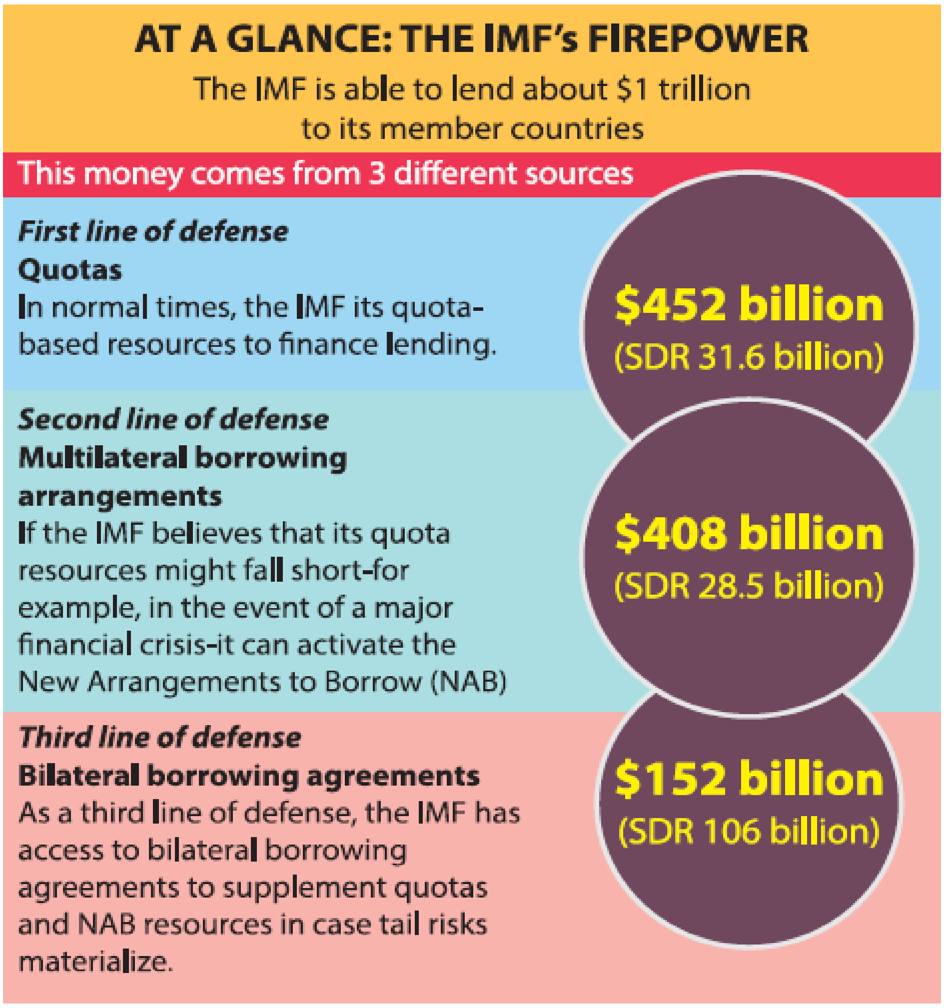
Significance of IMF's Quota

A member's quota plays several key roles w.r.t. the relationship between the International Monetary Fund and the concerned member, as described below.

- **Subscriptions:** The quota subscription of a member determines the maximum amount of financial resources that the member is obliged to pay to the organization.

- A member must pay its full subscription upon joining the International Monetary Fund.
- Up to 25 per cent of the quota must be paid in SDRs or foreign currencies acceptable to the organization, such as US Dollar, Japanese Yen, Euro, or British Pound Sterling, while the rest can be paid in the member's domestic currency.

- **Voting Power:** Each member's votes are comprised of basic votes plus one additional vote for every SDR 100,000 quota.
- **Access to Financing:** The amount of financing a member can obtain from the IMF (its access limit) is based on its quota.
  - Under Stand-By and Extended Arrangements, a member country can borrow up to 145 per cent of its quota annually, and 435 per cent cumulatively.



IMF and India: What is the Scenario?

- India is a **founder member** of the IMF.
- International regulation by IMF in the field of money has certainly contributed towards expansion of international trade. India has, to that extent, benefitted from these fruitful results.
- **Post-partition period,** India had serious balance of payments deficits, particularly with the dollar and other hard currency countries. It was the IMF that came to her rescue.
- The Fund granted India loans to meet the financial difficulties arising out of the Indo–Pak conflict of 1965 and 1971.
- From the inception of IMF up to March 31, 1971, India purchased foreign currencies of the value of Rs. 817.5 crores from the IMF, and the same have been fully repaid.
- Since 1970, the assistance that India, as other member countries of the IMF, can obtain from it has been increased through the setting up of the **Special Drawing Rights** (SDRs created in 1969).
- India had to borrow from the Fund in the wake of the steep rise in the prices of its imports, food, fuel and fertilizers.
- In 1981, India was given a massive loan of about Rs. 5,000 crores to overcome foreign exchange crisis resulting from persistent deficit in balance of payments on current account.
- India wanted large foreign capital for her various river projects, land reclamation schemes and for the development of communications. Since private foreign capital was not forthcoming, the only practicable method of obtaining the necessary capital was to borrow from the International Bank for Reconstruction and Development (i.e. World Bank).
- India has availed of the **services of specialists of the IMF** for the purpose of assessing the state of the Indian economy. In this way India has had the benefit of independent scrutiny and advice.

- The balance of payments position of India having gone utterly out of gear on account of the oil price escalation since October 1973, the IMF has started making available oil facility by setting up a special fund for the purpose.
- **Early 1990s** when **foreign exchange reserves – for two weeks' imports** as against the generally accepted **'safe minimum reserves'** of **three month equivalent** — position were terribly unsatisfactory.
    - Government of India's immediate response was to secure an emergency loan of $2.2 billion from the International Monetary Fund by pledging 67 tons of India's gold reserves as collateral security.
    - India promised IMF to launch several structural reforms (like devaluation of Indian currency, reduction in budgetary and fiscal deficit, cut in government expenditure and subsidy, import liberalisation, industrial policy reforms, trade policy reforms, banking reforms, financial sector reforms, privatization of public sector enterprises, etc.) in the coming years.
- The foreign reserves started picking up with the onset of the liberalisation policies.
- India has occupied a special place in the **Board of Directors** of the Fund. Thus, India had played a **creditable role in determining the policies of the Fund**. This has **increased the India's prestige** in the international circles.
- India has **not taken any financial assistance from the IMF since 1993**.
- Repayments of all the loans taken from the International Monetary Fund were completed on 31 May 2000.
- **The Finance Minister** of India is the **ex-officio Governor on the Board Governors** of the IMF.
    - **RBI Governor is the Alternate Governor at the IMF.**
- India's current quota in the IMF is SDR (Special Drawing Rights) 5,821.5 million, making it the **13th largest** quota holding country at IMF and giving it **shareholdings of 2.44%**.

- However, based on voting share, India (together with its constituency countries Viz. Bangladesh, Bhutan, and Sri Lanka) is ranked 17th in the list of 24 constituencies at the Executive Board.

What is India's Contribution to Lending Resources to IMF?

- In the London Summit of the Group of Twenty (G-20), a decision was taken to triple the IMF's lending capacity up to US$ 500 billion.
- In pursuance of this decision, India decided to invest its reserves, initially up to US$ 10 billion through the Notes Purchase Agreement (NPA), and subsequently up to US$ 14 billion through New Arrangement to Borrow (NAB).
- **As of** 7 April 2011, India has invested SDR 750 million (approx. 5,340.36 crores) through nine note purchase agreements with the IMF.

What is Criticism of IMF?

- IMF's governance is an area of contention. For decades, Europe and the United States have guaranteed the helm of the IMF to a European and that of the World Bank to an American.
  - The situation leaves little hope for ascendant emerging economies that, despite modest changes in 2015, do not have as large an IMF voting share as the United States and Europe.
- **Conditions placed on loans are too intrusive** and compromise the economic and political sovereignty of the receiving countries. 'Conditionality' refers to more forceful conditions, ones that often turn the loan into a policy tool.
  - These include fiscal and monetary policies, including such issues as banking regulations, government deficits, and pension policy.
    - Many of these changes are simply politically impossible to achieve because they would cause too much domestic opposition.
- IMF imposed the policies on countries without understanding the distinct characteristics of the countries that made those policies difficult to carry out, unnecessary, or even counter-productive.

- Policies were imposed all at once, rather than in an appropriate sequence. IMF demands that countries it lends to privatize government services rapidly. It results in a blind faith in the free market that ignores the fact that the ground must be prepared for privatization.

IMF Vs World Bank

Attributes	International Monetary Fund (IMF)	World Bank (WB)
Ownership and Governance	By appointees of member countries.	By appointees of member nations.
Main Objective	Broadening and Strengthening the economies of member nations.	Broadening and Strengthening the economies of member nations.
Headquarter	Washington D.C.	Washington D.C.
Function	Exchange rate stability, provide financial resources to solve the problem of balance of payment, and promote international Monetary cooperation.	Promote economic and social progress in developing and poorer countries by helping to raise productivity and providing loans at a very concessional rate.
Assistance	Only to the government of the member nations.	Both to the government and private sector of the member nation.
Association and Size	IMF has no associated institutes and hence has a smaller staff.	It consists of five institutes associated with it and therefore has a larger size comparatively than the IMF.
Source of Funding	It is more like a credit union wherein members have access to a common pool of resources and these resources come from quota subscriptions and contributions from each	A kind of Investment fund where it borrows from one and lends to the other. It also borrows money by selling notes and bonds directly to their member nation's government, their agencies,

	member according to the size of its economy.	and central banks which they lend to other poorer and developing countries.
Recipient of Funding	Both the wealthy as well as poor nations experience a shortage of foreign exchanges or are facing a Balance of Payments Crisis.	Only to the developing and poorer nations and at a very minimal interest rate. It lends to even the private sector where it feels that assisting them would help improve the living conditions of the people.

GATT- GENERAL AGREEMENT OF TARIFFS AND TRADE

GATT (General Agreement on Tariffs and Trade) was signed on October 30, 1947, in Geneva among 23 countries and took effect on January 1, 1948. This agreement helped in restoring economic health to the World after the disastrous effects of World War 2. It aims to reduce trade barriers by removing tariffs, quotas, and subsidies while preserving significant regulations. Its preamble states that the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis.

The General Agreement on Tariffs and Trade (GATT), which was signed on October 30, 1947, by 23 nations, was a legal agreement that aimed to reduce trade barriers by abolishing or decreasing quotas, tariffs, and subsidies while retaining considerable restrictions. The GATT was created to help the world economy recover after World War II by rebuilding and liberalising global commerce. On January 1, 1948, the GATT came into effect. It has been developed since then, culminating in the founding of the World Trade Organization (WTO) on January 1, 1995, which integrated and expanded it. By this time, 125 countries had signed on to its accords, which covered almost 90% of world commerce. The GATT is overseen by the Council for Trade in Goods (Goods Council), which is made up of representatives from all WTO member nations. Market access, agriculture, subsidies, and anti-dumping measures are among the topics addressed by the council's ten committees.

Why was GATT replaced by the WTO?

- GATT (General Agreement of Tariffs and Trade) was ad hoc and provisional in nature as well as never approved by the member countries Parliament.
- GATT used to deal with trade in goods but the WTO also used to deal with intellectual property and cover services at the same time.
- The dispute settlement of WTO is faster but their rulings can never be obstructed.
- WTO has a strong legal basis as its agreements are permanent and all the member countries have approved it in their Parliaments.
- WTO is far better than GATT in comparison. GATT lacked a proper institutional structure whereas WTO provides a more institutional framework for implementing its principles.

FUNCTIONS OF GATT

Most Favoured Nation (MFN) treatment

- MFN is the fundamental principle of the GATT and it appears in article one of the GATT 1947.
- This states that each contracting party to the GATT has to provide to other contracting parties the same condition of trade as the most favourable terms.

Reciprocity

- ❖ General Agreement on Tariff and Trade (GATT) was created after World War 2 and advocated the principles of "rights and obligations". This is closely associated with the MFN principle.

Transparency

- ❖ Transparent system of trade is needed to harmonize the system of import protection so that the trade barriers can be reduced by the process of negotiation.
- ❖ GATT Limited the use of quotas in some of the specific sectors like advocated Import regimes and agriculture which are based on tariff only.

Tarif binding and reduction

- ❖ Tariffs played the main role in trade protection and negotiation in the early years when GATT was established.

Objectives and Purpose of GATT

- ❖ GATT (General Agreement of Tariffs and Trade) the ultimate objective was to reduce barriers to international trade.
- ❖ It was created to establish regulations to remove the costly and inefficient characteristics of the prewar protectionist period like trade quotas and controls.
- ❖ The member countries had to eliminate all trade discrimination. Its main purpose was to remove harmful trade protectionism.

Principles of GATT

Non-discrimination

- ❖ The main objective of non-discrimination is to prevent protectionist measures. It guarantees the freedom of trade among all member states.
- ❖ It is created or made to secure trade fair conditions.

Most Favoured Nation Principle (MFN-principle), Article 1

- ❖ According to the MFN principle, a signatory state granting any trade or financial advantage to another state shall grant it to all the other signatory states.
- ❖ This happens unconditionally and immediately. In accordance with Article 1, custom tariffs or other fees charged by one country for the import or export of products have to be identical for all contracting parties. For all member states, equal conditions are established.

Principle of National Treatment, Art. 3

- ❖ This principle is supporting non-discrimination between the member states and guarantees national compliance with the non-discrimination rule in foreign trade.

- ❖ Therefore, it restraints unequal treatment of foreign imported and locally-produced goods.
- ❖ The Agreement on Subsidies and Countervailing Measures (SCM) is narrowing down this basic principle as it restricts certain subsidies to companies contingent upon the performance of their export and upon the use of imported or domestic goods.

Liberalization through negotiation

- ❖ One of the most important aims of GATT is to reduce tariffs and trade barriers substantially, it does not restrict any kind of custom tariffs of individual countries.
- ❖ By way of multilateral negotiations between the member states (for instance the so-called "Uruguay Round", which was held in Uruguay from 1986 to 1994, from which the World Trade Organization (WTO) arose), custom tariffs shall be reduced and made transparent.

Quantitative Restrictions on Import and Export

- ❖ GATT placed Quantitative Restrictions on imports and Export to liberalize trade.
- ❖ Article XI, validates "duties, taxes, and charges", but proscribes "prohibitions or restrictions" on the importation or exportation of products or on sale for export.

Challenges faced by GATT

- ❖ The nature of world trade changed by 1980. This was not addressed by GATT as it did not address the trade in services between Nations.
- ❖ GATT reduced the rights of a sovereign to rule its people like other free trade agreements. The agreement on trade and tariffs required the countries to synchronize their domestic laws in accordance with the agreement to gain trade benefits. However, since countries did not agree to this provision it led to disputes between the Nations.
- ❖ The rapid proliferation of the bilateral and regional trade free trade agreements like RCEP, NAFTA, etc across the globe also raised concern over trade diversion.

Key Provisions of GATT 1994

GATT 1994 is composed of the original GATT 1947 text, along with several additional agreements and modifications that reflect the outcome of the Uruguay Round. Some of the key provisions of GATT 1994 include

- ❖ **Tariff Reduction:** GATT 1994 retains the core focus on reducing tariffs on goods. Countries commit to binding their tariff rates, which means they cannot increase tariffs beyond a certain level without negotiating compensation with their trading partners. This creates a more predictable and stable trading environment.

- **Non-Tariff Barriers:** While the original GATT focused primarily on tariffs, GATT 1994 addresses non-tariff barriers, such as quotas, import licensing, and technical standards. These barriers can often be more restrictive than tariffs, and their regulation is essential for promoting free trade.
- **Trade in Services:** While GATT 1947 focused exclusively on goods, GATT 1994 is part of the broader WTO framework that includes the General Agreement on Trade in Services (GATS). This agreement aims to liberalize trade in services, including sectors such as banking, telecommunications, and transportation.
- **Intellectual Property Rights:** The inclusion of the TRIPS Agreement under the WTO framework extends GATT 1994's scope to intellectual property rights. This agreement sets minimum standards for the protection and enforcement of intellectual property, such as patents, copyrights, and trademarks.
- **Dispute Resolution:** One of the most significant reforms introduced by GATT 1994 is the establishment of a more robust dispute settlement mechanism through the WTO. The Dispute Settlement Understanding (DSU) provides a legal framework for resolving trade disputes between member countries. It ensures that disputes are resolved in a timely and transparent manner, with the possibility of imposing sanctions on non-compliant countries
- **Agriculture:** GATT 1994 also includes provisions related to agricultural trade, which had previously been excluded from GATT 1947. The Agreement on Agriculture (AOA) aims to reduce protectionism in agricultural markets by cutting subsidies and tariffs, thus allowing for fairer competition in this sector.

EVOLUTION OF GATT (GENERAL AGREEMENT ON TARIFFS AND TRADE)

1. Background

- After World War II, countries realized the need for international economic cooperation.
- To promote free trade and avoid protectionism, 23 countries signed an agreement in **1947**.
- This agreement was known as the **General Agreement on Tariffs and Trade (GATT)**.

2. Establishment of GATT (1947)

- GATT was signed on **30 October 1947** and came into force on **1 January 1948**.
- It was not an international organization but a **legal agreement**.
- Objective: **To reduce tariffs and other trade barriers** and promote free international trade.

3. Key Features of GATT

- Based on **Most Favoured Nation (MFN)** principle – equal trade treatment to all members.
- Focus on **negotiations (rounds)** to reduce tariffs.
- Dealt only with **trade in goods** (not services or intellectual property).
- Temporary arrangement, but functioned for nearly 50 years.

5. Major Rounds of Negotiations

Round Name	Years	Key Focus/Outcome
Geneva Round	1947	First round, tariff reductions among 23 countries
Annecy Round	1949	Further tariff reductions
Torquay Round	1951	More tariff cuts
Dillon Round	1960–61	Tariff concessions for EEC countries
Kennedy Round	1964–67	Anti-dumping and tariff reduction
Tokyo Round	1973–79	Non-tariff barriers and trade rules
Uruguay Round	1986–94	Major changes including services and IP rights

5. Limitations of GATT

- No enforcement power (unlike a full organization).
- Covered only **trade in goods**.
- Dispute settlement was slow and ineffective.
- Could not handle modern trade issues like services and digital trade.

6. Transition to WTO

- Due to limitations, member countries agreed to replace GATT with a more permanent and structured organization.
- After the **Uruguay Round**, the **World Trade Organization (WTO)** was established in **1995**.
- WTO replaced GATT but **GATT 1994** remains as one of its core agreements.

Summary:

- GATT was a **temporary agreement** to promote global trade.
- It played a **crucial role from 1948 to 1994** in reducing trade barriers.
- Its evolution through negotiation rounds led to the formation of the **WTO**, a stronger organization dealing with modern trade issues.

WORLD TRADE ORGANISATION (WTO)

❖ Before World Trade Organization (WTO), General Agreement on Trade and Tariffs (GATT) was established as a global trade organization in 1948 with 23 countries. GATT was set up to regulate all multilateral trade agreements by granting all nations equal access to the worldwide market for trade purposes. The WTO was established in 1995 to replace the General Agreement on Trade and Tariffs (GATT).

❖ The **World Trade Organisation (WTO)** is a cornerstone of the healthy system of global trade. By promoting free and fair trade, and resolving related disputes, it plays a crucial role in encouraging economic growth.

❖ The World Trade Organization (WTO) is a multilateral organization headquartered in Geneva, Switzerland. It came into existence on January 1, 1995, as a successor to the General Agreement on Tariffs and Trade (GATT). The organization functions as a central body that facilitates global trade.

❖ The WTO provides a common platform to negotiate trade agreements among member countries and to resolve any trade disputes. It manages 60 global and about 300 regional trade agreements. The 60 trade agreements are accorded the status of international law.

The WTO comprises 164 member states. There are also observer states that are not signatories to the WTO agreements, and they do not participate in free trade.

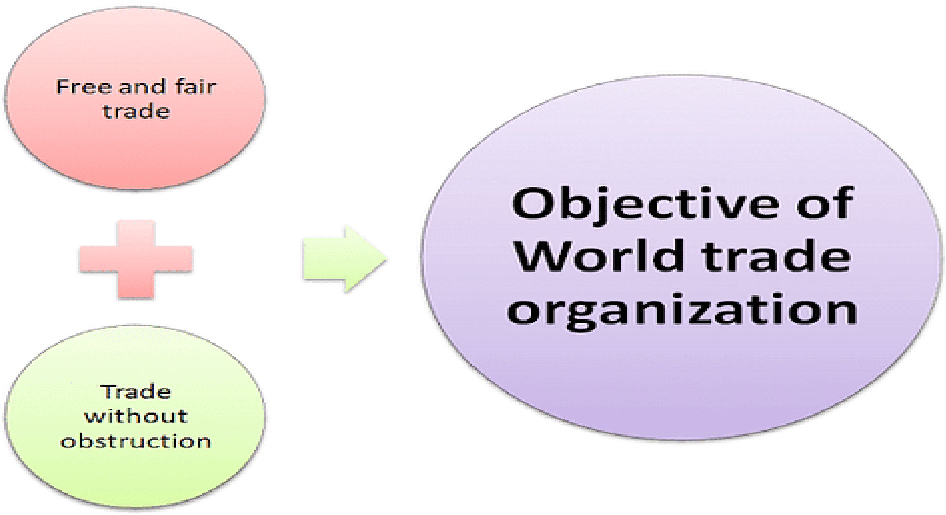
About World Trade Organisation (WTO)

- World Trade Organisation is a global multilateral organisation established in 1995 for the rules based trading between the nations of the world.
- It is a global membership group that promotes and manages free trade.
- It serves as a forum for governments to negotiate trade agreements and settle trade disputes.
- Overall, it aims to help producers of goods and services, exporters, and importers conduct their international businesses smoothly.
- At present, the WTO consists of
  - 164 members (including European Union), and
  - 23 observer governments (like Iraq, Iran, Bhutan, Libya etc).

Features of World Trade Organisation (WTO)

1. In order to promote international trade, WTO agreements cover trade in goods and services.
2. There are 164 members of WTO at present, and every member is obligated to follow the laws and policies framed under WTO rules.
3. India has been on the frontline of establishing fair international laws and regulations as a significant member of the WTO.
4. India has complied with the WTO's demands and has responsibly liberalized trade by abolishing import restrictions and lowering tariffs.

OBJECTIVES OF WORLD TRADE ORGANISATION (WTO)



1. Creating and Enforcing International Trade Regulations:

The General Agreement on Trade in Services, the Trade-Related Aspects of Intellectual Property Rights Agreement, and the Agreement on International Trade in Goods, all serve as the foundation for the World Trade Organization (WTO). The WTO uses a multilateral dispute settlement system to enforce its rules when one of its member countries violates a trade agreement. The methods and decisions must be respected and adhered to by the members through signed agreements. Creating and Enforcing International Trade Regulations

2. Making the Decision-Making Process More Transparent:

The WTO has tried to promote transparency in decision-making by encouraging participation and, in particular, the use of the consensus rule. Such measures work together to increase institutional transparency.

3. Collaboration between International Economic Institutions:

The onset of globalization has made strong collaboration amongst multilateral institutions necessary. The World Trade Organization, the International Monetary Fund, the United Nations Conference on Trade and Development, and the World Bank are some international economic institutions These institutions help develop and carry out a framework for international economic policy. Policy making may be disturbed in the absence of regular cooperation and mutual participation.

4. Serving as the World's Leading Forum:

The WTO is the international platform for regulating and negotiating additional trade liberalization. The foundation of WTO liberalization initiatives is based on members' benefits to make the best use of their comparative advantages as a result of a free and fair trade system.

5. Settlements of Trade Disputes:

Before the WTO, trade disputes usually arise from the breach of agreements between the member nations. Such trade disputes are settled through a multilateral system with predetermined rules and regulations.

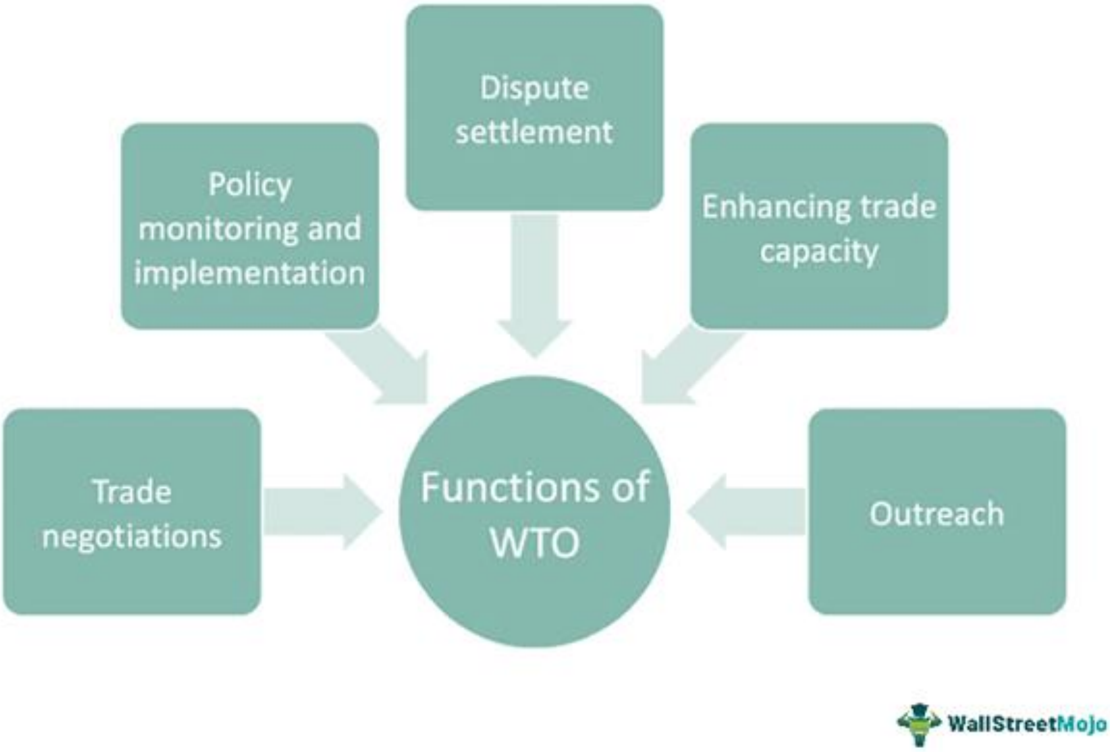
6. Others:

Some of the other objectives of the World Trade Organisation are as follows:

- ❖ To ensure optimum utilization of world resources.
- ❖ To protect the environment.
- ❖ To ensure full employment and a significant rise in effective demand.
- ❖ To raise the level of standard of living for citizens of member nations.

- To embrace the idea of sustainable development.

FUNCTIONS OF WORLD TRADE ORGANISATION (WTO)



1. Implementation of Trade Policy Review Rules:

The member nations of the world organizations have come to an overall consensus due to the stability and assurance of trade agreements. The rules are examined to make sure that the multilateral trading system continues even in the face of continuously changing trade conditions. Additionally, it helps in creating a reliable and transparent foundation for conducting business.

2. Discussion of Plans of Member Nations:

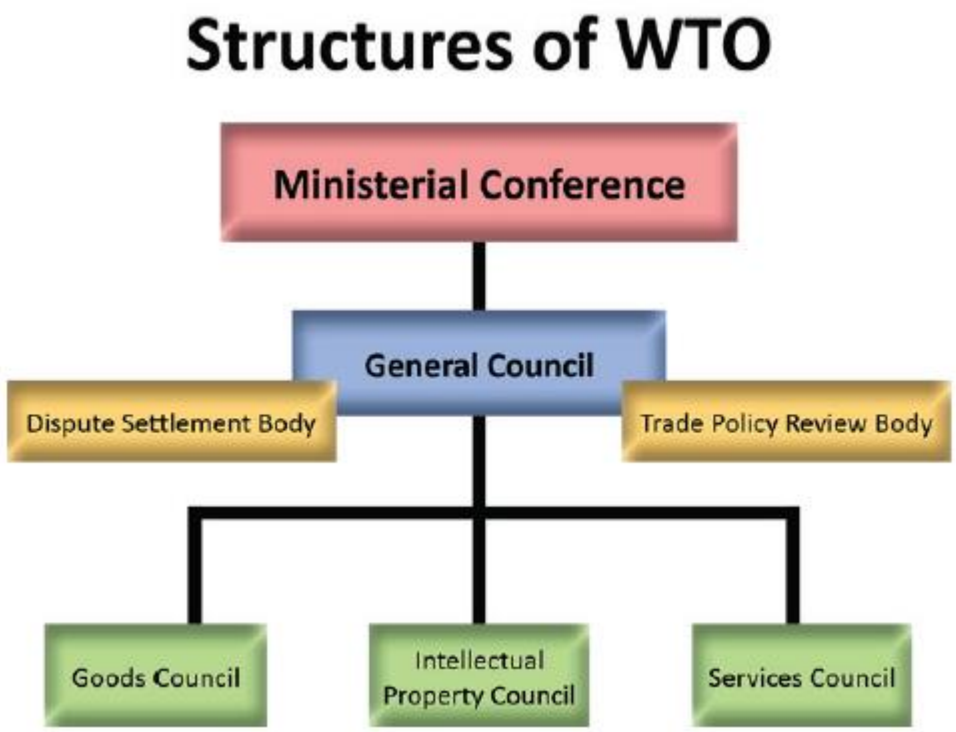
Trade negotiations within the global trading system are made possible through WTO. Without trade negotiations, the economy may stagnate, and issues related to dumping and tariffs might go unsolved. Consistent trade discussions are also a requirement for further trade liberalization.

3. Administrating and Carrying out Bilateral and Multilateral Trade Agreements:
The parliaments of different member nations must ratify any bilateral and multilateral trade agreements. The non-discriminatory trading system can not be implemented until such ratification occurs. Every member will be ensured to be treated fairly in the marketplace of other countries due to the signed contracts.

4. Settlement of Trade Disputes:
Trade disputes are addressed by the WTO's dispute settlement process. Independent tribunal specialists interpret the agreements and issue judgments mentioning the essential obligations of the involved member nations. It is advised to consult with other members to resolve disagreements.

5. Best Possible Use of the World's Resources:
By utilizing the trade capabilities of developing countries, resources all around the world can be used to their maximum potential. For least-developed economies, a special provision in the WTO agreement is necessary. Such initiatives include more significant trading opportunities, a longer duration to implement commitments, and to provide assistance to build infrastructure.

Organisational Structure of WTO:



Ministerial Conference (MC)

- ❖ The Ministerial Conference (MC) sits at the top of the structural organisation of the WTO.
- ❖ It is the supreme governing body that makes the final decisions on all matters.
- ❖ It is constituted by representatives of all the member countries, who are usually, Ministers of Trade of the respective countries.
- ❖ It usually meets after every 2 years.

General Council (GC)

- The General Council is the highest-level decision-making body of the World Trade Organisation.
- It is located in Geneva, and meets regularly to carry out the functions of the World Trade Organisation.
- The General Council (GC) is composed of representatives from all the members.
- It is the real engine of the Organisation, which acts on behalf of the Ministerial Conference (MC).
- It also acts as the Dispute Settlement Body (DSB) as well as the Trade Policy Review Body.

Three Councils of WTO

- There are three WTO councils operating under the General Council. They include:
    - Council for Trade in Goods,
    - Council for Trade in Services, and
    - Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS)
- These Councils, with their subsidiary bodies, carry out their designated specific responsibilities.

Director General (DG)

- The administration of the World Trade Organisation is conducted by the Secretariat, headed by the Director General (DG)
- The Director General (DG) is appointed by the Ministerial Conference (MC) for a tenure of four years.
- The Director General (DG) is assisted by the four Deputy Directors from different member countries.

Trade Policy Review Body (TPRB)

- The General Council meets as the Trade Policy Review Body (TPRB) to undertake trade policy reviews of members under the Trade Policy Review Mechanism (TPRM) and to consider the Director-General's regular reports on trade policy development.
- Thus, the TPRB is open to all the members of the WTO.

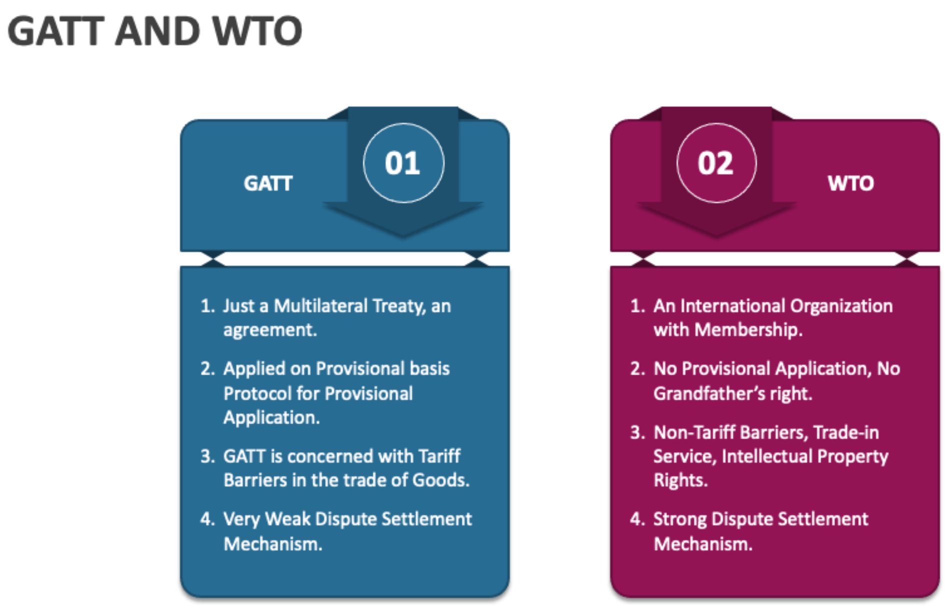
Dispute Settlement Body (DSB)

- The General Council convenes itself as the Dispute Settlement Body (DSB) to deliberate upon and resolve the disputes among the WTO members.
- Such disputes may arise w.r.t. any agreement contained in the Final Act of the Uruguay Round that is subject to the Understanding of Rules and Procedures Governing the Settlement of Disputes (DSU).
- The DSB has the authority to:
    - establish dispute settlement panels,
    - refer matters to arbitration,
    - adopt panel, Appellate Body and arbitration reports,
    - maintain surveillance over the implementation of recommendations and rulings contained in such reports, and
    - authorise suspension of concessions in the event of non-compliance with those recommendations and rulings.

Appellate Body

- The Appellate Body was established in 1995 under Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).
- The DSB appoints persons to serve on the Appellate Body for a term of four years.
- It is a standing (permanent) body of 7 persons that hears appeals from reports issued by panels in disputes brought by members of the World Trade Organisation.
- The Appellate Body can uphold, reverse or modify the legal findings and conclusions of a panel.
- Once adopted by the Dispute Settlement Body (DSB), the reports of the Appellate Body must be accepted by the parties to the dispute.
- The seat of the Appellate Body is in Geneva, Switzerland.

Difference between GATT AND WTO



GATT	WTO
GATT was a multilateral agreement that was formed to reduce tariffs. It was a series of rules without any institutional framework with just an ad Hawk secretariat, originated from the attempt to establish an International Trade Organisation in 1940.	WTO is a permanent institution with a proper institutional framework and its own secretariat
GATT covered only trade in goods	WTO not only covers goods but also services in trade which includes aspects of intellectual property.
GATT was a mere set of rules which had no institutional foundation. It was a multilateral agreement with a small functioning associate secretariat	WTO is a global body that has a permanent institution along with a secretariat.
GATT was an ad hoc provisional agreement	WTO has goals and existence that are full and permanent

The nations that participated in GATT were called contracting parties	The members of WTO are called member states
GATT was less powerful and the participating countries did not pay much heed and attention to it. It also had a very slow and inefficient dispute resolution system which made the countries not take it seriously	The WTO holds a lot of power and accounts for nearly 96% of the global GDP. It has a much faster and efficient dispute settlement department.
GATT was initially very selective in nature and it was much later in the 1980s when the notion of plurilateral nature of agreements was added.	From the very get-go, the WTO involves memberships and commitments which are multilateral in nature.
Under GATT, domestic legislation could continue even if they violated any agreements of GATT	The same was not permissible under WTO.
GATT was signed only by 23 nations	WTO has 164 member states who collectively work towards international trade.
GATT has a permanent appellate body to review findings and settle disputes.	Disputes under WTO are resolved faster as the settlement system has a select time frame

UNIT WISE IMPORTANT QUESTIONS

UNIT-I

1. **Define Business Environment. Explain its nature and significance.**
2. **What are the elements of internal and external business environment?**
3. Discuss the salient features of the Indian economy.

UNIT-II

1. What are the major elements of the political environment of business?
2. Describe the role of government in business facilitation.
3. Write a note on the Competition Act.
4. **What is FEMA? Explain its importance in foreign exchange regulation**.
5. **Discuss about of Industrial Policy 1991.**
6. Explain the licensing policy in India.
7. What are the elements of the economic environment of business?

UNIT-III

1. Define MSMEs and classify them based on recent definitions.
2. What are the key features of the MSMED Act, 2006?
3. Discuss current government schemes for MSME development.
4. What are the major challenges faced by the MSME sector in India?
5. Explain the role of clusters in promoting MSMEs.

UNIT-IV

1. **What is Balance of Payments? Explain its components.**
2. What are the causes of disequilibrium in the BOP?
3. Suggest measures to correct disequilibrium in BOP.
4. Define exchange control and its importance.
5. Discuss about current account and capital account convertibility.
6. Explain the concept of convertibility of currency.

UNIT-V

1. **Write short notes on the functions of the International Monetary Fund (IMF).**
2. **Discuss the evolution and objectives of GATT.**
3. **What are the functions and objectives of the World Trade Organization (WTO)?**
4. Explain the role of international economic institutions in promoting global trade.