Gist of EPW September Week 4, 2021

The Economic and Political Weekly (EPW) is an important source of study material for IAS, especially for the current affairs segment. In this section, we give you the gist of the EPW magazine every week. The important topics covered in the weekly are analyzed and explained in a simple language, all from a UPSC perspective.

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1. An Assessment of Mandatory Corporate Social Responsibility Expenditure

Context

The article analyses the CSR expenditure by companies after the implementation of the mandatory CSR spending rule.

Introduction

- CSR as a concept has become essential in contemporary times with the capitalist mindset driving businesses for the exclusive benefits of shareholders.
- Corporate social responsibility lead companies to address social development issues and promote responsible business conduct.
- The adoption and implementation of CSR ensure in many ways that the company operates in a socially responsible manner and fulfils its duties towards society.
- CSR ensures corporate accountability, legitimacy and responsible business conduct.

CSR & Value Gains

- CSR practices of business organisations help in enhancing the brand value, securing better employee engagement and building a positive image in the business environment.
- Many recent developments around the world have made it mandatory for companies to adopt CSR practices and contribute to society.
- The CSR practices of companies also bolster the efforts of the government to achieve Sustainable Development Goals.

India and CSR

- India adopted the legislative route to ensure the social responsibility of business.

- The enactment of a law on CSR becomes significantly important in the context of the growing imbalances in demographic distribution, regional social upliftment, provision of welfare schemes, urban and rural development and educational opportunities.
- The Companies Act 2013 mandates that companies should spend a certain proportion of their profits in areas such as education, gender equality, health, training, infrastructure, poverty reduction or any other area that contributes to the upliftment of society.
    - According to a CSR survey conducted by KPMG (2019), CSR spending by companies is consistently increasing every year since the introduction of the mandatory CSR Act.

Companies Act 2013

- The enactment of the Companies Act, 2013 imposed statutory obligations on companies to adopt social development practices for the well-being of the people.
- Enactment of Section 135
    - It states that the CSR activities should not be undertaken in the normal course of business but must be implemented on activities mentioned in Schedule VII of the Indian Companies Act, 2013.

- The CSR spending of each company is to be overseen by a subcommittee of the company's board of directors, whose duties include developing a CSR policy, recommending CSR activities to be undertaken and the amount of spending on each activity, and monitoring the company's CSR policy.
- Section 135 of the Companies Act, 2013 provides the threshold limit for applicability of the CSR to a company
    - net worth of Rs 500 crore or more
    - turnover of Rs 1000 crore or more
    - net profit of Rs 5 crore or more

CSR and SDGs

- The SDGs and CSR legislation can drive sustainable growth and at the same time align the country to the global agenda.
- Most of the thematic developmental areas mandated under CSR and SDGs overlap in terms of activities that need to be implemented.
- Indian companies have consistently allocated the highest amount of CSR expenditure on SDG 4 that is quality education followed by good health and well-being (SDG 3) during the period 2015 to 2019.
    - Rs 58,000 million have been spent on education in the financial year 2018–19.
- It is interesting to observe that CSR expenditure on SDG 11 that is sustainable cities and communities has significantly improved over the years.
- CSR expenditure on responsible consumption that is SDG 12 and industry innovation and infrastructure that is SDG 9 have been the minimum.

Public Sector and Private Sector's CSR

- Public sector companies spend way more than private sector companies.
- Studies suggest that public companies undertake more CSR and social development activities to legitimise their existence in society.
- Between 2014–15 and 2018–19, the average CSR expenditure of private sector companies ranged between Rs 4.5 million and Rs 6.1 million, whereas, in the case of public sector companies, the average CSR expenditure ranges between Rs 57.14 million and Rs 62.98 million.
- An independent sample t-test was conducted to compare the proportion of average net profits spent on CSR by public sector and private sector companies.
- There was a statistically significant difference in the CSR spending of public sector companies and private sector companies.
- The results indicate that public sector companies spent a larger proportion of profits on CSR in comparison to private sector companies.
- The implication of this finding suggests that private sector companies primarily focus on meeting mandatory CSR norms instead of proactively engaging in environmental and social development activities.

State Wise CSR Expenditure

- There is a huge disparity in the allocation of CSR expenditure.
- Major CSR spending has been in states like Maharashtra, Gujarat, Tamil Nadu, Andhra Pradesh, and Karnataka.
- Estimates show that CSR expenditure in these five states accounts for 59% of the total CSR expenditure in the country.
- Poor states like Uttar Pradesh, Bihar, Jharkhand, Chhattisgarh, and the seven states in the North East get less funding from CSR allocations.
- These findings also support the argument that companies need to do more than merely fulfilling obligations under the mandatory CSR rules.

Conclusion

- The CSR Act has delivered mixed results; it has been noted that the well-off states, which were already robust in comparison to other states, continue to attract higher CSR spending.
- Education is a priority area for government spending, and has also been the primary beneficiary of CSR spending.
- The CSR spendings need to be diversified as currently it appears excessively concentrated in a few segments.

2. Technology Diffusion through Foreign Direct Investment

Context

The article analyses FDI Spillover Effects in the manufacturing sector in India. It focuses on the relationship between the level of FDI and Total Factor Productivity of domestic enterprises in India.

Introduction

- The innovation and diffusion of technology are crucial for economic growth in developing countries and the main source of technology diffusion is through spillovers from foreign direct investment.
- FDI spillovers resulted in rapid economic growth in East Asian countries in the late 20th century, referred to as the East Asian Miracle by the World Bank.
- In India, FDI increased significantly after the 1991 Indian economic crisis and subsequent economic reform supported by an International Monetary Fund stabilisation programme.
- India became an attractive FDI destination due to its large labour force, low production costs, and high technological innovation potential.

Horizontal & Vertical Spillover Effect

- By accepting FDI from developed countries, domestic firms in the host country can reap benefits such as technology transfer, management expertise, and export market access.
- Advanced technology transfers to other non-FDI-accepting producers in the same industry through imitation, reverse engineering, or the mobility of highly skilled personnel. Subsequently, advanced technology gradually spreads within the industry, which is known as the Horizontal Spillover Effect.
- The advanced technologies also diffuse through inter-industry linkages.
- In developing countries, FDI-accepting companies often purchase intermediate goods from local suppliers.
- FDI-accepting companies can supply intermediate goods or services to local suppliers, facilitating the transfer of advanced technology to these suppliers by providing quality intermediate goods. This is referred to as the Vertical Spillover Effect.

Method

- The empirical analysis is based on census data for the manufacturing sector in India, divided into units, which represent the various sub-industries of the manufacturing sector.
- The unit-level data were obtained from the Annual Survey of Industries (ASI) which contains economic data for India's industrial sector and are published annually by the Central Statistics Office.
- The ASI contains unit-level data for India's "organised" manufacturing enterprises, defined as enterprises with more than 10 employees (power-assisted) or more than 20 employees.
- The ASI data is divided into two categories: census sector, which contains large-scale enterprises with more than 100 employees, and sample sector, which contains small-scale manufacturing enterprises not categorised as census enterprises.
- The study mainly focuses on the situation of medium and large size of manufacturing units.

FDI Spillover Effects

- The analysis of forward spillover effects yields varying results depending on the estimation model.
- The results of the empirical analyses highlight three key issues.
- An increase in FDI appears to negatively affect TFP (Total Factor Productivity) growth through horizontal linkages.
- This is an indication that the expansion of foreign affiliates' market share reduces the total output of local firms, resulting in relatively high fixed costs for local firms and a consequent reduction in TFP growth. Therefore, a negative spillover effect is observed.
- The backward linkages affect TFP growth negatively in the short term, positive significant spillover effects are captured in the long term.
- The short-term results indicate a gestation period of investment; however, the long-term results require a more detailed analysis.
- Final assembly sectors can procure their input materials locally or from overseas.
    - In India, many foreign affiliate companies invest in local industries, traditionally as a result of strict local content requirements imposed by the Indian government until 2000.
    - The foreign subsidiaries created domestic supply-chain networks in India in the same context and enhanced productivity and technology in the local manufacturing sector.
    - No significant evidence of forward spillover effects is detected in the results.

Conclusions

- The results of the empirical analyses of technology diffusion through FDI posit a significant relationship between FDI and technological progress in the manufacturing sector.
- The acceptance of FDI contributes to technological progress and, as such, is beneficial to India's long-term economic growth.