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GENERAL STUDIES
INDIAN ECONOMY

CONTENTS

Economy and Economics	1 - 24
Macro, Micro and meso economics	3
Political economy	3
Liberal and neo-liberal economics	4
Keynesian economics	5
Socialist and communist economics	5
Development economics	6
State capitalism or Beijing Consensus	6
Mercantilism	7
Behavioural Economics	7
Green Economics	8
Measuring Economic Growth	8
Economic Growth: Its Benefits and Side Effects	8
Need To Measure Economic Growth	8
GDP and GNP	9
GDP vs GNP	10
National Income and Gross Value Added (GVA)	10
Potential GDP	10
Per capita income	11
Estimating GDP	11
Factors Production	12
Market Price and Factor Cost	12
Transfer Payments	12
GDP and NDP	13
Real and Nominal GDP	13
GDP Deflator	13
Base Year	14
Seasonality	14
National Income Statistics in India	15
New GDP Series 2015	15
GDP has limitations in coverage	16
GDP has limitations in the quality of data	16
GDP is a measure of growth and not progress	16
Other measures of Development	16
Human Development Index (HDI)	17
Genuine Progress Indicator (GPI)	17
Social Progress Index	17
Gross National Happiness (GNH)	18
Happiness Index	18
Indian states and Happiness	18
The OECD Better Life Index	18
Green GDP	19
Natural resources accounting and green GDP	19
Commission on the Measurement of Economic Performance and Social Progress (CMEPSP)	19
Purchasing Power Parity: PPP	20

Big Mac Index	21
Structural Composition of Economy	21
Structural change in the economy	21
Indian economy: Sectors and their components	22
Formal and informal sectors of economy	22
Business Cycles	22
2008 Subprime Crisis	23
Developed, developing and least developed countries	23
World Bank classification	23
Least Developed Countries (LDCs)	24
Macro-economy and Human capital	24
Public goods	24
Opportunity costs of government expenditure	24
Planned Economic Development and Niti Aayog	25 - 39
History of Economic Planning in India	25
Sir Mokshagundam Visvesvaraya	25
Bombay Plan	25
Mixed Economy	26
Planning Goals	26
Financial Resources For The Five Year Plans	27
History of Planning	27
Nehru-Mahalanobis Model of Economic Growth	27
Other Elements of the Model Are	28
Rolling Plan	29
Rao-Mannohan Singh Model of Growth	29
Indicative Planning	30
Achievements of Planning	31
The failures of planning are equally clear	32
Economic Reforms	32
NITI Aayog	33
Aims and Objectives of NITI Aayog	34
NITI Aayog vs Planning Commission	35
Critical Appraisal	35
NITI's Achievements By 2017	36
Vision Document, Strategy & Action Agenda beyond 12th Five Year Plan	36
India And The Manufacturing Sector	36
Services sector-led growth in India	37
Services Sector Growth and jobs in India	39
FISCAL SYSTEM	40 - 52
Fiscal Policy Definitions	40
Definitions of Deficits	41
Effective revenue deficit (ERD)	41
Deficit Financing	42
How Much of Fiscal Deficit Is Right?	43
Fiscal stimulus	43
FRBM Act	44
Revenue deficit target abolition: Pros and cons	45
Twin Deficit Challenge	45
Fiscal Consolidation	45
N.K. Singh Review Committee on FRBM	46

State Development Loans (SDLs) -----	46
WMAs, special WMAs and overdraft -----	46
Zero Base Budgeting (ZBB) -----	47
Crowding Out -----	47
Small Savings -----	47
Budget Reforms -----	48
Plan And Non Plan Expenditure Classification And Its Unsustainability -----	48
Public Debt -----	49
External Debt -----	49
External Debt Management -----	50
Rupee Debt -----	50
Sovereign debt crisis (SDC) -----	50
Internal Debt -----	50
Masala Bonds -----	51
NRI Bonds -----	51
Debt-GDP ratio -----	52
Fiscal Drag -----	52
Fiscal Cliff -----	52
MONETARY AND CREDIT POLICY -----	53 - 71
Definitions -----	53
Monetary Policy -----	53
LAF -----	54
MSF -----	54
Bank Rate -----	54
Base Rate and MCLR -----	55
Reserve Requirements -----	55
Statutory Liquidity Ratio (SLR) -----	55
LCR -----	56
Cash reserve ratio (CRR) -----	56
Incremental CRR -----	56
SLR vs CRR -----	57
Standing Deposit Facility -----	57
Open Market Operations (OMO) -----	57
Market Stabilization Bonds -----	57
Quantitative Easing -----	58
Liquidity Trap -----	58
Qualitative tools -----	58
Liquidity Trap -----	59
Qualitative tools -----	59
Selective credit controls -----	59
Moral Suasion -----	59
Interest Rates and their importance -----	59
Negative Interest Rates -----	60
Demonetisation -----	60
Pros and cons of Demonetisation -----	61
Urjit Patel Committee -----	61
Indian Financial Code (IFC) -----	61
Monetary Policy Committee (MPC) -----	62
Monetary Policy Framework Agreement -----	63
Monetary Policy Transmission -----	63

Reserve Bank of India	63
RBI's Functions	63
Bank of Issue	64
Legal tender and fiat money	64
Gold standard	64
RBI and Printing Currency	64
Seigniorage	64
Banker to Government	65
Banker's Bank	65
Lender of last resort	65
Controller of Credit	65
Agent and Adviser of the Government	65
RBI as the debt manager of the Government	65
RBI as National Clearing House	66
Custodian of Foreign Reserves	66
Supervisory Functions	66
Promotional Functions	66
Debt Management Office (DMO)	66
RBI's role in economic and financial stability	67
RBI And Bitcoin	68
Autonomy for RBI	68
Section 7 of the RBI Act 1934	69
RBI Assets, Capital and Dividend	69
Money Supply	70
Monetary aggregates	70
FSDC	70
Financial Stability Board (FSB)	71
Macro Prudential Analysis	71
INFLATION: CONCEPTS, FACTS AND POLICY	72-83
Measures of Inflation	73
GDP deflator	73
Cost of living index	73
Producer Price Index (PPI)	73
Wholesale Price Index (WPI)	74
Consumer Price Index (CPI)	74
Causes of inflation	74
Demand-pull inflation	74
Cost-push inflation	74
Structural inflation	74
High Inflation Hurts	75
Deflation	76
Price Stability and Optimal Inflation	76
GDP, Potential GDP and inflation	77
Inflation and Corruption	77
Inflation Targeting	77
Indices of Inflation in Detail	77
WPI	78
New Wholesale Price Index (WPI)	78
Consumer Price Index (CPI)	79
New CPI Series 2015	80

Difference between WPI and CPI-----	81
Relevance of the two indices of WPI and CPI-----	81
Price index for services-----	81
Food Price Indices-----	82
CFPI-----	82
FAO Food Price Index-----	82
Residex-----	82
House Price Index (HPI) of Reserve Bank of India (RBI)-----	82
Collection of Statistics Act, 2008-----	82
Growth-Inflation Trade Off-----	82
Government Steps to Control Inflation-----	83
Fiscal Measures-----	83
Administrative Measures-----	83
Other Measures Taken To Control Inflation-----	83
TAXATION	84 - 104
Importance of taxation for the Government, economy and society-----	84
Taxation in India-----	84
Tax Reforms in India-----	85
Direct and Indirect Tax Ratio-----	85
Tax to GDP ratio-----	86
Number of Taxpayers-----	87
Broadening Tax-Base-----	87
Tax Amnesties Schemes-----	88
IDS 2016-----	88
Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)-----	88
Operation Clean Money 1 and 2-----	88
Direct Taxes Code (DTC)-----	88
Capital Gains Tax-----	89
Inverted Duty Structure-----	89
Tax Expenditure-----	90
Tax Havens-----	90
Panama and Paradise Papers-----	90
Base Erosion and Profit Shifting (BEPS)-----	91
Double Taxation Avoidance Agreement (DTAA)-----	91
DTAA with Mauritius, Singapore and Cyprus amended-----	92
Limitation of benefits-----	92
General Anti Avoidance Rules (GAAR)-----	92
Place of Effective Management (PoEM)-----	93
Tax Information Exchange Agreements (TIEA)-----	93
Convention on Mutual Administrative Assistance in Tax Matters-----	93
Transfer Pricing and APA-----	93
Tobin Tax-----	94
Pigovian Tax-----	95
Goods and Services Tax (GST)-----	95
GST is necessary-----	95
GST and Revenue Neutral Rate-----	96
GST and Fiscal Autonomy Issues-----	97
Constitution (101st) Amendment Act, 2016-----	97
Tax slabs under the GST 2017-----	97
Composition of the GST Council-----	98

Functions of the GST Council	98
GST and federalism	98
Main Constitutional Changes	98
GST (Compensation to States) Act, 2017	99
Dual GST	99
GST and Cross-empowerment	99
Anti-profiteering clause of GST	99
National Anti-Profiteering Authority (NAA)	100
GSTN	100
GST And Petro-Products	100
GST Benefits Small Entrepreneurs And Small Traders	101
HSN Code in GST	101
Laffer Curve	101
Minimum Alternative Tax (MAT)	101
Rajaswa Gyan Sangam	102
Some Tax Related Terms	102
BANKING SYSTEM IN INDIA	105 - 123
Commercial banks	105
State Bank of India	106
Bank Nationalisation	106
Banking sector reforms from 1991	107
Narasimham Committee	107
Bank Loans: Good and Bad	108
Standard Assets or NPAs	108
Stressed assets	108
NPAs can occur for a variety of reasons	109
SARFAESI Act	110
Asset Reconstruction Company (ARC)	110
Asset Quality Review (AQR)	110
PCA	111
Stress Tests	111
Safety of Banks And Basel Norms	111
Prudential Norms	111
Basel Norms	112
Capital Adequacy Norms	113
India and CAR	113
BIS	113
Write off, Write down and Haircut	113
Insolvency and Bankruptcy Code 2016	113
Highlights of the Code	114
The procedure and the process	114
Banking Regulation (Amendment) Act 2017	115
TBS Challenge	115
PARA	116
P. J. Nayak Committee	116
Bank Consolidation	116
Indradhanush	116
Banks Board Bureau	117
Differentiated Banking	117
Small Finance Banks (SFBs)	117

Payments Bank	118
Objectives of payments banks	119
India Post Payments Bank (IPPB)	119
MUDRA Bank	120
Recapitalisation	121
FDI In Banks	121
Foreign Banks: Subsidiary Vs Branch	121
Development Banks	122
Co-operative Banks	122
Shadow Banks	123
Universal Banking in India	123
Bank Run	123
MONEY MARKET AND CAPITAL MARKET IN INDIA:	
INSTRUMENTS AND DYNAMICS	124 - 132
Call Money	124
Government Securities	124
Treasury Bills	124
Cash Management Bills (CMBs)	125
Inter Bank Term Money	125
Certificates Of Deposit	125
Inter Corporate Deposits Market	125
Commercial Paper	125
Ready Forward Contracts (Repos)	125
Commercial Bills	126
Discount and Finance House of India (DFHI)	126
Libor	126
Mibor - Mumbai Inter-Bank Offer Rate	126
Money Market Reforms	126
Capital Market	127
G - Secs (Gilt Edged Securities)	127
State Development Loan (SDL)	128
DFIs or Development Banks	128
Merchant Banks / Investment Banks	128
CIS	128
Alternative Investment Funds	129
REITs	129
Mutual Funds	129
Hedge Fund	129
Venture Capital	129
Angel Investors	129
Private Equity	130
Hundi	130
Chit Funds	130
QIPs	130
NBFC	130
ECBs	131
Euro Issues	131
Credit Default Swap	132
Infrastructure Debt Funds (IDFs)	132
FII's Investment in Debt	132

Take-out Financing (TOF)	132
External Sources of Finance For India	132
STOCK MARKET	133-147
Importance of Stock Exchanges	133
Primary Market	133
Secondary Market	134
Stock Exchanges in India	134
Bombay Stock Exchange (BSE)	134
National Stock Exchange (NSE)	134
Metropolitan Stock Exchange of India (MSE)	135
United Stock Exchange of India (USE)	135
INX 2017	135
Sensex	135
Demutualization	135
BSE SME and NSE Emerge	135
Classification of companies listed in BSE	136
Securities and Exchange Board of India (SEBI)	136
SEBI and the Reforms	136
Securities Laws (Amendment) Act 2014	137
SEBI's Role as Protector of Investors	137
Capital Market Reforms	137
Types of Shares	138
Derivatives	138
Futures	138
Buyback of Shares	138
Anchor Investor	139
Global Depository Receipts (GDR)	139
American depository receipts (ADRs)	139
Difference between FDI and FII	139
Foreign Portfolio Investor (FPI)	140
FIIs	140
QFIs	140
FATF	140
Sub account	141
IOSCO	141
Sustainable Stock Exchanges (SSE)	141
Participatory Notes (PN)	141
Clearing House	142
Demutualisation	142
Commodity Exchanges	142
FMC	143
Depository	143
National Securities Depository Limited (NSDL)	143
Important Indices in the World	143
Nasdaq	144
Dow Jones Index	144
Decoupling	144
Clause 49	144
Shariah Index	144
BRICS Cooperation among Exchanges	144

Power Exchanges	145
Stock markets and macro-economy	145
Indian Stock Market performance	145
Mutual Fund	146
Share	146
Bond	146
Debenture	146
Bear	146
Bull	146
Bear Market	146
Bull Market	147
Blue Chip	147
Largecap, Midcap or Small cap Company	147
Retail Investor	147
Negotiated Dealing System	147
Short Selling	147
Market Capitalization	147
MPS Norms	147
Sweat equity	147
Insider Trading	147
BALANCE OF PAYMENTS	148 - 172
India's Balance of Payments (BOP) Crisis in 1991	148
Devaluation And Depreciation	148
Convertibility of Rupee	149
Rupee Convertibility	149
Convertibility has the following dimensions	150
Full Convertibility	150
Benefits of fuller convertibility	150
Tarapore Committee on CAC	151
Capital Account Convertibility Relaxations So Far	152
Tarapore II on Fuller Rupee Convertibility 2006	152
Internationalization of Rupee	153
Benefits of Internationalization of Rupee	153
Balance of Payments and Invisibles	153
Invisibles are in three parts	154
Remittances	154
Exchange Rate	154
Currency Mechanisms	155
Current Account Deficit	155
2013 And The Exchange Rate Of Rupee: Why Did The Rupee Slide To Historic	
Lows Of Nearly 69 In 2013	156
Steps taken by the RBI and the government of India to stabilise the currency	
markets	156
What is the Real Value of the Rupee?	157
Forex Reserves	157
Reasons For Accumulation of Forex	158
Adequacy or Otherwise of The Forex Reserves	158
Problems of Plenty With Large Forex Reserves	158
Strong Rupee 2017: Causes And Effects	159
Sovereign Wealth Fund	160

Rupee Devaluation/Depreciation and Export Performance and Promotion--	160
Rupee Appreciation: Why And What It Does -----	161
Currency Manipulation -----	161
Currency War -----	162
Dollarization -----	163
Currency Board -----	163
Global Reserve Currency -----	163
Hard And Soft Currency -----	164
Flight of Capital -----	164
Capital Controls -----	164
Exchange Rate -----	165
Currency Mechanisms -----	165
Current Account Deficit -----	166
Rupee depreciation in 2018 -----	166
Real Value of the Rupee -----	167
Devaluation/depreciation and its effects -----	167
Appreciation and its effects -----	168
Forex Reserves -----	168
Currency War -----	170
Currency Manipulation -----	170
Global Reserve Currency -----	171
Hard and Soft Currency -----	171
Flight of Capital -----	171
Capital Controls -----	172
Currency Board -----	172
Dollarization -----	172
Sovereign Wealth Fund -----	172
World Trade Organisation (WTO)	173 - 201
WTO since 1995: The Ministerial Conferences -----	173
GATT and WTO -----	174
Trade Negotiations -----	175
Decision making in the WTO -----	175
Dispute Settlement -----	175
Three foundational principles -----	176
National Treatment -----	176
MFN -----	176
Exceptions to MFN -----	177
S&D Provisions -----	177
S&D -----	178
WTO Agreements -----	178
India and the amber box -----	178
Export Subsidies -----	179
Market Access -----	179
Special Products and Special Safeguard Mechanisms -----	179
Special Products (SPs) -----	179
Special Safeguard Mechanisms (SSMs) -----	180
G33 -----	180
WTO and safeguard duty -----	180
Safeguard duty in India -----	181
Countervailing Duties (CVDs) -----	181

Anti-Dumping Duty	181
TRIPS	182
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)	182
of WTO	182
TRIPS and patents	182
Product and process patents	182
Patents (Amendment) Act 2005	183
Highlights of the Act	183
TRIPS and Public Health Safeguards	184
Incremental Innovations	184
Voluntary Licensing	185
Anti-Counterfeiting Trade Agreement (ACTA)	185
Sui Generis System	185
Geographical Indications (GI)	185
Rasgolla	187
Basmati rice	187
APEDA	187
IPR Policy 2016	187
PPVFR Act	188
TBT and SPS	189
GATS	189
Trade Facilitation	190
World Trade Organization (WTO) and e-commerce	190
Singapore Issues	191
Doha Round	192
India and Bilateral Investment Treaty (BIT)	192
Solar Panels	193
H1B Visa Fee Hike and WTO-Compatibility	193
Generalized System of Preferences (GSP) and India	194
India, US and GSP	194
Rules of Origin (ROO)	195
Regional Trading Arrangements (RTA) and Multilateralism under WTO	195
Some regional trading arrangements in force and in negotiations	196
India and WTO	197
Groups	198
Protectionism	198
Trade war	199
Threats to the WTO	200
Asian Clearing Union	200
WTO Words	200
BRETTON WOODS INSTITUTIONS: INTERNATIONAL MONETARY FUND	202 - 211
IMF	202
IMF Objectives	202
Governance Structure	202
International Monetary and Financial Committee (IMFC)	203
Development Committee	203
Functions of IMF	203
IMF Quota	203

Special Drawing Rights (SDRs)	204
SDRs as global reserve currency	204
IMF Borrowing Arrangements	205
How the IMF lends	205
The changing nature of IMF lending	205
IMF Facilities	205
IMF and Conditionality	206
IMF and the global financial crisis	207
IMF and social protection	207
IMF, Money-laundering and terror finance	207
FATF	208
India and the IMF	208
Reforming the IMF	209
Chiang Mai Initiative	209
BRICS CRA	209
G-10	210
G-15	210
G-20	210
G-24	211
G-77	211
WORLD BANK GROUP	212 - 219
IBRD and IDA	212
IDA	213
IFC	213
MIGA	214
ICSID	214
India and the World Bank	214
IMF and WB	214
IMF and WB Group :Differences	215
Bretton Woods 2.0	215
Groups and Institutions	215
G-7	215
International Financial Architecture	216
ADB	216
ECB	216
OECD	217
NDB	217
AIIB	218
EBRD	218
India and EBRD	218
POVERTY: CONCEPTS, DATA, POLICY and ANALYSIS	220 - 230
Types of Poverty	220
Poverty Line	221
Headcount Ratio	221
Poverty Gap (PG)	221
Misery Index	221
World Bank and poverty definitions	221
Planning Commission and Poverty	221
NSSO and Poverty Estimates	221
Committees	222

NC Saxena Committee	222
Urban Poverty	222
S. R. Hashim Committee	222
Pronab Sen Committee	223
SECC	223
Rangarajan Committee	223
Eradication of Poverty	224
Niti Aayog Task Force on Poverty Elimination	224
MDGs and SDGs	224
MDGs 2000	224
SDGs	225
Similarities and Differences between MDGs and SDGs	226
Niti Aayog and SDGs	226
India's VNR	227
Universal Basic Income (UBI)	228
Basic income in India	228
Multidimensional Poverty Index (MPI)	228
Non-monetary aspects of poverty	229
Poverty is a cognitive tax	230

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Economy and Economics

Economy is the social activity where people come together to produce, stock, distribute, trade and facilitate consumption of goods and services. The entire activity is meant for the market- that is for selling. Goods and services may either be exchanged for other goods and services (barter) as it used to happen as a practice in primitive economies or they are exchanged for money which is the practice for contemporary economies in the world. Economics as a term comes from Greek- oikos means family, household, or estate and nomos stands norm or law. The origin of the term itself is revealing. Be it household or village or a nation-state, the universally acknowledged reality is that people have limitless needs and the available resources to meet the needs are limited. What is the norm at the micro level (household) is true for the macro economy as well- be it at the national or even global level. The need for the field of economics as a branch of social science becomes relevant to balance the needs with resources. Study of rational management of scarce resources is the substance of economics. Rationality is choosing the right means for the chosen end. Since last century, economic rationality which started with the study of production, distribution and consumption, has come to include equity and sustainability as well.

Economic growth is the quantitative difference in the production of goods and services between two points of time. If the difference is negative, it is called degrowth.

Economic development on the other hand qualifies economic growth with development in terms of education, health, equity and so on.

Economic policy is a government policy aimed at generating growth and development, among other aims. It has many subsets like fiscal policy, monetary policy, industrial policy, agricultural policy, foreign trade policy and so on.

We need to understand economics as a discipline based on scarcity. Take for example, land. It is a scarce resource. India has 15% of global population but only 2.4% of the global land. Thus there is huge pressure on land. It is needed for agriculture (food and non- food); manufacturing; residential purposes and so on. The task of economics is to arrive at optimal ways of prioritizing the use of such limited resources. Land Acquisition and Rehabilitation and Resettlement Act 2013 address the land claims of farmers, industry and other sections in a balanced manner.

Similarly, water is scarce and is becoming even more so. There are demands for agricultural, industrial, domestic and other uses. How to apportion the existing amount of water among all these users is a public policy challenge tackled in the Draft National Water Policy (NWP, 2012).

Same is the purpose of the food security law. Food security is essential for welfare as well as productivity. Being a welfare state, Government is committed to it. But there are many operational challenges relating to the quantity of food that can be given at concessional prices and the methods of distribution- should it be through government outlets or by public private partnerships (PPP). Besides, the extent of food subsidy- the gap between the market price and the government price- is also a critical matter as it impinges on government finances and influences the market prices. Economics as a field of study draws from experience, within the country and from other countries and advises on public policy.

Initially, economics focused on wealth and later welfare. That is, initially, what mattered was creation of wealth at any cost. It did not interest economists to be sensitive to the human dimension- the misery that it produced. Later, by the late 19th century, there was hue and cry about children being made to overwork and receive paltry payment for their work; the inhuman conditions of work, the squalor and so on. Some even justified it on grounds that it gives comparative advantage in trade as it cuts down the cost of production. When there was relative prosperity and government collected enough taxes and democratic dissent grew, welfare became

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the new concern of the discipline. Kuznets curve shows, in the form of an inverted U, the initial increase in inequality and how inequality reduces with economic growth.

In the study of government policies, from the perspective of economics, there are trade offs because scarcity of resources is the overriding assumption of the discipline. Tradeoffs involve making choices in policies wherein there is a compromise on one goal to achieve another goal. It is a way of balancing among desirable goals. Multiple examples can be given. Reserve Bank of India aims at price stability which it is the overriding objective of its monetary policy even as some growth is eroded in the process. Thus, a bit of growth is traded off for price stability. Similarly, government wants to give subsidies to the poor and weak. It may mean more borrowings and thus some fiscal excess but poverty is addressed and thus political stability is gained. Thus, fiscal prudence may be traded off to some extent in pursuit of welfare. Similarly, public investment is crucial and so is the need to limit government borrowings. Setting the right level of balance between the two involves a trade off. Fiscal Responsibility and Budget Management (FRBM) Act laid down 3% of annual central government borrowing whereby infrastructure investment is facilitated even as government finances are partly strained. In the land acquisition law, compensation for the land owners is increased to balance the interests of the farmers and industrialists. Investment may moderate in the process, but social justice gets addressed. Land is to be acquired for manufacturing and consent of the land owner may be conditionally dispensed with in public interest- that is the tradeoff. Property rights are relaxed, compensation for the land owner is raised; and land is diverted to industrial use as its productivity is more compared to the agricultural use.

The concept of tradeoffs is related to opportunity costs. Resources like money or land, for example, can be put to multiple uses. Choices have to be made as to what is the best way to use resources. The choice that is made is in preference over others. Among the competing choices, the best course of action is chosen and others are discarded. The cost of discarding the second best choice is the opportunity cost. Literally, it is the cost of the second best opportunity that is not chosen. For example, money can be deposited in a bank earning interest or invested in stock market. If the latter is preferred, what is foregone, the interest that the money would have earned in a bank, is the opportunity cost. In government finance, the concept is at times relevant. For example, should the government borrow money and invest or allow the private sector to do so.

There is government land in a city and it can be used in many ways and the work of the economist is to choose among the following models that we can speculate upon-

1. build hospital or school
2. build municipal park
3. give it free of cost to a private investor who will build a hospital or school and provide free services to poor and low income groups
4. auction it to the highest bidder

Which choice is made depends on many considerations- government's financial position, availability of private sector talent etc. Whichever choice is made will have an opportunity cost as described above.

As mentioned above, the study of economic activity called the discipline of economics began with focus on growth which may also be understood as wealth generation. Adam Smith, regarded as the Father of Economics and author of the classic "An Inquiry into the Nature and Causes of the Wealth of Nations" defined economics in two ways. One corresponds to the title of his book - as the science of wealth. The other definition is a predictable one: the science relating to the laws of production, distribution and exchange. He called economics a science but that is debatable though the urge to make it science is laudable.

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Initially, the definition in terms of wealth creation was attractive but later it dawned that it meant that economic growth at any cost in the name of wealth was at the expense of equity and the social groups that could not participate in the market economy were seen as liabilities. For example, women, children and old people. Misery of the weak was taken as a necessary price for economic growth. Such a perspective being unconscionable in democratic terms underwent evolution with 'markets with a human face' opinion gaining ground. There was a demand to balance wealth creation with focus on social and human welfare. Thus came the shift in the focus to welfare economics- growth should be accompanied by equity. All social groups should benefit from economic growth. It was achieved partly by factory legislation demanding of the employers that they limit work hours and provide just and humane conditions of work. Partly, the fiscal position of the government with tax collections also enabled the emergence of welfare economy. Economics as a study incorporated social justice and not money and goods alone.

As the production process evolved and as more problems cropped up, the discipline expanded bringing within its fold the need to balance growth with human development, environmental sustainability, human happiness and so on as we will see ahead.

Macro, Micro and meso economics

Macroeconomics, which deals with the entire economy of a given unit- province, nation or the world itself. For example, variables like the size of the economy in the form of national income, economic growth, inflation, employment, foreign trade, poverty, inequality are the phenomena that characterize the economy as a whole, though with local variations.

Microeconomics, on the other hand, studies the units of the economy and their behavior- consumers, sellers, business firms etc.

The two belong to the same economic system and influence each other. Interest rates are a macroeconomic feature but they impact the consumers, traders and firms. Taxes influence prices and thus consumption and investment decisions. Consumer and business confidence depends on the state of economy. Consumer confidence or sentiment is the optimism of the consumer about the economy and their financial position. If they are confident, it is reflected in purchases and sales and thus economic growth. Similarly, business confidence helps in investment and growth picking up. They micro and macro factors feed into each other.

'Meso-economics' studies the intermediate level of economic organization in between the micro and the macroeconomics like study of a sector of economics like auto, infrastructure- may be considered meso-economics while the study of each unit may fall under micro.

Political economy

We need to understand another approach to the study of economic activity. It is the school of political economy. Its position is that politics and economics need to be studied together to understand why public (government) policy takes a particular direction. For example, land reforms are a political decision for re-distributive justice. But its impact is on economic productivity, investment in agriculture, agri-exports, employment and so on. To understand land reforms, we need to understand the politics of social and economic justice. Similarly, bank nationalisation had costs and benefits. To see why the policy was adopted in 1969 and 1980, the political dimension of financial inclusion, checking concentration of economic wealth and planned economic development need to be grasped. The two can not be separated. Equally, the entire economic model based on liberalisation, privatisation and globalisation that became the global norm since 1980's can be understood only from the political perspective of retreat and demise of communism as a political idea. The de-globalisation that started some years after the 2008 global financial and economic crisis that is reflected in economic nationalism (nation's resources should be used for the nationals themselves with a limited view as to who make up the nationals), protectionism (protecting the domestic economy with high tariff walls on imports and

restrictions on inbound foreign investments) and trade war (nations fighting with higher tariffs to weaken each other) can be understood only as a subject of political economy. It aims at addressing the anxieties of those who lost in the globalisation process like workers. Thus, it is a political response to popular demands expressed as economic policies.

If we take the example of demonetization that took place in India in 2016 which is a millennial event, the entire process of choosing to embark on it was a political choice aimed at eliminating black economy and enforcing fiscal laws strictly; while the economy went through so many fundamental effects of it- banking, fiscal, industrial, agricultural etc.

In China, a political party, Communist Party of China, decided how the economy is to be structured. The priorities and policies of economy drastically altered according to the beliefs and biases of the political party and its leaders.

Politics sets the larger framework in which economy operates. Thus, understanding the two as they interconnect is the substance of political economy studies. While politics sets the values, economists set the prices! In simple terms, political economy describes production, buying and selling, and their relations with law, custom, and government, as well as with the distribution of national income and wealth. It refers to examining how political forces affect the choice of economic policies. We can further elucidate political economy with the examples of liberalism, neo-liberalism and socialism.

Liberal and neo-liberal economics

Liberalism as an economic philosophy is founded on the belief that individuals are rational in the decisions they take in the economic system. Producers produce goods and services that are in demand. Consumers spend their money to realise maximum value for it. The rationalities of all the economic actors- producers, traders, consumers and others add up to collective and systemic rationality that guides the economy well. Based on this premise, Adam Smith said that there is an invisible hand (collective rationality) that steers the economy well and so there is no need for State regulation. In other words, the self interest of each when rationally followed becomes the common interest of all. State should only provide support services like public goods- police, judiciary, essential infrastructure etc. The euphoria in markets that is based on the principle of laissez faire (French term that literally means 'let do' and practically stands for minimum government controls by way of laws and regulations in economic transactions) did not find justification in decades that followed industrial revolution in the mid-18th century. Thus, the central premises of liberal school were-

1. individual economic actors are rational and so
2. State need not regulate their actions by way of too many laws
3. State should provide only public goods and thus facilitate economic activity; and
4. economy should be left to the market forces- laissez-faire.

Liberalism as a philosophy suffers from many infirmities

- rationality of the producer is to maximize profit and if human misery, steep economic inequality and environmental degradation result from it, liberals after Adam Smith had no answer
- Market failure also is a relevant issue: market failure is defined as an inefficient distribution of goods and services in the free market which has negative implications for vast pockets of society and geographies
- Consumer rationality is distorted by lack of reliable information.

While the economies grew initially based on the above philosophy, there was widespread poverty and exclusion created by the economic growth. As a reaction, welfare and socialist schools of economics emerged. However, by the late 20th century, liberalism found renewed

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favour with the world after all other models of growth showed their inadequacies as we will see ahead. The return of liberalism late last century is known as neo-liberalism (any school of thought that returns after decline is given the prefix, neo).

Neoliberal philosophy did not change much from liberal assumptions and policies. After all, it returned to popularity because its adherence to free market economic model was proved historically right as communist command economy with state ownership did not yield long term growth and proved to be antithetical to innovation and entrepreneurship. Neoliberals championed as earlier for withdrawal of State from economic activities, globalisation, privatisation, price deregulation, a reduced size of government (that government is the best which governs the least). Margaret Thatcher who was British Prime Minister between 1979-90 privatised many industries and utilities: steel, railways, airways, airports, gas, electricity, telecoms and water. Donald Trump, American President, discarding the Obamacare health insurance programme and cutting down the corporate tax rates steeply are two typical examples of neoliberal preferences. Neo-liberalism is the same as Washington Consensus – the free market approach of the IMF and other institutions. Individualism, competition and economic rationality and efficiency are its basic values.

India's economic reforms since 1991 are largely centred around it.

While supporters of neoliberal school cite the above advantages, critics hold that inclusivity suffers; inequality sharpens; public services will be neglected and even rolled back; education and health, when privatised will harm public interest; environmental degradation could deteriorate as profiteering and 'growth at any cost' may become the motive; and so on.

Keynesian economics

It essentially believes in the liberal economic principles but distinguishes itself by its prescription when the economy slows down dramatically or stops growing or goes into negative mode of degrowth. The Keynesian solution is known as stimulus or pump priming the economy which is-

- government should borrow and spend on infrastructure and other core economic activity that leads to more investment by the private sector and thus public and private sector investment converge to create employment, business and demand. For example, Bharat Mala for national highways and Pradhan Mantri Gram Sadak Yojana (PMGSY).
- The central bank should reduce interest rates and make more money available to consumers and investors and thus create demand and supply.

It is a time tested solution for general macroeconomic slowdown. It was tried successfully across the world, including India, in the aftermath of the global economic crisis and deep recession that lasted for a few years since 2008.

Socialist and communist economics

Communist economics is complete ownership of the national economy in government hands and there is no room for private property. Socialist economics believes that a large part of economic resources should be in government hands so that inequality can be minimized and can give workers greater control of the means of production. It comes in many forms- Nehruvian socialism where there is public and private sector coexisting and complementing called mixed economy. An extreme form of socialist economics is communist control where the entire economy is held by State and there is no private property at all. For example, Soviet economy and China under Mao Zedong (1893 –1976).

- Nehruvian economics is a subset of socialist economics. It is the thought of Jawaharlal Nehru (1889 –1964) who was the first Prime Minister of India. It rests on state -ownership of basic parts of economy like infrastructure, higher education, metal and other industries etc. through centralized socio-economic planning. India adopted Nehruvian socialism for a variety of

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reasons: Soviet Russia showed that it could be an expeditious way of achieving equitable growth; Nehru personally believed in the values of welfare state and equity; given the historical circumstances in which it emerged, self-reliance in economic growth seemed to make more sense; India lacked any significant private sector when we became Independent.

- Gandhian economics is the set of ideas that Mahatma Gandhi (1869- 48) propounded which have a unique socialist content. Gandhian socialism is not a set of State policies but are a decentralized growth of economy based on full participation of adult labour and certain moral prescriptions. Mahatma Gandhi questioned the scarcity assumption when he said: "Earth provides enough to satisfy every man's need but not for every man's greed". Gandhian socialism- his economic thought- is based on small scale and locally oriented production; using local resources and meeting local needs, so that employment opportunities are made available everywhere everywhere and to everyone; promoting the ideal of Sarvodaya: the welfare of all, in contrast to the rich dominating. Gandhian economy aims to boost employment which is very desirable for India where there is abundance of labour. It had no aversion to machinery and welcomes it where it avoids drudgery and reduces monotony, for example, sewing machine. However, it is opposed to labour-displacing technology. It emphasises dignity of labour, and criticises the society's contemptuous attitude to manual labour. It insists on everybody doing some 'bread labour': to live by one's own labour to satisfy all one's primary needs both moral and physical, an idea that Gandhi borrowed from Leo Tolstoy and John Ruskin. Another principle of Gandhian economics is trusteeship: while an individual or group of individuals is free to set up an economic enterprise and even accumulate wealth, their surplus wealth above what is necessary to meet basic needs and investment, should be held as a trust for the welfare of all, particularly of the poorest and most deprived. Which means wealth may be privately owned but should be for public use. It thus combines economics of employment-intensive development with ethics of equity, self-reliance (with minimum wants), sustainability, trust and cooperation.

Development economics

After the World War II, many countries were decolonised. Their economies were distorted by the imperialist countries and there was widespread poverty and no sizeable private sector. Traditional schools of economics did not have answers to them in a manner that combined democratic values with equitable economic growth. These poor countries were the focus of school of development economics. Development economics looked at the policies and institutions that raise per capita income for all. Their concern was not only the human challenge of promoting economic growth and structural change (from agriculture to industry to services) but also improving the well being of the population as a whole through focus on health , education and employment, whether through public or private channels or a blend of the two through public private partnerships. The most prominent contemporary development economists are Nobel laureates Amartya Sen and Joseph Stiglitz and also Jean Dreze and Jeffrey Sachs.

State capitalism or Beijing Consensus

There are many ways of understanding state capitalism. One is that the State owns large businesses itself and they co-exist with the private sector. It is the simplest model which is also called mixed economy and we find it in India. State capitalism in China is different: This is a form of market economy- capitalism, in which the State acts as the dominant economic player, by owning and controlling businesses, and uses markets primarily for political capital. This model of state capitalism is called Beijing Consensus which is floated as a rival of the Washington Consensus. In the Beijing Consensus, State sets long-term strategic priorities and pursues them in five-year-plans. It does not follow text book economics but sets out its own mix of State, market and redistribution. Its growing global reach is striking. Officially it is called socialism with Chinese characteristics but critics call it capitalism with Chinese characteristics.

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State capitalism also describes a system in which the state intervenes in the economy to protect and advance the interests of large-scale businesses. For example, the bailouts that the large companies received from the US government after the Lehman crisis in 2008 when their very survival was in question.

Mercantilism

Mercantile school advocates that Government should make policies for maximising net exports because the best way of ensuring a country's prosperity is to expand market to the entire world by promoting exports. It will lead to foreign exchange reserve build up which will have humongous benefits by way of foreign investments, acquisitions, loans that are very commercially attractive. The reserves can be used to manipulate the currency as well to give further advantage to foreign trade. In the last century mercantilists believed that the country with huge gold reserves could dominate the world. In the present global economic order, it is the accumulation of foreign currency that is the biggest advantage as gold is available as a commodity that can be purchased. It dominated European economic thought and policy thought between the 16th and 18th centuries.

There are two models of mercantilism that we see presently. China followed mercantilist policies and shifted global trade balance in its favour by exporting to the whole world by putting up huge economies of scale for global supply since the 1980's. But it did not follow import substitution policies that are associated with mercantilism. (Import substitution means using domestically produced goods instead of importing the same.) Its single focus was on export-oriented economic growth for which it liberally allowed multinationals into its economy who are encouraged to make for exports. Chinese companies came up in competition and took on the sale exporting role. Domestic economy grew thus creating jobs and reducing poverty.

Another example is that of the trade policies followed by US under President Donald Trump. Donald Trump stands for — America First. He wants the US trade deficit to be cut with rest of the world. His mercantilism is based on waging trade wars with all major trading partners of the US. It includes imposition of relatively high tariff walls on imports. Re-negotiating long standing trade agreements like North American Free Trade Agreement (NAFTA) in favour of the US. Applying bilateral pressure through State dominance to open up markets for American exports is another aspect of it. Also, making the work of multilateral trade body- World Trade Organisation (WTO) difficult by weakening its dispute settlement process. Invocation of national security clauses in an unprecedented manner in the WTO to resort to high import duties. Besides, barring human capital from abroad by tightening the immigration norms. It also involves making US companies invest in the USA and not abroad for which he cut the corporate tax rates.

Behavioural Economics

Behavioural economics is a multidisciplinary study and application that uses findings from various fields of study to understand economic behavior of people. Behavioral observes human behavior to establish to what extent it is rational. We need to remember that an entire model of free market growth is premised on human economic rationality. Richard Thaler, who won the Nobel Memorial Prize in Economic Sciences in 2017 challenged that view by writing about anomalies in people's behavior that could not be explained by standard economic theory. Thaler's ideas led to the creation of behavioral science teams called nudge units to help to motivate and influence people's behavior by making subtle changes to the context in which they make decisions. Nudges can make a significant difference to micro and macro economy. It can improve savings; make people comply with tax laws; help people formalize their businesses; adopt cleanliness (Swachh Bharat); volunteer social work for health or education or traffic management etc.

Green Economics

Economic growth was accompanied by environmental costs in the form of pollution of air, water and land at a rate that threatened human and social well being. It made economic growth itself unsustainable as it depleted natural resources and caused productivity losses. The school of economics that alerts us about sustainability issues and advocates harmonious interaction between humans and nature and attempts to reconcile the two is the school of green economics. Examples are in agriculture (Green revolution in India that degraded land by overdrawing water from underground); irrigation where the improper mix of small and big dams led to environmental degradation by cutting of forests; industrial development driven by fossil fuels that cause climate change and so on. Limits to Growth report in 1972 commissioned by the Club of Rome first alerted us to the threat of unsustainability. Thomas Malthus's An Essay on the Principle of Population (1798) was the earliest such warning. Our Common Future, published by the UN's World Commission on Environment and Development (1987) popularly known as Brundtland Commission as it was headed by Gro Harlem Brundtland which famously defined sustainable development as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. That is, sustainable development is inter-generational in nature.

Green economics advocates a triple bottom line: sustaining and advancing economic, environmental and social well-being. New indices of measuring growth have been developed to promote green economy: Green GDP, Social Progress Index and Environmental Performance Index (EPI) are some examples. Millennium Development Goals (MDGs) and Sustainable Development Goals (SDGs) also advocate green economics.

Measuring Economic Growth

Economic growth is the change- increase or decrease, in the value of goods and services produced by an economy. It needs to be measured as government and private sector decisions and policies need a base for their actions. All important aspects of economy are linked to growth: tax collections; interest rates; inflation and its expectations; employment; foreign trade and so on. Without measuring growth, there is no rationality in behavior- both public and private. Investment decisions depend on the growth and inflation rate, to give one example. That is the reason for Central Statistics Office (CSO) of India to project growth figures weeks before the Union Budget is presented facilitating rational projection of revenues and expenditure which in turn influences the private sector decisions.

Economic Growth: Its Benefits and Side Effects

The first benefit of economic growth is wealth creation. It helps create jobs and increase incomes. It ensures an increase in the standard of living. Government has more tax revenues: fiscal dividend. Economic growth boosts tax revenues and provides the government with extra money to finance spending projects. For example, the flagship programmes of the government like Pradhan Mantri Awas Yojana-Gramin (PMAY-G), Pradhan Mantri Ujjwala Yojana (PMUY), Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY), Pradhan Mantri Gram Sadak Yojana (PMGSY), Ayushman Bharat, Saubhagya are a direct result of the tax buoyancy of growth. It sets up the positive spiral: rising demand encourages investment in new capital machinery which helps accelerate economic growth and to create more employment.

Side effects are the inequalities, environmental degradation, mental stress etc.

Need To Measure Economic Growth

The following aims can be attributed to the study and measure of economic growth:

- when growth is quantified, we can understand whether it is adequate or not for the given

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- goals of the economy. We can understand its potential and accordingly set targets
- we can adjust growth rates for their sustainability
 - we can prevent inflation or deflation to some extent if we see the performance of the economy in quantitative terms
 - we can balance the contributions of the three sectors of the economy and steer the direction of growth towards national goals- away from agriculture to manufacturing as in the case of India in recent years
 - target appropriate levels of employment creation and poverty alleviation
 - forecast tax revenues for governmental objectives
 - corporates can plan their business investments

Economic growth can also have a self-defeating effect: Environmental costs can be huge unless suitable managed; Inequality can have polarizing effects causing instability due to radicalisation.

Thus, unless growth is measured, growth rates can not be calculated. In the absence of such data, economic rationality- both investment and consumption diminishes. US economy in the Great Depression (1929-39) could be ended only when data was available. Therefore, Simon Kuznets, an economist gave the notion of National Income in mid 1930's to capture all economic production by individuals, companies, and the government in a single measure. It is popularly known as Gross Domestic Product (GDP) and its variant, Gross National Product (GNP). Calculation of national income is a complex and elaborate exercise. The rules and formulae that are used to capture economic growth data and conclude on relevant statistics is known as national income accounting.

GDP is defined as the total market value of all final goods and services produced within the country in a given period of time- usually a calendar year or financial year or a fraction like quarter.

GDP and GNP

While GDP includes the production within a country by all producers- citizens as well as foreign multinational corporations, GNP captures all that is produced by the citizens of a country- whether it is within the geography of the country or abroad. In other words, GDP is a geography related concept while GNP is a citizen related. GDP focuses on where the output is produced while GNP shows who produced it. GNP is GDP plus net factor income from abroad. That is, from the domestic product, we need to deduct what the foreigners have produced in the country and to that amount we need to add what citizens have produced outside the country. In the age of MNCs and globalization, one country's GDP is another country's GNP. For example: in the case of a German-owned car factory operating in the US, the profits from the factory would be counted as part of German GNP and US GDP.

If it is a highly globalized and competitive economy and many of its MNCs are operating in other countries, its GNP tends to be more. For example, Japan. Chinese GDP till last decade was almost equal to its GNP. But till last decade, there were many foreign MNCs operating in China and thus its GDP was far more than its GNP. But with China's Belt and Road initiative gaining ground, its GNP will outweigh its GDP.

In a closed economy relatively, GDP is more. For example, India till we opened up in 1991.

For most countries, however, GDP and GNP have more or less the same values.

Take the case of Ireland. Its GNP is much larger than its GDP. In Ireland, Google, Apple, Microsoft, Accenture and such other multinational corporations are headquartered due to the tax advantage they get as corporate tax rates are very low. They only have registered offices in Ireland without any production activity. The higher GDP value however is illusory as these companies are in reality non-Irish. Ireland is a tax haven, thus, attracting companies to register there rather than giving them the ecosystem for production and innovation as China did since 1980's.

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India's GDP is a little more than its GNP as inbound Foreign Direct Investment (FDI) is many times that of outbound FDI. That is, the Indian MNCs produce far less abroad than what foreign MNCs produce in India. There are remittances from abroad sent by Indians working across the world and they amounted to about US \$69 billion in 2017 but that is outnumbered by the outflows on a variety of accounts- interest payments, royalty on technology etc.

GDP vs GNP

Analysts tend to say that GDP is a better measure than GNP. The reason is that GDP is domestic production where employment is created; inflation is moderated; tax revenues are more, exports can be made for foreign currency earnings that helps in foreign exchange reserve build up and so on. GNP also has its advantages and India is a big beneficiary of it- remittances from abroad; acquisition of foreign companies; invest abroad to tap on foreign opportunities etc. But the consensus is that former is of greater value than the latter for the reasons cited.

National Income and Gross Value Added (GVA)

National Income is calculated by deducting indirect taxes from Net National Product and adding subsidies. National Income (NI) is the NNP at factor cost.

$NI = NNP - \text{Indirect Taxes} + \text{Subsidies}$

GVA is GDP minus indirect taxes. It helps us know the tax-GDP link. If the output grows and the tax buoyancy is not commensurate, the meaning is one of the following or both: non-taxed part of GDP is growing (for example, agriculture) or there is tax evasion.

Potential GDP

The actual GDP is what is being produced. It can be boosted by a variety of means. Government can borrow more than advisable and enable consumption through subsidies. Interest rates can be reduced to encourage consumption and investment but it has its own risks if the broader economy is not responding. Imports can be liberalized to encourage consumption. But its impact on trade deficit and currency valuation can be destabilizing. Thus, output growth has to be non-inflationary and sustainable. Potential gross domestic product (GDP) is the level of output that an economy can produce sustainably and without inflating the economy excessively. It is the highest level of real gross domestic product (output) that can be sustained over the long term. Sustainability, as mentioned above, is in terms of prices, fiscal deficit, current account deficit (exports can not be boosted by devaluing the exchange rate as it can be dysfunctional), financial sector not accumulating non-performing assets (NPAs) etc. Potential output in the long run, depends on a variety of factors like infrastructure, human capital and skills, potential labour force (which depends on demographic factors), level of technological development and labour productivity. The limits thus relate to natural and institutional factors.

An associated concept is output gap. It means the difference between the actual and potential GDP. If actual GDP rises and stays above potential output, it is called positive gap. It is inflationary as demand exceeds supply due to excess of money which may once again be due to fiscal excess or reduction in interest rate. Rise in demand can also be due to wage rise which is once again inflationary. In the opposite set of conditions, if actual GDP is below potential GDP, called negative gap, inflation will come down. Employment implications are that when the gap is positive, there will be full employment (all those looking for work, find work) and in fact productivity will also rise. Ideally, potential GDP is not to be exceeded for the reasons given above. Towards this objective, government's fiscal policy and Reserve Bank of India (RBI) monetary policy is suitably used.

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Per capita income

GDP/GNP divided by mid year population of the corresponding year. Per capita income is shown as an indicator of how rich or poor the country is; its standard of living and so on. But like all averages, per capita income is indicative of the prosperity of a country to a limited degree as there can be steep inequality which is often the case in majority of the countries.

Estimating GDP

There are three different ways of calculating GDP. **Output approach** adds the market value of final goods and services. The **expenditure approach** adds consumption, investment, government expenditure and net exports (exports minus imports). The **income approach** adds what factors earn: wages, profits, rents etc. The three methods must yield the same results because the total expenditures on goods and services (GNE) must by definition be equal to the value of the goods and services produced (GNP) which must be equal to the total income paid to the factors that produced these goods and services. In reality, there will be minor differences in the results obtained from the various methods due to changes in inventory levels. This is because goods in inventory have been produced (and therefore included in GDP), but not yet sold. Also, payments may not have been made, that is interest on loans; salaries or rents are not paid. So value of goods and services is arrived at but it does not match the income or expenditure as the case may be. Inventory is a detailed list of all the items in stock.

GDP considers only marketed goods. If a cleaner is hired, his pay is included in GDP. If one does the work himself, it does not add to the GDP. Thus, much of the work done by women at home- taking care of the children, aged, chores etc. which is called 'care economy' is outside the GDP. Even when the elder sibling teaches the younger one is outside the scope of national accounts.

In estimating GDP, only final goods and services are considered. That is, goods that go into making other goods – input goods, are counted only once when the final product is valued. Otherwise it becomes double counting- counted as an input and again counted as an output. Final goods are goods that are either consumed or used in the production of another good or service. For example, a car sold to a consumer is a final good and so is a car that is used as a cab. Former is consumption and the latter is investment.

Some goods are used both as inputs and also as final goods. Car tyres sold to the car manufacturer are intermediate (input) goods. The same tyres, if sold to a consumer, would be a final goods. If intermediate goods were included in the calculation of GDP, this would lead to double counting; for example, the value of tyres would be counted once when they are sold to the car manufacturer, and again when the car is sold to the consumer. It artificially inflates/deflates the value of production.

In calculating GDP, only newly produced goods are counted. Transactions in existing goods, such as second-hand cars, are not included, as these do not involve the production of new goods. Resale is excluded but the services provided by the agents are counted. That is, when a used car or house is sold, no new goods are being produced. But the auto or the real estate agent makes some money through commission which adds to the service economy.

There are 'imputed values' as a part of the GDP. All houses are assumed to be rented as it is not possible for the government to check which one is owner- occupied and which one is not. Thus, rental value of all houses is a part of GDP. It is called imputation.

Transfer payments- pensions, scholarships and universal basic income (UBI), if any that the government gives does not fetch any direct returns in terms of addition to the GDP and thus such expenditure is not included in the GDP.

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Factors of Production

Economic production is essentially value addition: inputs are added value to, to produce goods and services. Inputs are called factors of production or resources. There are four factors of production: land, labor, capital and enterprise. The first three are brought together to produce a commodity. There are two types of factors: primary and secondary. Primary factors are land, labor (the capacity to work), and capital goods. Materials and energy (fuel) are secondary factors as they are produced from land, labor and capital. Land includes not only the site of production but natural resources above or below the soil. Capital has many forms: physical, technological, financial, human, intellectual and social capital (networks of relationships necessary for cooperative work for production of value) and even civic capital (citizens working together for facilitating rights that include rule of law, right to business, good governance which are crucial for economic growth).

Market Price and Factor Cost

Market price refers to the actual transacted price and it includes indirect taxes- GST, custom duty, etc. Factor costs are the actual production costs at which goods and services are produced by the firms and industries in an economy. They are the costs of all the factors of production such as land, labor and capital. It means the rent for the land along with the cost of resources that land supports; interest on the capital that is used to buy various inputs; and labour which has to be paid wages. Factor cost refers the price arrived at after deducting from the market price the indirect taxes and adding to the resulting number government subsidies if any.

$MP = FC + \text{Indirect taxes} - \text{Subsidies}$

The concept of GDP at factor cost is useful to see how competitive market forces are and how distortionary indirect taxes are. If there is high productivity of factors, there is no need to subsidise. The differences between the two values shows the extent to which the GDP is impacted due to indirect taxes. The differentiation helps public policy to rationalize both indirect taxes and subsidies. If the government is imposing high indirect taxes and also subsidizing significantly, the two can be reduced proportionately to simplify the accounting process.

Transfer Payments

Some government expenditures are related to acquisition of goods and services and go into the production process directly. They are a part of GDP. Some expenditure like pensions, scholarships, UBI are direct transfers of money and do not directly absorb resources or create output. They are called transfer payments. They are a 'one-way' payment of money for which no good, or service is received in exchange. Governments use such payments as means of income redistribution (universal basic income) under social welfare programs such as social security, old age or disability pensions, student grants, unemployment compensation, etc. There is a need to differentiate them from subsidies. Transfer payments are a part of personal income. Subsidies paid to exporters, farmers, manufacturers are not considered transfer payments because they are linked to an economic transaction.

Transfer payments may be conditional cash transfers or unconditional cash transfers (universal basic income). Under Indira Gandhi Matritva Sahyog Yojana (IGMSY) GOI provides financial aid to pregnant women who undergo institutional delivery in hospital. The sum is also meant to help with their child's vaccination, as well as nutritional food. The money is directly transferred to the bank accounts of pregnant women. The scheme is aimed at encouraging institutional deliveries in order to reduce maternal as well as infant mortality. IGMSY is a transfer payment. It is a conditional cash transfer.

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Similar is the case with Rythu Bandhu scheme (Farmers' Investment Support Scheme {FISS}) which is a welfare program to support farmer's investment for two crops a year by the Government of Telangana. The government is providing farmers certain amount per acre per season to support the farm investment for rabi and kharif seasons. This is a first direct farmer investment support scheme in India in which the cash is paid directly.

GDP and NDP

GDP is a gross value. In the production of goods and services, the productive machinery and infrastructure undergo wear and tear. Monetary value can be attached to such depreciation- the erosion in the value of the productive base. If the depreciation is removed from GDP, what we get is net domestic product (NDP).

Real and Nominal GDP

GDP can be real or nominal. Nominal GDP is GDP without adjusting to inflation. For example, even if the amount of production is the same as last year, the market value of GDP can vary depending upon inflation or deflation- the former increases the market value while the latter decreases even as the actual production remains the same. Real GDP refers to the current year production of goods and service valued at prices of the year of comparison. The latter, for now, can be referred to as base year. Thus, current production valued at, let's say, previous year prices gives real production. Rest is price difference. Unless we know the real production, there can be statistical illusion due to inflation that can distort decision making.

GDP Deflator

Arriving at real from nominal involves use of deflator. It helps take out the contribution of inflation to the value of the output. GDP deflator is a price index. When we value the current production at base year prices or prices of any other year for comparison, price changes are captured. For example, if 10 apples made up the GDP last year/base year and the monetary value was Rs.10 and the current year GDP is valued at Rs.15 it does not automatically mean that in the current year 15 apples are produced. The number may be anything – 1 apple or more. In order to arrive at the number of apples (assuming that apples are the only goods making up the GDP) produced in the current year, we have to count the apples produced. If we produced 15 apples and the value of the current GDP is Rs.15, inflation has been zero. That is GDP deflator shows zero. If we produced only 10 apples in the current year also, then inflation is 50% on a base of Rs.10 which is the value of the GDP last year/base year. GDP deflator shows it as 50%. It is called deflator because it takes the value of the current year and compares it to the last year/ base year and thus generally we go from high to low prices. It is deflation from current to base year and inflation from base year to current year. Value is the same. Terms are different for the reasons said above.

GDP Deflator is a measure of inflation that tracks the price changes in the entire economy and not a specific limited basket of goods and services as in the price indices of Wholesale price index (WPI) and Consumer price index (CPI). It is implicitly derived from national accounts data as a ratio of GDP at current prices to constant prices. It is available with a long lag and hence has very limited use for measures related to price stability on a short term basis.

A change in prices can distort perception of actual gross domestic product even without an increase or decrease in the quantity of goods and services produced by an economy. In 2015, in India, the goods and services produced were higher than their market prices indicated. That was an exception. Normally, it is the opposite- market value of the production is higher than the actual goods produced. In both cases, there is distortion that can misguide public policy.

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Therefore, the impact of prices has to be removed to arrive at a true measure of economic growth. A deflator is used to restate output estimates at current prices into what they would be if calculated with reference to prices in an earlier year- be it the immediately preceding year or the base year or any year in between. This will give an idea of the real growth in the economy, minus the price effect. When the GDP deflator is in the negative as mentioned above, nominal GDP is less than real GDP. It means there is deflation in the country.

Base Year

For economic growth to be measured by comparison, there has to be a starting point in time. It is called the base year. All the organized production in that year makes up the GDP and based on that number, measurement of growth is made in subsequent years in percentage terms. For example, if GDP is worth 100 rupees in the base year 2011-12 and in the next year (2012-13) the value was 108, the rate of growth is 8%. Same goods and services are considered as the output in both the years. If there are new goods produced in later years after the base year is fixed, those goods are not added and considered for comparison. Nor do they make up a part of the GDP. That is a limitation we have to accept if we have to measure growth from one point to another.

Base year prices are considered constant as they make up the base for comparison of two or more figures. It is allocated the value of 100 in an index. The market value of the current year GDP for the given output is valued at the base year prices (current vs the constant prices) and the growth rate is arrived at. It gives the real output (base year prices) which is different from the nominal output (current prices). In the process, the increase in the value of the GDP due to inflation is excluded and the 'real increase' of goods and services is found out.

National income series includes growth figures of all the years having the same base year.

The base year of the national accounts is changed periodically to take into account the new goods and services in the economy and thus to depict a true picture of the economic growth. For example, software, digital hardware etc are of recent origin and if the base year remained in the 1990's, the same would be not tracked. Thus, the numbers do not give a true picture of growth and related concepts like employment. Similarly, when we continue to measure the goods and services that are no longer in production as they were- jute, type writers etc, we see the decline as fall of growth while in reality they are replaced by new products. Therefore, base year needs to be brought closer to the current year. The National Statistical Commission wants that the base year should be revised every five years.

The criteria based on which a base year is chosen are

- Should be as close as possible to the current year
- At the same time, data should be available on a reliable basis
- It should not be an exceptional year with large fluctuations due to any one- off event like demonetization, war, severe drought etc.

Seasonality

When we measure and compare economic growth, similar periods need to be compared. When we say that economic growth in a certain quarter of the year is 5%, it means that on the base provided by the same quarter in the previous year, there is a 5% growth. It is called seasonality- in very simple terms, same seasons should be compared. Seasonal adjustment ensures that the movements in GDP, or any other feature like inflation, employment, foreign financial inflows, more accurately reflect true patterns in economic activity.

National output is seasonally determined. For example, in the quarter October- December, there are many festivals and so there is more production and purchase. Also, kharif crops comes into the market. Same quarters in different years should be compared. If we compare the July-

September quarter of the current year with same quarters in the previous years, it yields actionable results. Southwest monsoons begin in June and continues for 2-3 months which impacts of construction activity.

National Income Statistics in India

The Central Statistical Office (CSO) in the Ministry of Statistics and Programme Implementation (MoSPI) is responsible for the compilation of National Accounts Statistics (NAS). At the State level, State Directorates of Economics and Statistics (DESS) have the responsibility of compiling their State Domestic Product and other aggregates. The statistics that are released by the CSO and the State DESS relate to various macro-economic aggregates of the Indian economy at current and constant prices which include gross and net domestic product, consumption, saving, capital formation, public sector transactions, per capita income etc. The CSO releases both annual and quarterly GDP estimates. Since 2015, in the new national income series the data relate to GVA too.

The first official estimates of national income were prepared by the Central Statistical Office (CSO) with base year 1948-49. These estimates were published in 1956. Since then base years changed as Indian economy grew to make new goods and services. In 2015, CSO changed base year to 2011-12. Normally, when the base year of national accounts statistics is changed, there is some change in the levels of GDP estimates due to widening the coverage as new commodities produced in the economy are covered; some informal economy becomes formal as the enterprises grow; and also because of more sophisticated methods of data collection. The CSO revises the base year of the NAS series periodically.

The first estimates of growth for the current year called Advance Estimates (AE) of National Income are released before the fiscal year is over - sometime in January, so that the budget figures can be projected rationally for the upcoming fiscal year. The advance estimates are subsequently revised and released as Quick Estimates of NAS after the full fiscal year is completed. But they are still not fully validated. Quick estimates are further revised to Provisional Estimates and the last figures are the Final estimates. The improvisation is based on the availability of data in course of time. Final estimates arrive years after the quick estimates.

New GDP Series 2015

The Central Statistics Office (CSO) came out with a new series of national accounts with 2011-12 as base year for computing size of the economy and economic growth rate. It has the effect of broadening the coverage across segments including farm, corporate and unorganised. Under the new series, the data for corporate income is collated from the corporate affairs ministry's MCA21 records, a comprehensive compendium that allows collecting granular information even from the level of the small firms. In the earlier series such data was taken primarily from the Reserve Bank of India's study on companies and finances.

On the basis of new data available by 2015, it came to be known that the 2004-05 GDP data was under-estimating industrial growth as the coverage was low and the weights were misallocated. Under the new GDP series, share of manufacturing increased to 15.8% from 11.9% in 2004-05. The share of agriculture has increased marginally in the new series to 17.2% from 16.8%.

The new series is praised as its base is wider and collection methods are more exhaustive.

Real GDP or GDP at constant (2011-12) prices for the year 2017-18 is estimated at 130.11 lakh crore. Growth rate of GDP at constant (2011-12) prices for the financial year 2017-18 is estimated at 6.7 percent. Real GVA, i.e., GVA at basic constant (2011-12) prices for the year 2017-18 is estimated at 119.76 lakh crores showing a growth rate of 6.5 percent over 2016-17.

India's per capita income was Rs 1,12,835 in March 2018.

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GDP has limitations in coverage

The measurement of national income encounters many coverage issues

- GDP does not capture black money which may be generated by two means: Illegal activities like smuggling and also by unreported incomes due to tax evasion. Thus, parallel economy poses a serious hurdle to accurate GDP estimates.
- In the rural economy, considerable portion of transactions occur as the barter economy. GDP does not cover it.
- Quite a large portion of the economy is in the informal sector- small and marginal farmers, land-less labourers, vegetable vendors, domestic help and so on. It is outside official GDP estimates
- The national income accounts do not include the 'care economy'- domestic work and housekeeping.
- Social Services are ignored- voluntary and charitable work- as it is unpaid.

GDP has limitations in the quality of data

GDP data does not capture the following qualitative data

- a. Environmental costs. National income calculations are not useful to see whether the output causes pollution or not. What matters is the output and its market value
- b. Poverty is not revealed as it yields only quantitative data about the value of the output which is the basis for calculating per capita income. In a rich country, the illusion is created that everyone enjoys a high standard of living.
- c. Inequality is not indicated.
- d. Health and education standards escape calculation in the GDP figures except as a sectoral estimate.

GDP is a measure of growth and not progress

GDP indicates growth that is quantitative. Development, progress and well being on the other hand, factor in the qualitative aspects of growth as we shall see ahead. Seen thus, GDP shows broad national economic growth in output. Simon Kuznets, who pioneered the notion of national income and GDP, did not offer this benchmark as a measure of welfare but only as a way to quantify, monetize and compare.

Growth, it must be stressed, is a precondition for welfare. Countries with higher GDP often score highly on measures of welfare, such as life expectancy.

However, even in such developed countries, GDP can not be cited as a measure of progress because it does not value intangibles like leisure, quality of life which is determined by many criteria other than economic goods like relationships; lack of stress; good mental health; quality gender relations; clean environment; culture etc.

Even while the above limitations exist in GDP methods, the reasons for using GDP as an indicator of advancement of the economy and standard of living are that it is measured frequently, widely and consistently. It can be undertaken relatively conveniently. Global comparisons are feasible.

Other measures of Development

According to critics of GDP as a concept, not only is it inadequate, it even distorts and misleads. Following examples amplify the point-

1. Rising crime rates can lift GDP by raising expenditures on security personnel and technology
2. Despite the destruction wrought by the oil spills, it boosts GDP as cleaning up adds to hiring and purchasing services and equipment

3. When more guns are sold as people feel insecure, it magnifies GDP
4. Commercial agricultural production boosts GDP even when it is unsustainable.

GDP is used as a measure of growth and other metrics that have emerged of late are used to indicate a variety of dimensions like Green GDP, Human Development Index (HDI), Inequality adjusted Human Development Index, Social Progress Index (SPI), Gross National Happiness (GNH), natural resource accounting have been suggested. These new indices and concepts are proposed to give a more complete picture of the level of well-being and sustainability of natural resources.

Human Development Index (HDI)

UN Human Development Index (HDI) was developed in 1990 by the Pakistani economist Mahbub ul Haq who was assisted by Amartya Sen and has been used since 1993 by the United Nations Development Programme in its annual report. The HDI measures the average achievements of a country in three basic dimensions of human development:

- A long and healthy life, as measured by life expectancy at birth.
- Knowledge, as measured by the adult literacy rate ; and the combined primary, secondary, and tertiary gross enrolment ratio
- A decent standard of living, as measured by gross domestic product (GDP) per capita at purchasing power parity (PPP) in US Dollars.

Each year, UN member states are listed and ranked according to these measures. The 2010 Human Development Report came up for the first time with an Inequality-adjusted Human Development Index (IHDI), which factors in inequalities in the three basic dimensions of human development (income, life expectancy, and education) and adjusts the HDI.

130 out of 189 countries were in the 2018 human development rankings of which India's HDI value for 2017 was 0.640, which put the country in the medium human development category. Between 1990 and 2017, India's HDI value increased from 0.427 to 0.640, an increase of nearly 50 percent – and an indicator of the country's remarkable achievement in lifting millions of people out of poverty.

Genuine Progress Indicator (GPI)

Redefining Progress is a think tank in the USA that devised a new measure to assess national progress in 1990's. It is called the Genuine progress indicator (GPI). It is a metric that is designed to take fuller account of the well-being of a nation beyond the size of the nation's economy, by incorporating environmental and social factors which are not measured by GDP. GPI deducts environmental costs of economic activity like biodiversity loss, resource depletion, pollution, loss of farmland and wetlands, and ozone depletion, and social costs like increase in crime and family breakdown.

Social Progress Index

Social Progress Index is similar to the GPI as it factors in social and environmental factors to set of economic growth to arrive at an indicator of progress. The indicators are different in number and weights but the basic thrust is the same. The index is published by the nonprofit Social Progress Imperative, and is based on the writings of Amartya Sen and Joseph Stiglitz.

The index has three sides

1. Basic human needs
2. Foundations of well-being
3. Opportunity

The above three broad heads include: health, sanitation, personal safety, ecosystem sustainability, shelter, access to knowledge, personal rights, and tolerance and inclusion. India

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faces challenges across many dimensions. India scores particularly low on shelter in the basic human needs dimension, access to information in the foundations of well-being dimension, and tolerance and inclusion in the opportunity dimension.

Gross National Happiness (GNH)

GNH is an attempt to define quality of life in more holistic terms than Gross National Product. The term was coined by Bhutan's former King Jigme Singye Wangchuck. While conventional development models stress economic growth as the ultimate objective, the concept of GNH is based on the premise that true development takes place when the following four dimensions are fulfilled in right measure

- equitable and sustainable socio-economic development
- preservation and promotion of cultural values
- conservation of the natural environment
- good governance.

Happiness Index

The World Happiness Report is a measure of happiness published by the United Nations Sustainable Development Solutions Network to help nations make their public policies for the happiness of their people. It is inspired by the GNH of Bhutan. The first World Happiness Report was released in 2012. World Happiness Report 2018, ranked 156 countries by their happiness levels. Finland is the world's happiest country followed by Norway, Denmark and Iceland in the 2018 World Happiness Report.

Six key variables are the basis to assess well-being: income, healthy life expectancy, social support, freedom, trust and generosity.

The entire top ten were wealthier developed nations. Yet money is not the only ingredient in the recipe for happiness. In fact, among the wealthier countries the differences in happiness levels had a lot to do with differences in mental health, physical health and personal relationships: the biggest single source of misery is mental illness.

Few factors that are strikingly different in the report are generosity, social support and so on.

It placed India in the 133rd position. Among the South Asian Association for Regional Cooperation (SAARC) countries, Pakistan was ranked 75th, while Nepal was ranked at 101st. Bhutan has been placed at 97th rank and Sri Lanka at 116th position. Bangladesh is ranked at 115th and Afghanistan was ranked 145th. Data is compiled from surveys.

Indian States and Happiness

Madhya Pradesh became the first state to set up happiness department. Andhra Pradesh is the second state. Madhya Pradesh set up an Anand Department, happiness department made up of members to work in the areas of culture, society, psychology and academia. It started happiness festivals helping people to be happy through folk music, dance, singing, drama etc. and sports and traditional activities. It also created Anand Clubs for people to form self-help groups in their local communities where skills to live a happy life could be taught and shared among members.

The OECD Better Life Index

It was adopted by the club of rich countries, Organisation for Economic Co-operation and Development (OECD) in 2011 and takes the best metrics of well-being based on the recommendations of the Commission on the Measurement of Economic Performance and Social Progress (2009). The OECD Better Life Initiative includes two main elements: "Your Better Life Index" and "How's Life?". Your Better Life Index (BLI) is an interactive tool that allows people

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to compare countries' performances according to their own views of a better life. It includes 11 "dimensions" of well-being:

1. Housing: housing conditions and spendings (e.g. real estate pricing)
2. Income: household income and financial wealth
3. Jobs: earnings, job security and unemployment
4. Community: quality of social support network
5. Education: education and what you get out of it
6. Environment: quality of environment (e.g. environmental health)
7. Governance: involvement in democracy
8. Health
9. Life Satisfaction: level of happiness
10. Safety: murder and assault rates
11. Work-life balance

Green GDP

Green Gross Domestic Product (Green GDP) is an index of economic growth with the environmental consequences of the growth factored in. From the final value of goods and services produced, the cost of ecological degradation is deducted to arrive at Green GDP. In 2004, China announced that the green GDP index would replace the Chinese GDP index. But the effort was dropped as green GDP figures shrank the size of the GDP to unimpressive levels.

Natural resources accounting and green GDP

Natural resources is the natural capital that includes the biodiversity, soil, water and air. They support one another. There is a widespread recognition that natural capital should be of the same importance as man-made capital in accounting terms, so that the ability to generate income in the future is sustained by using the stock of natural capital judiciously. By failing to account for reductions in the stock of natural resources, standard measures of national income do not represent economic growth genuinely.

National Biodiversity Action Plan published by Government of India, Ministry of Environment, Forests and Climate Change in 2008 highlighted the value of goods and services provided by biodiversity. More specifically, the Action Plan states: to assign appropriate market value to the goods and services provided by various ecosystems and strive to incorporate these costs into national accounting.

In the Nagoya (Japan) meet in 2010 on biodiversity protection, India declared that it will adopt natural resource accounting. The 2010 UN biodiversity summit decided to respect the link between economic policy, natural capital and human well being; and that there should be global partnership to mainstream natural resources accounting into economic planning. An Expert Group headed by Partha Dasgupta was convened in 2011 to examine the prospects of developing green national accounts in India. It submitted its report in 2013.

Commission on the Measurement of Economic Performance and Social Progress (CMEPSP)

The Commission on the Measurement of Economic Performance and Social Progress (CMEPSP) under Joseph Stiglitz was set up by the French Government in 2008 to examine how the wealth and social progress of a nation could be measured and if alternatives to gross domestic product (GDP) could be developed. The Final Report was published in 2009. It critiqued GDP as a measure of progress and wanted items like leisure to be included in any metric of social progress.

Purchasing Power Parity: PPP

The value of the GDP of a country is estimated in domestic currency. It is Indian rupee in the case of India. But the same can be expressed in terms of another currency. For example, US dollar. For this, the rupee value of GDP is converted into USD at the prevailing exchange rate or the average rate in a given year. For example, about Rs.70 in the calendar year 2018 is the number of rupees that fetched a USD. But many critics of this method base their criticism on the factors behind the exchange rate of rupee in relation to dollar as the markets decide it. Markets decide the rate based on a variety of factors like net foreign currency inflows; forex reserves; growth rate of the economy and its prospects; commodity dependence of the economy on global supplies and the price behavior of the latter and so on. If these factors are favourable, currency strengthens. That is, its exchange rate is strong. Meaning, the cost of foreign currency comes down in term so of domestic currency.

However, there is so much speculation in the forex markets that the market rate is far from what it should be, in the opinion of the critics of market rate of foreign currency.

A crucial factor in the determination of the exchange rate is the confidence that the international and domestic investors have in the currency of a country. Based on the confidence, they buy or sell a global currency.

In order to arrive at a more genuine rate of exchange, there is a method called purchasing power parity (PPP). It is arrived at by comparing the purchasing power of two currencies, say Indian Rupee and USD. A basket of tradable goods and services are taken and their value in rupee and dollar is taken. Based on the values, a parity is set. That is the true exchange rate because it is reflected in the market value of goods and services. PPP is defined as the number of units of a country's currency required to buy the same amount of goods and services in the domestic market as one dollar would buy in the US.

Purchasing power parity exchange rates are useful for comparing living standards between countries. Actual exchange rates can give a very misleading picture of living standards. For example, rupee fell about 15% in relation to USD in 2018 till October. At the diminished market rate of conversion, India's GDP in dollar terms fell correspondingly and so did its per capita income. But the market exchange rate may not mirror ground level conditions because living standards have not fallen in India. In fact they did not fall at all and have improved. Market exchange rate doesn't reflect the purchasing power of a currency in relation to goods and services domestically.

Measuring income in different countries using purchasing power parity exchange rates helps to avoid this problem.

PPP is used to estimate poverty and is used by the United Nations in constructing the human development index.

India's GDP by PPP is USD 9.5 trillions. USA's is 19.5 USD and China's is USD 23.2 trillion. India is the third largest by this metric. It takes that many USD to buy all goods and services produced in the country in 2017. The market conversion rate will value India's economy in 2017 at \$2.6 trillion, according to International Monetary Fund's World Economic Outlook (WEO). That made India the world's sixth largest economy, displacing France. The five economies ahead are the United States, China, Japan, Germany and United Kingdom.

It is interesting to note that US GDP is valued higher by market rate than by PPP as the global confidence in the USD is more than its real strength. Opposite is the case with Chinese Yuan.

Big Mac Index

The Big Mac index was developed by The Economist magazine of London. It is based on the theory of purchasing-power parity (PPP). It shows the parity of any two currencies, for example, between Indian Rupee and the USD based on their purchasing power of a specific variety of hamburger sold by MacDonald called Big Mac in America and Maharaja Burger in India. The parity generally works out to around 20-25 rupees per dollar. Thus, rupee is seen to be grossly undervalued.

The advantage with PPP is that it corresponds to the ground level value of the currency in India and it does not change in a volatile manner.

Structural Composition of Economy

Basically, going by the nature of economic activity, there are three sectors in the economy: extraction of raw materials (primary), manufacturing (secondary), and services (tertiary). The structure of the economy consists of these three sectors. As economy advances, the proportion of these sectors changes and there is a progression from primary to secondary to tertiary sector. Progress from one sector is caused by technology, innovation, productivity, education and human skills- all of them being interrelated.

The primary sector of the economy involves converting natural resources into goods. This sector is the supplier of raw materials for the more advanced economies. This sector includes agriculture, fishing, forestry and all mining and quarrying industries. In developing countries it plays a large role and has a diminishing share in the GDP as economy evolves.

The secondary sector of the economy includes those economic activities that work on raw materials of the primary sector with technology and turn out finished products: manufacturing and construction. It has both manufacturing and non-manufacturing. Cement, steel, chemicals and auto parts are examples of manufacturing. Water supply and construction are non-manufacturing part of the secondary sector.

Industrial sector has capital intensive-heavy and light industry. Light industry is labour intensive make largely consumer goods. Clothes, shoes, furniture and household items like consumer electronics are the examples of light industry. Heavy industry is capital intensive and produces goods for businesses: auto, steel, cement, petroleum etc in large quantities.

The tertiary sector of economy (service sector) produces "intangible or invisible goods" to businesses as well as consumers. Service sector is made up of the "soft" aspects of the economy such as health, banking, tourism, insurance, government, retail and wholesale trade, education, entertainment, transport etc.

With the rapid advancement of the tertiary sector, a new subsector of the tertiary sector emerged: quaternary sector which consists of research and development, science and technology, information services, intellectual property producing services requiring highly educated manpower.

Quinary sector is not clearly conceptualized like the preceding four sectors. Some include the highest levels of decision making in an economy in it: CEOs of firms; HODs in government, science, universities, nonprofit, healthcare, culture and the media. Some economists include care economy in it.

Structural change in the economy

When the contributions of the three main sectors of the economy change due to modernization and technological developments, the changes that the structure of the economy undergo are called structural changes. Initially agriculture dominated and later industry and still later the services sector become the predominant portions of the economy as it progresses.

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The above given meaning of structural change is the original and main view. It may also mean: a subsistence economy is transformed into commercial economy or a regulated economy is liberalized. An insulated and protectionist economy becomes open and globalized. India has been structurally reorienting its economy since the 1991 under which there is more room for markets; public sector is exposed to domestic and global competition; greater flow of foreign investment and foreign goods etc.

Indian economy: Sectors and their components

CSO in India divides the three sectors of the economy with their respective components in the following way:

I. Agriculture, forestry & fishing Crops Livestock Forestry & logging Fishing and aquaculture

II. Industry Sector Mining & quarrying Manufacturing Food Products, Beverages and Tobacco Textiles, Apparel and Leather Products, Metal Products Machinery and Equipment Other Manufactured Goods Electricity, gas, water supply & other utility services Construction

III. Services Sector Trade, repair, hotels and restaurants Trade & repair services Hotels & restaurants Transport, storage, communication & services related to broadcasting Railways Road transport Water transport Air transport Services incidental to transport Storage Communication & services related to broadcasting Financial, real estate & professional services Financial services Real estate, ownership of dwelling & professional services Community, social & Personal Services Public administration & Defense Other services

Notice that mining and quarrying are in the secondary sector.

At 2011-12 prices, composition of Agriculture & allied, Industry, and Services sector are 15 %, 31 %, and 54%, respectively.

Formal and Informal sectors of economy

Economic production may be formal and informal. Formal sector is one that is registered with the government and many government laws apply to them. For example, Factories Act and Shops and Establishments Act. Informal sector is unregistered. It consists of street vendors, domestic help, small and marginal farmers and landless labourers etc and is sizeable in size.

Units that have 10 employees or more using electricity or 20 or more without electricity are the entry level for the formal sector. All bigger companies are also in the formal sector. They are called the organised sector and it is necessary for them to register and report to the government. Employees of such firms have a variety of benefits in the form of limited working hours; holidays; insurance etc. Those forms below the above criterion are the unorganised sector. They are registered but are below the threshold of organised sector. They are formal and unorganised.

- There is thus a need to 'formalise' the economy for which in recent years government took many steps like demonetisation; GST; Jan Dhan; Digital India and incentives.

Public policy becomes more accurate with genuine data for which formalisation is important. Even otherwise, formalisation is inevitable with the evolution of economy.

Business Cycles

Economic growth is cyclical. There are periods of expansion and stagnation or decline and growth resumes. It is built into the nature of a nation's economy that boom is followed by bust. In boom more is produced due to the economies of scale which makes supplies cheap when produced in bulk. Its sales take time and thus there is slowdown. Factors not inherent in the growth process can also cause such slowdowns: commodity prices can rise and create inflation that can reduce demand and so there is slowdown. Banking crisis- bad loans and non-recovery can take place when economic expansion comes to a halt. Alternating periods of growth and

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slowdown in economic activity is called business cycle. When slowdown leads to negative growth, it is called recession or de-growth.

When an economy slows down to a level where it starts to produce less what it produced, it is in a recession. It may be called contraction or de-growth. Macroeconomic indicators like investment, consumption, employment, prices, capacity utilization, profits of companies, government tax revenues all show downward negative trend. Technically, recession is when in two successive quarters economic production is less than the same two quarters in the previous year. Recession may be caused by various events, such as a financial crisis (2008), an external trade shock (exports suffer or imports cost much more), an adverse supply shock- price shock or physical supplies etc. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply through the monetary authority, increasing government spending and decreasing taxation. Recession may end with the corrective measures taken by the government and the market. If it does not end and relapses for any reason, due to external or internal shocks, it is called double dip recession. When recession worsens, de-growth deepens with more job losses and even greater deflation, it is called 'great recession' which lasted in the world for some years after the Lehman crisis in 2008. If the great recession did not get corrected and became worse with a contraction of the GDP by approximately 10% after the recession set in, it is called depression.

2008 Subprime Crisis

The 2008 Financial Crisis refers to essentially a five year period (2008-13) of economic crisis that saw negative growth (recession), severe unemployment and homelessness. It was caused by reckless lending to those who are otherwise not creditworthy — called subprime. Interest rates were very low and thus money was cheap. Adding to it, there was excessive financial speculation. Even the crisis started in the USA, because of globalisation, it affected the whole world as the world is linked with investments and trade. Fiscal and monetary stimulus helped to reverse the recession.

Developed, developing and least developed countries

Based on criteria like GDP, level of industrialization, HDI, infrastructure and standard of living, countries can be classified. If the above criteria are in advanced stage of development, such a country is developed. Developed countries have post-industrial economies: service sector is highly developed and provides predominant portion of the GDP. A developing country or underdeveloped country, is one with an underdeveloped industrial and infrastructural base though there may be pockets of development, low Human Development Index (HDI), standard of living is low, demographic growth rate is high and so on. Among the developing countries, those which opened up economies in the nineties or later and are rapidly urbanizing, like India, are classified as newly industrialized countries (NIC). Some place them between developed and developing countries. NICs are attractive investment destinations given their strong economic growth rates and future potential.

World Bank classification

Based on per capita income, World Bank classified countries as shown in the table below:

Category Per Capita (current US\$)

- Low-income < 1,005
- Lower-middle income 1,006 - 3,955
- Upper-middle income 3,956 - 12,235
- High-income > 12,235

A high-income economy is defined by the World Bank as a country with a per capita income of US\$12,235 or more in 2017. A high income country need not be developed country though all developed countries have a high per capita income. According to the United Nations, for

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example, some high income countries may also be developing countries. The GCC (Persian Gulf States) countries, for example, are classified as developing high income countries. GCC countries are rich but not developed. They have pockets of export economy based on oil and gas and the rest of the economy is underdeveloped.

Least Developed Countries (LDCs)

According to the United Nations, a country is classified as a Least Developed Country if it meets three criteria:

- Poverty: per capita less than US \$1,035
- Human resource weakness (based on indicators of nutrition, health, education and adult literacy)
- Economic vulnerability (based on instability of agricultural production, instability of exports of goods and services, economic importance of non-traditional activities, merchandise export concentration, handicap of economic smallness, and the percentage of population displaced by natural disasters)

LDC criteria is reviewed every three years. There are currently 47 countries on the list of LDCs.

Macro-economy and Human capital

Human capital is the sum of knowledge, health, skills that make up the ability to perform labor to produce economic value. It is the lifeline of economic development. It needs to be built up for sustained and inclusive growth.

Public goods

Public goods and private goods are the two classes of goods that we have in the economy. Public goods are non-excludable and non-rivalrous. 'non-rivalry' means that one person's enjoyment of a good does not diminish the ability of other people to enjoy the same good. For example, municipal park, street lights and public roads. The other is 'non-excludability' meaning that people cannot be prevented from enjoying the good. Air quality is an example of a public good. Oxygen cylinder or gas mask is a private good. National defence is non-excludable. Everyone in the country is protected and no one can be excluded.

Markets do not produce public goods and government provides them.

There are merit, non-merit and demerit goods. Merit goods are worthy of subsidisation by the government. For example, food for low income groups and fertilisers and seeds for small and marginal farmers. Non-merit goods are relatively unworthy of subsidies. Even while they are important for public consumption and need to be made available affordably, the government is not in a position to do so for fiscal/financial reasons. For example, all college education. Demerit goods are those whose consumption needs to be discouraged as it is unhealthy for the consumers as well as society at large, so-called 'sin goods': tobacco, alcohol etc. It may not be feasible to ban them and so they are highly taxed.

Opportunity costs of government expenditure

Resources like money can be used for several purposes and all of them produce returns that are desirable. But only one can be chosen leaving the rest. The cost of the next best opportunity is opportunity cost. For example, when the government spends on Bharatmala, it is clear that the same expenditure on some other public utility also will yield useful results. But the government chooses to spend on national highways as it sees the benefits as a larger multiplier than any other item. Here, the opportunity cost of the expenditure is- what it costs in not opting for the next best. The criteria of calculating opportunity costs for welfare programmes are not commercial. That however does not mean the government can crowd out economic resources and lose sight of economic growth and productivity. Challenge lies in calibration.

Planned Economic Development and Niti Aayog

Independent India's economic development was driven by socio-economic planning by government. Planned economy is one in which the state owns, partly or wholly the economy and directs it in a centralized manner, that is, power is concentrated at the highest level of governance- the Union Government in India. . State sets the priorities for growth. Private sector is given a role- large or small depends on how capable it is. Till the 1970's, private sector in India had a residuary role. Later it expanded and today it dominates the Indian economy. It is referred to as command economy as the economy works at the command of the government. Command economies were set up in communist China and USSR for rapid economic growth and social and economic justice but have been dismantled in the last three decades as they do not create wealth sustainably and are not conducive for innovation and efficiency. North Korea is still command economy.

In a market economy, state has a limited role in the management of the economy. Production, distribution and consumption decisions are predominantly left to the market, that is demand and supply.

History of Economic Planning in India

India adopted socio economic planning after Independence for the following reasons: there was no significant private sector in the country; Russian experience with planning for economic development attracted our leaders; planning held superior benefits by way of balanced regional development and redistribution of wealth; British colonialism through East Indian company was severely resented by people; Jawaharlal Nehru was attracted to the benefits of democratic socialism. But before Independence itself, there were attempts to prepare Independent India for planned economy though the models offered by different sections differed quite significantly.

Sir Mokshagundam Visvesvaraya

M. Visvesvaraya (1860-1962) who was an engineer and designed the Krishna Raja Sagara Dam and sponsored the Bhadravati Iron Works. He was an admirer of Japan's industrial progress and also studied the Soviet Five Year Plans and the initiatives of the American President Roosevelt whose New Deal (it was a huge government economic intervention to revive economy that was mired in the Great Depression) showed the power of State to rebuild economies. In 1934 he published suggestions for a ten-year plan for India which was the first attempt at economic planning in India. It is proposed under the Plan to double the income of the country within ten years. He believed that left to private enterprises, industries will not make satisfactory progress. Government should take the lead; an official planning body should be set up, and correct comprehensive statistics should be published yearly. In his book titled "Planned Economy for India" (1934), he set the goal of poverty eradication through growth.

The Indian National Congress established a National Planning Committee under the chairmanship of Jawaharlal Nehru (1938) to formulate plans to ensure an adequate standard of living for the masses and get rid of poverty. It advocated heavy industries that were essential both to build other industries and for Indian self-defence; heavy industries had to be in public ownership, for both redistributive and security purposes; redistribution of land away from the big landlords would eliminate rural poverty.

Bombay Plan

In 1944 leading businessmen and industrialists (including Sir Purshottamdas Thakurdas, JRD Tata, GD Birla and others) put forward "A Plan of Economic Development for India" - popularly known as the 'Bombay Plan'. It saw India's future progress based on further expansion of the textile and consumer industries already flourishing in cities like Bombay and Ahmedabad; state

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should provide infrastructure, invest in basic industries like steel, and protect Indian industry from foreign competition. Its objectives were a doubling of the output of the agricultural sector and a five-fold growth in the industrial sector over 15 years. Bombay Plan was premised on the view that the economy could not grow without government intervention and regulation.

MN Roy and People's Plan: During the 1940's, the Indian Federation of Labour published its People's Plan by MN Roy that stressed on employment and wage goods.

SN Agarwala and Gandhian Plan: He was a follower of Mahatma Gandhi and published Gandhian Plan that emphasized on decentralization; agricultural development; employment; cottage industries etc.

Mixed Economy

India is a mixed economy combining features of both market economies and socialist planned economies. Thus, there is a regulated private sector (the regulations have decreased since liberalization from the late 1980's) and a public sector. The public sector generally covers areas which are deemed too important; or not profitable enough for the private sector. Such services as railways passenger services and atomic energy are exclusively carried out by the government.

Since Independence, for the first three-four decades the public sector dominated and in fact sectors like banking saw nationalization. From the time of economic reforms (since 1991) greater role for the private sector defined the economy- be it by deregulation, divestment or privatisation. Thus, the state-market mix changed towards the market since 1991 but the economy is predominantly mixed.

Planning Goals

India launched five year plans for rapid growth from 1951. The long term goals that were common to all the five year plans.

- Growth
- Modernization
- self-reliance and
- social justice

New Delhi

Economic growth was one of the primary objectives and is expected to spread to all sections and regions; raise resources for the Government to spend on socio-economic priorities etc. It would trickle down to all people and regions. Growth is the precondition for all other objectives like poverty eradication, employment generation; inequality reduction; human capital building etc.

Modernization is improvement in technology. It is driven by innovation and investment in R&D. Education is the foundation of modernization.

Self-reliance means relying on the resources of the country and not depending on other countries and the foreign MNCs for investment and growth. It was a pragmatic as well as an aspirational decision to be self-reliant. Since India had no foreign exchange to import, it was important that we produce the goods ourselves. Invitation to MNCs re-generated the fears of colonialism returning as neo-colonialism. Nehru-Mahalanobis model of growth that closed Indian economy and relied on basic industries is the main plank for self-reliance. However, opting for the Liberalization, Privatization and Globalization model (LPG) since 1991 and later becoming a founding member of World Trade Organization (WTO) in 1995 made us depart from self-reliance as LPG offered scope for faster growth and also by then India was in a position to globalize and benefit unlike immediately after Independence.

The term self-reliance should not be confused with self-sufficiency – the former means depending on resources of the one's own country as much as possible and only then resorting to imports or foreign investment, thus, and avoid dependence on external inflows; the latter means that the country has all the resources it needs. No country can be self-sufficient.

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Social justice means inclusive and equitable growth where inequalities are not steep and benefits of growth reach all- rural-urban, man-woman; caste divide and inter-regional divides are reduced. While the above four are the long term goals of the planning process, each five year plan has specific objectives and priorities.

Financial Resources For The Five Year Plans

- The resources for the Plan come from-
- Central budget
- State budgets
- PSEs
- Domestic private sector
- FDI which is foreign direct investment into India to produce goods and services like producing cement or setting up a bank, for example.
- Gross Budgetary Support: GBS is the amount from the central Budget that goes to fund the plan investments during the plan period. It is the central share in the five year plan; assistance to states for their five year plan shares; and also funding the central public sector.

History of Planning

First Plan (1951- 56): The First Plan stressed on agriculture, in view of large scale import of foodgrains and inflationary pressures on the economy. The annual average growth rate during the First Plan was 3.61% as against a target of 2.1%. Renowned economist KN Raj was one of the main architects of India's first five-year plan.

Second Plan (1956-61): With agricultural targets of previous plan achieved, major stress was on the establishment of heavy industries. Rate of investment was targeted to increase from 7% to 11%. The Plan achieved ahead of targeted growth rate. The plan was based on Nehru-Mahalanobis model: self-reliance and basic-industry driven growth.

Nehru-Mahalanobis Model of Economic Growth

Indian economy at the time of Independence was characterized by dependence on exports of primary commodities like cotton and natural minerals; negligible industrial base; underproductive agriculture etc. 1st FYP focused on agriculture for food security. But industrialization was urgently needed to modernize the economy and improve technology and national defence.

To deliver these results, 2nd FYP plan adopted is Nehru-Mahalanobis strategy of development as it was articulated by Jawaharlal Nehru's vision and P.C.Mahalanobis was its chief architect. The central idea underlying this strategy is well conveyed by the following statement from the plan document. "If industrialization is to be rapid enough, the country must aim at developing basic industries and industries which make machines to make the machines needed for further development."

The Mahalanobis model of growth is based on the predominance of the basic goods (capital goods or investment goods which are goods that are used to make further goods like machines, tools, factories, etc). It is based on the premise that it would attract all round investment, ancillarisation (the industries that supply inputs), build townships and result in a higher rate of growth of output- trickle down effect. That will boost employment generation, poverty alleviation, exports etc. The emphasis was on expanding the productive ability of the system, through forging strong industrial linkages, as rapidly as possible.

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Other Elements of the Model Are

- Import substitution. Protective barriers against foreign competition to enable Indian companies to develop domestically produced alternatives for imported goods and to reduce India's reliance on foreign capital.
- A sizeable public sector active in vital areas of the economy including atomic energy and rail transport.
- A vibrant small-scale sector driving consumer goods production for dispersed and equitable growth and producing entrepreneurs.

In terms of the core objective of stepping up the rate of growth of industrial production, the strategy paid off. Rate of growth of overall industrial production picked up. The strategy laid the foundation for a well-diversified industrial structure within a reasonably short period and this was a major achievement. It gave the base for self-reliance.

However, the strategy is criticized for the imbalances between the growth of the heavy industry sector and other spheres like agriculture and consumer goods etc that resulted. It is further criticized as it relied on 'trickle down effect'- benefits of growth will flow to all sections in course of time. This approach to eradication of poverty is slow and incremental. It is believed that frontal attack on poverty is required. It should be noted trickle down effect does produce results but given our the size of the population, growth has to be in double digits for a long period sustainably for the trickle down effect to work.

Third Plan (1961-66): It tried to balance industry and agriculture. The aim of Third Plan was to establish a self sustaining economy. For the first time, India resorted to borrowing from IMF. Rupee was also devalued for the first time in 1966. India's conflict with Pakistan and repeated droughts also contributed in the failure of this Plan.

Annual Plans: As the Third Plan experienced difficulties on the external front (war with China in 1962 and Pakistan in 1965); and the economic troubles mounted on the domestic front- inflation, floods, forex crisis- and there was political instability with the death of Nehru and Lal Bahadur Shastri, the Fourth Plan could not be started from 1966. There were three annual plans till 1969. This period is called plan holiday i.e. when five year plans are not implemented and only annual plans are operated. The Annual Plans were: 1966-67, 1967-68 and 1968-69.

Fourth Plan (1969-74): The main objective of this Plan was growth with stability. The Plan laid special emphasis on improving the condition of the under-privileged and weaker sections through provision of education and employment. Bank nationalization, privy purse abolition to princes (Privy Purse was a payment made to the families of erstwhile princely states as part of their agreements to integrate with India after Independence); results of green revolution, oil shocks (oil export countries raising the price of oil many times to use it as a political weapon to demand a home for Palestinians), Indo-Pak war are the significant developments in this plan period.

Fifth Plan (1974-79): The main objective of the Plan was Growth for Social Justice. It was cut short by the Janata Party that came to power in 1977. Janata 6th FYP was launched in 1977 but was removed from official records by the government that came to power in 1980 and the official 6th FYP was launched. The year 1979-80 was thus a gap year when there was no FYP and again became a plan holiday.

Rolling Plan

It was adopted in India in 1962, in the aftermath of Chinese attack on India, in the Defence Ministry in India. Professor Gunnar Myrdal (author of 'Asian Drama') recommended it for developing countries in his book - Indian Economic Planning in Its Broader Setting. It was contemplated by the Janata government in 1977. In the rolling plan model, even as annual and multi year goals are set, they are not rigidly followed as ground level conditions may not be conducive; and so they are liable to be reset according to the circumstances. Rolling plan becomes necessary in circumstances that are fluid. It is in between a normal FYP and a plan holiday (annual plans). The main advantage of the rolling plans is that they are flexible and are able to overcome the rigidity of fixed five year plans by resetting targets, projections and allocations as per the changing conditions in the country's economy. The main disadvantage of this plan is that if the targets are revised each year, it becomes very difficult to achieve them. Frequent revisions result in instability of the economy.

Sixth Plan (1980-1985): Removal of poverty was the foremost objective of Sixth Plan. Another area of emphasis was infrastructure, which was to be strengthened for development of both industry and agriculture. The achieved growth rate of 5.7% was more than the targeted one. Direct attack on poverty was the main stress of the Plan. Integrated Rural Development Programme (IRDP), Training of Rural Youth for Self Employment (TRYSEM), Development of Women and Children in Rural Areas (DWCR), National Rural Employment Programme (NREP) and Rural Landless Employment Guarantee Programme (RLEGP) were started in the 6th plan to aid economic growth in tackling poverty. 1981 saw India take a loan from the International Monetary Fund.

Seventh Plan (1985-90): This Plan stressed on rapid growth in foodgrains production and increase in employment opportunities. The growth rate of 5.81% achieved in this Plan was more than the targeted one. The plan saw the beginnings of liberalization of Indian economy. Consensus was built during the plan for economic liberalization. Long-term fiscal policy was started. For the first time 3 year Export-Import policy was announced.

The 8th Plan could not start in 1990 due to economic crisis, external uncertainties and political instability. There were two annual plans- plan holiday- 1990-91 and 1991-92.

Eighth Plan (1992-1997): It is a watershed plan as the country's economic growth model was reoriented. India had to take IMF loan to ease the balance of payments (BOP) situation when the foreign currency reserves were depleted to a unmanageably low level. The twin deficits of budget and current account had to be managed and so 'big bang' reforms were adopted. India became a member of the World Trade Organization on 1 January 1995. Panchayati Raj and Nagar Palika institutions were given Constitutional status so that plan benefits could percolate to grassroots. Securities and Exchange Board of India (SEBI) that was already there was given a statutory status for which an Act of parliament was passed. The major objectives included controlling population growth, poverty reduction, employment generation, strengthening the infrastructure, institution building, involvement of Panchayati Raj, Nagar Palikas were the other aspects of the plan. The target growth rate was 5.6% and the actual growth rate was 6.8%. The Plan was based on Rao-Manmohan Singh model of liberalization.

Rao-Manmohan Singh Model of Growth

Economic reforms since 1991 are based on the Rao-Manmohan model. Mr. Narasimha Rao, was the PM in 1991 and Finance Minister was Dr. Manmohan Singh. The model has the following contents:

- Reorient the role of State in economic management. State should refocus on social and infrastructural development, primarily

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- Dismantle selectively controls and permits in order to permit private sector to invest liberally
- Open up the economy and create competition for PSEs- for better productivity and profitability
- External sector liberalization in order to integrate Indian economy with the global economy to benefit from the resource flows and competition.
- Forex reserves accumulated thus alleviating BOP pressures and the foreign flows- FDI and FII increased. Indian economy became competitive. Exports started to pick up.

Indicative Planning

It is characterized by an economy where the private sector is given a substantial role. State would turn its role into a facilitator from that of a controller and regulator. With the launch of the economic reforms in 1991, indicative planning was inevitable. It was adopted since 8th five year plan (1992-97). It was decided that trade and industry would be increasingly freed from government control and that planning in India should become more and more indicative and supportive in nature. In other words, the remodeling of economic growth necessitated recasting the planning model from imperative and directive ('hard') to indicative ('soft') planning. Since the Government did not contribute the majority of the financial resources, it had to indicate the policy direction to the corporate sector and encourage them to contribute to plan targets. Government should create the right policy climate- predictable, irreversible and transparent- to help the corporate sector contribute resources for the plan: fiscal, monetary, forex and other dimensions.

Indicative planning is to assist the private sector with information that is essential for its operations regarding priorities and plan targets. Here, the Government and the corporate sector are more or less equal partners and together are responsible for the accomplishment of planning goals. Government unlike earlier, contributes less than 50% of the financial resources. Government provides the right type of policies- tax, trade, investment and other related policies in aid of the priorities and creates the right type of milieu for the private sector including the foreign sector to contribute to the results. Indicative planning gives the Government an opportunity to give the private sector encouragement to achieve growth in areas where the country has inherent strengths. It is known to have brought Japan results in shifting towards microelectronics. In France, too indicative planning was in vogue.

Planning Commission would work on building a long-term strategic vision of the future. The concentration would be on anticipating future trends and evolving strategies for competitive international standards. Public sector would be gradually withdrawn from areas where no public purpose is served by its presence. The new approach to development will be based on "a re-examination and re-orientation of the role of the government".

Ninth Five Year Plan (1997-2002): The plan started in the midst of a coalition government that was unstable. East Asian financial crisis took place in 1997. Millennium changed during the plan. India went for its first American depository receipt (ADR) in 1999- first Indian company was listed in a stock exchange in the USA called Nasdaq. 9/11 terrorist attack took place. Kargil war took place in 1999. Nuclear bomb was detonated in 1998. Swarnajayanti Gram Swarojgar Yojana (SGSY) was launched in 1999 by subsuming previous programmes like - IRDP (Integrated rural development program in 1980), TRYSEM, DWCRA (Development of women and children in rural areas in 1982) etc. Pradhan Mantri Gram Sadak Yojana (PMGSY) was started in 2000. Golden Quadrilateral (GQ), national highway network connecting the four major metro cities of India- Delhi (north), Kolkata (east), Mumbai (west) and Chennai (south) was launched in 2001. Privatisation of public sector units was started during the ninth plan while disinvestment began in the previous plan.

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Tenth Five Year Plan (2002–2007) The main objectives of the tenth Five Year Plan of India were:

- Attain 8% GDP growth per year.
- Reduction of poverty rate by 5 percentage points by 2007.
- Providing gainful and high-quality employment at least to those who become eligible for work every year (there are millions of people already looking for work, the backlog of unemployed)
- Reduction of gender gaps in literacy and wage rates by at least 50% by 2007.

The plan began on a note of severe drought that the nation suffered from in 2002-13. GDP growth plunged to about 4%. The next year, due to 'base effect', growth went beyond 8%. Base effect is: when absolute numerical changes are expressed in percentage terms, they look muted or magnified. On a low base, the same number looks large while on a high base, it looks small. For example, 5 on 10 is 50% but on 100 is only 5%.

The plan saw global economy grow. India also benefited. NREGA and National Rural Health Mission were begun in this plan.

Economy grew at 7.8%.

Eleventh Five Year Plan (2007-12): The plan was launched when the global economy went into great recession with the bankruptcy of Lehman Brothers in the USA and many banks and insurance companies in US and western Europe. Greece suffered sovereign debt crisis when the government could not service the loans it took from the world. Fiscal stimulus was the norm in the world post-Lehman-crisis when government borrowed beyond prudence and spent to revive the economies in the Keynesian manner.

'Towards Faster and More Inclusive Growth' is the central theme of the plan. It promised to accelerate economic growth and make it more inclusive: lower poverty, generate 70 million new jobs, and reduce unemployment to less than 5%. The chief thrust of the plan was agriculture, education and infrastructure – all areas that remain a concern in a rapidly growing economy. Growth target was 9% but actual achievement was 8%.

Twelfth Five Year Plan (2012-17): aimed to achieve annual average economic growth rate of 8 per cent. Its aim was 'Faster, Sustainable, and More Inclusive Growth.' Government changed in 2014 and the plan was not pursued. It achieved 6.9% rate of growth. Demonetisation took place in this plan in 2016.

Achievements of Planning

In the last about 65 years since planning began, the National Income increased many times. In 2018, India is the third largest economy in Asia with about \$2.85 trillion GDP after China and Japan. By 2018, India is the sixth largest in the world after the U.S., China, Japan Germany and France. By PPP measurement, India is 3rd largest in the world.

Social indicators improved - Maternal Mortality Rate (MMR), Infant mortality rate (IMR), literacy, disease eradication etc. The industrial infrastructure is relatively strong – cement, steel, fertilizers, chemicals, etc Agricultural growth is also gaining momentum with food grains production at record levels.

Forex reserves are substantial which is a dramatic turnaround from 1991 when we had one billion dollars. India's services sector is acknowledged globally. There has been considerable expansion of higher education. At the time of Independence there were 20 universities and 591 colleges while today there are more than 700 universities and about 40,000 colleges.

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The failures of planning are equally clear

- Poverty is still rampant
- Unemployment is high
- Quality of education outcomes is low
- Gender disparities are still steep
- Research and Development(R&D) is not globally competitive
- Exports are not growing much
- Farm productivity is low
- Regional imbalances are intensifying
- Malnutrition haunts about half the children in India.

Economic Reforms

Since July 1991, India took up economic reforms towards greater involvement of market forces and private investment, to achieve higher rates of economic growth so that socio-economic problems like unemployment, poverty, shortage of essential goods and services, regional economic imbalances and so on can be successfully solved. The reasons to reform the economy are:

- Indian economy reached a level of growth and strength to benefit from an open market model
- Private sector in India had come of age and was willing and capable of playing a major role
- Indian economy needed to integrate with the world due to advantages like capital flows, technology, higher level of exports, state of art stock markets. Indian corporates can raise finances abroad and so on.

The country under the leadership of Dr. Manmohan Singh, Union Finance minister (1991-1996 and Prime Minister 2004-14) converted the economic crisis — caused by domestic cumulative problems of economy, political instability and gulf crisis — into an opportunity to initiate and institutionalise economic reforms to open up the economy. The deep crisis in 1991 could not be solved by superficial solutions. Therefore, structural reforms were adopted. The old structure was closed, overregulated and uncompetitive. Therefore, liberalization, privatization and globalization (LPG) strategy was embarked upon.

It was realized that by closing economy to global influences, the country was missing on technology developments and also gains from global trade and investments. India needed exports, FDI and FPI for stability on the balance of payments front and higher growth rates for social development. Worldwide, countries were embracing market model of growth, for example China, with proven results. So, India could make the historic shift from centralized planning to market-based model of growth.

Initially reforms were feared and resisted as there was scepticism and fear related to-

- Large scale unemployment due to capital intensity of growth process to be competitive (WE WANTED/ ARE LABOUR INTENSIVE GROWTH PROCESS)
- Worsening of poverty as fiscal concerns will reduce social sector expenditure
- Flood of imports as customs duties will come down.
- food security will suffer as social sector expenditure will be reduced
- Pressures on labour sector due to domestic industry's compulsions to cut costs
- Some fears have indeed come true- jobless growth and uncertainty in farming. But by and large, reforms have done well.

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Reforms mainly targeted the following areas:

- Dismantling the licence raj so that private sector and government were on a level playing field
- Drive public sector towards sustainable profitability and global play by dereservation; disinvestment; professionalization of management etc
- Fiscal reforms (FRBM) for a variety of objectives
- Monetary policy institutional infrastructure revamped with Monetary Policy Committee; inflation targeting introduced
- Banking sector is selectively deregulated and global prudential norms are adopted for financial stability
- move towards free float of rupee and relaxation of controls on convertibility; aggressive export promotion; FDI and FII inflows etc.

Reforms were prioritized and sequenced in such a way as to make them sustainable and render further reforms feasible. For example, first generation reforms involved essentially non-legislative government initiatives- reduce SLR and CRR for the banking sector. Disinvestment of the PSEs. Deregulation of the rupee gradually and later make exchange rate of the rupee market-driven and so on. The second generation reforms depend on the success of the first generation reforms; involve legislative reforms and touch a wider section of the society- labour reforms; GST, FDI expansion etc. The former prepares the economy for the latter.

Above all, reforms with human face was the goal, unlike elsewhere in the world like in South America in the 1980's. It yielded results- the social effect of the reforms in India is seen in the flagship schemes making an impact on health, education, social protection etc. The reforms gained consensus and showed positive results as can be seen below.

- Rates of economic growth went up
- BOP crisis has been solved in the first few years and today the country has about sizeable forex reserves
- Services sector (tertiary sector) has grown in importance and today contributes almost 55% of GDP emerging as a global player-India being the global back office.
- Resilience of the economy in the face of Great Recession (2008-13)
- Consumer choice has increased
- Tax-GDP ratio may have shrunk but the tax collections and base increased
- Nature of external debt has changed and the short term component is less
- Indian companies are listed on Nasdaq and New York Stock Exchange and raised billions of dollars for investment
- FIIs and FDI picked up.
- Indian corporates have become MNCs and acquired global majors like Jaguar and Anglo-Dutch steelmaker Corus.

NITI Aayog

In 2015, Government of India set up the NITI Aayog or National Institution for Transforming India Aayog by replacing Planning Commission. In Hindi, NITI means Policy, and Ayog means Commission. The reasons were that the nature of economy changed towards a market-dominated system and that the rights of states were to be given greater consideration for which a new structure and dynamic was required. Planning Commission is largely portrayed as overriding the sensitivities and priorities of states and thus was not respectful of federalism. Niti Aayog is a policy think-tank of Union Government of India that aims to involve the states in economic and development policy making in India. It provides strategic and technical advice to the government. Prime Minister of India heads the Aayog as its chairperson.

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The reason for Niti Aayog is: India is a diversified country and its states are in various phases of economic development along with their own strengths and weaknesses. In this context, a 'one size fits all' approach to economic planning is obsolete. It cannot make India competitive in today's "global economy"

It has two wings: one is political (Governing Council) and the other is Full-time organisation. NITI Aayog comprises the following:

1. Prime Minister of India is the Chairperson
2. Governing Council comprising the Chief Ministers of all the States /UTs and Lieutenant
3. Governors of Union Territories and special invitees
4. Full time Organizational framework comprises of
 - Vice-Chairperson
 - Members: Four Full-time
 - Part-time members: Maximum of two from leading universities research organizations and other relevant institutions in an ex-officio capacity. Part-time members will be on a rotational basis
 - Ex Officio members: Maximum of four members of the Union Council of Ministers to be nominated by the Prime Minister
 - Special invitees from the Union Council of Ministers
 - Regional Councils may be formed to address specific issues and contingencies impacting more than one state or a region. These are formed for a specified tenure. Regional Councils will be convened by the Prime Minister and will comprise of the Chief Ministers of States and Lt. Governors of Union Territories in the region. These will be chaired by the Chairperson of the NITI Aayog or his nominee
 - Experts, specialists and practitioners with relevant domain knowledge as special invitees nominated by the Prime Minister
 - Chief Executive Officer: To be appointed by the Prime Minister for a fixed tenure

At the core of NITI Aayog's creation are two hubs – Team India Hub and the Knowledge and Innovation Hub. The Team India Hub leads the engagement of states with the Central government, while the Knowledge and Innovation Hub builds NITI's think-tank capabilities. These hubs reflect the two key tasks of the Aayog.

Aims and Objectives of NITI Ayog

NITI Aayog provides a critical directional and strategic input into the development process. It is a "think-tank" that will provide Governments at the central and state levels with relevant strategic and technical advice across the spectrum of key elements of policy such as Make in India, Digital India and Swachh Bharat.

It will foster better Inter-Ministry coordination and better Centre-State coordination. It will help evolve a shared vision of national development priorities, and foster cooperative federalism, recognizing that strong states make a strong nation.

It will develop a mechanisms to formulate credible plans at the village level and aggregate these progressively at higher levels of government- bottom up approach to development. It will ensure inclusive economic growth.

It will create a knowledge, innovation and entrepreneurial support system through a collaborative community of national and international experts, practitioners and partners.

NITI Aayog will monitor and evaluate the implementation of programmes and focus on technology upgradation and capacity building.

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Through the above, the NITI Aayog will aim to accomplish the following objectives and opportunities:

- An administration paradigm in which the Government is an “enabler” rather than a “provider of first and last resort.”
- Progress from “food security” to focus on a mix of agricultural production, as well as actual returns that farmers get from their produce.
- Ensure that the economically vibrant middle-class remains engaged, and its potential is fully realized.
- Leverage India's pool of entrepreneurial, scientific and intellectual human capital.
- Incorporate the significant geo-economic and geo-political strength of the Non- Resident Indian Community.
- Use urbanization as an opportunity to create a wholesome and secure habitat through the use of modern technology.
- Use technology to reduce opacity and potential for misadventures in governance.
- Leveraging of India's demographic dividend, and realization of the potential of youth, men and women, through education, skill development, elimination of gender bias, and employment
- Elimination of poverty, and the chance for every Indian to live a life of dignity and self-respect
- Redressal of inequalities based on gender bias, caste and economic disparities
- Integrate villages institutionally into the development process
- Policy support to more than 50 million small businesses, which are a major source of employment creation
- Safeguarding of our environmental and ecological assets

NITI Aayog vs Planning Commission

The composition and functions of the two bodies are different

1. Planning Commission did not have state/UT representation
2. Planning Commission was the operational arm of the National Development Council (NDC) which is a political institution. Niti Aayog has the Governing Council that approximates to the NDC. That is, Niti is PC and NDC in one body.
3. Planning Commission was directed by the National Development Council to flesh out the Five Year Plans. Niti Aayog on the other hand has both the political wing composed Union Ministers and Chief Ministers as well as the think tank wing in a single body.
4. Niti Aayog has provision of regional councils that Planning Commission did not have.
5. Planning Commission had more members and all were full time members.
6. Planning Commission had allocative functions – recommending plan financial transfers; centrally sponsored schemes etc. Niti Aayog does not have such function.

Critical Appraisal

The government's move to replace the Planning Commission with Niti Aayog to play a facilitative role and not allocative role and assist in federalizing the growth process in the country with empowerment of states received mixed reactions. Supporters say: the idea to create an institution where states' leaders will be part of the collective thinking with the Centre and other stakeholders in formulating a vision for the development of the country is right as compared with the previous structure, where few experts formulated the vision and presented it to the National Development Council (NDC).

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The relationship under the previous institution (Planning Commission) was unequal, because the institution gave plan assistance to states and made states dependent on it making the relationship unequal. Now, Niti tried to have a more equal relationship.

There is a very good example of the equality in the relationship (between NITI Aayog and states). In 2015, three sub-groups of chief ministers were set up for making recommendations in three important areas (centrally-sponsored schemes, skill development and Swachh Bharat). The sub-group on centrally-sponsored schemes was asked to study 66 centrally-sponsored schemes and recommend which ones to continue, which to transfer to states, and which to cut down.

NITI Aayog does monitor, coordinate and ensure implementation of the globally accepted Sustainable Development Goals (SDGs). It is nominated as the nodal body that will bring the 17 development goals into action across India.

NITI's Achievements By 2017

Its initiatives include "15 year vision map", "7 year strategy" and "3 year action agenda", AMRUT, Digital India, Atal Innovation Mission, Medical Education Reform, agriculture reforms (Model Land Leasing Law, Reforms of the Agricultural Produce Marketing Committee Act, Agricultural Marketing and Farmer Friendly Reforms Index for ranking states), Indices Measuring States' Performance in Health, Education and Water Management, Sub-Group of Chief Ministers on Rationalization of Centrally Sponsored Schemes, Sub-Group of Chief Ministers on Swachh Bharat Abhiyan, Sub-Group of Chief Ministers on Skill Development, Task Forces on Agriculture and Elimination of Poverty. Amrut is Atal Mission for Rejuvenation and Urban Transformation, the scheme was launched in 2015 with the focus to establish infrastructure that could ensure adequate sewage networks and water supply for urban transformation by implementing urban revival projects.

Vision Document, Strategy & Action Agenda beyond 12th Five Year Plan

Replacing the Five Year Plans beyond March, 2017, NITI Aayog prepared the 15-year vision document; A 7-year strategy document spanning 2017-18 to 2023-24 to convert the longer-term vision into implementable policy and action as a part of a "National Development Agenda". The 3-year Action Agenda for 2017-18 to 2019-20 aligns development plans to the 14th Finance Commission Award period.

India And The Manufacturing Sector

India's development experience with planning in the 1950's began with heavy emphasis on manufacturing. The Nehru-Mahalanobis model (2nd FYP) is premised on capital goods industry and self-reliance. India had the manpower. Technical institutes were set up and higher education received its due. R&D was focused upon to feed into manufacturing through better technology. However, the momentum could not be sustained for a variety of reasons-

- Entrepreneurial initiative was discouraged with laws like Industries (Development and Regulation) Act, 1951 (IDRA) which was enacted in pursuance of the Industrial Policy Resolution, 1948 and was formulated for the purpose of development and regulation of industries in India by the Central Government. But it led to license-permit raj that dampened the private sector
- Monopolistic and Restrictive Trade Practice under MRTP Act, 1969 suppressed large scale production
- 17% of the world population lives in just 2.4% of the global area that is India and thus there is huge pressure on land and it posed problems of land acquisition
- Rehabilitation and Resettlement Policy(R&R) for big infrastructural and industrial projects could not be implemented satisfactorily and as a result land acquisition became even more difficult in a democracy

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- We did not open up to FDI and thus competition suffered as did productivity
- Our neglect of primary and secondary education along with health did not create adequate human capital for sustained manufacturing
- Infrastructure bottlenecks – power, roads, telecom etc. acted as bottlenecks to industrial growth
- Reservation for the MSMEs and favourable terms to them led to the moral hazard- they developed a vested interest in not scaling up
- Rigid labour laws deterred investment and thus competition suffered and so did growth in industry. Manufacturing being labour intensive, suffered more.
- Lack of ease of doing business also hampered investment and industrial growth though the World Bank rankings have boosted India's position since 2016. In 2018 India reached 77th position on the Ease of Doing Business (EODB) index which is almost double of what it was recently.
- In the last two decades, services sector emerged as a globally strong force and it seemed that we could skip the secondary sector and focus on becoming a global back office. In the process, manufacturing further became neglected

By the nineties, China already was becoming an global industrial powerhouse. Since then Chinese imports did not allow Indian local manufacturing and in fact led to de- industrialisation in India eg. solar cells, tyres, steel, electronic items etc. India's bilateral trade with China was \$89.6 bn in 2017-18 of which \$63 billion was the trade deficit in favour of China.

Services sector-led growth in India

The services sector is the dominant sector in India's GDP with about 55% contribution. There is more FDI into services sector than manufacturing. Service exports are making up for merchandise trade deficit. In general, services sector grows after the industrial sector has developed. In today's developed economies, manufacturing led the growth process in early stages of development. After agriculture matured, services took over the lead role only after a fairly high level of industrial development had been reached. The same pattern was also observed in the East Asian "tiger" economies and in China.

Like many other developing countries, India's economic growth has not conformed to this classical historical pattern of agriculture to industry to services. We opted to promote services sector in preference to manufacturing as we saw global opportunity in it as also because our land resources did not allow us to go for large scale manufacturing- SEZs (special economic zones), thermal power plants, nuclear power plants, steel plants, huge multipurpose dams all faced problems of land acquisition. India differs from China in this regard as well as the fact that in China the government held all the land.

Services sector did not require such sizes of land. Inadequate attention to development of physical infrastructure constrained manufacturing more than services.

In the 1990's government policies favoured services and disadvantaged manufacturing. Compared to manufacturing, services were not taxed till 1994 and since then were lightly taxed. Rise in per capita income also had a significant effect on the demand for better services in the country- education, health, transport, finance, advertising, telecom, insurance etc.

And since the reforms of the early 1990s, trade and foreign investment for services have been more liberal than those for manufacturing.

Services contribute more than manufacturing to India's "output growth, productivity growth and job growth."

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Technology and globalisation helped India to think of scaling up through digitisation. The digital push to economic growth made globalization inevitable and irreversible and raised prospects for service sector growth in India. It automatically led to growth in financial services, telecom, retail and spread to transportation, travel, tourism, media, health services and so on as government policies favoured and the per capita incomes rose. Technology facilitated new ways of doing business via increasing computing power, data storage capacity and data transmission capacity. Telecom connectivity has grown at a rapid pace. Farmers who were earlier dependent on middlemen, now have better information on pricing. The organised retail sector has brought in efficiency in the supply chain. We are now seeing the rapid growth of e-commerce and online retail stores. The automobile industry is a key contributor as the rise in sales of personal vehicles has created a multiplier effect on support services required after sales.

Transportation and logistics services grew rapidly as demand for goods grew across the country. Service sector not only creates direct output and direct employment, but also the ancillary services and employment generation. For every job created in the IT and IT enabled services sector, four jobs are created elsewhere.

India's current per capita income is about US\$2,000 and has enormous implications for savings growth, consumption demand and the ability to be a sustainable driver for the demand in services. Travel sector is seeing growth as air and road travel grow, in turn leading to a growth in demand for tourism and hotels. It is aided by initiatives like Paryatan Parv organized by Ministry of Tourism in collaboration with other Central Ministries and State Governments across the country.

Similarly other sectors like media, entertainment, health care and education all benefited with increased aspirations of the retail consumer.

Technology continues to drive innovation and creation of new smart business models which are based on leveraging digitisation, mobility and social media. Given these factors, coupled with our demographic dividend and the expected jump to a higher trajectory for both growth and per capita GDP, we have the right conditions for a virtuous cycle to sustain for many years. GOI wants services sector boosted and so has many incentives in a wide variety of sectors such as health care, tourism, education, engineering, communications, transportation, information technology, banking, finance, management, among others.

Ejaz Ghani, World Bank economist and a service sector evangelist for India's rapid economic growth, says: 'The digital revolution, by lowering transaction costs in services and overcoming problems of asymmetric information, has made services more dynamic than in the past. The emergence of e-commerce platforms is an example of how digital revolution can lower transaction costs, increase productivity as well as make it more inclusive. There is mounting empirical evidence that developing countries are relying more on services and less on manufacturing as drivers of growth and job creation. Globalization of services is the tip of the iceberg. Services, which account for more than 70% of global output, are still in their infancy. The long-held view that services are non-transportable, non-tradable, and non-scalable no longer holds with the technological changes in the digital world. For example, telemedicine, consultancy, knowledge process outsourcing (KPO) The globalization of services provides new opportunities for India to find areas beyond manufacturing, where it can specialize, scale up, and achieve high growth. As the services produced and traded across the world expand with globalization, the possibilities to develop based on services will continue to expand. This pace of change will be rapid in line with the digital revolution. Global internet usage has grown. But this growth is much faster in developing countries.'

Given its stage of development, India needs accelerated investments in both physical and human infrastructure to support new drivers of growth and job creation. But unlike in the manufacturing sector, for services, investments in human infrastructure, education and skills, matter much more.

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Some policy experts have rightly argued that India is on the “brink” of a techno-institutional revolution. For example, mobile technology’s role in banking. Expansion of digital technology can play a big role in improving rural access to banking. Payments Banks since 2016 have been helping in the process which in turn could help medium-size cities, small towns and villages to become new drivers of growth. Digital India, Jan Dhan, Skill India, Payments Banks are some examples.

Services Sector Growth and jobs in India -

There are three basic groups of services-

- traditional services which include “wholesale and retail trade, “hotels and restaurants” and “transport and storage”
- modern services which include “communication”, “financial services” and “real estate-renting-business services” — banking and insurance, education, computer related services, research and development, health, communication, legal services and accounting
- social services which include “public administration and defence” and “community, social and personal services”.

The traditional and the modern services are mostly in the private sector while the social services are mostly in the public sector.

Modern and social services are produced in the organised sector and mainly by formal employees. Traditional services are essentially produced in the unorganised sector and mainly by self-employed workers and employ generally low-skilled workers while modern and social services employ high-skilled workers. Labour productivity in traditional services is much lower than that in modern services. According to available statistics, modern services accounted for less than 11 per cent of total services employment and 38 percent of services output, while traditional services accounted for 58 per cent of services employment and 40 percent of services output. Thus, modern services productivity is higher.

India’s services-led growth has not been jobless. It has created not only large number of jobs but also high quality, formal, highly skilled jobs. Real wages of both regular-formal and casual employees have also increased though the former have gained much more than the latter.

But in India, the share of the services sector to GDP is about 55%, while its share of total employment is much less, at 28.6%. – about half of its contribution to GDP.

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FISCAL SYSTEM

Fiscal Policy Definitions

- That part of government policy which is concerned with raising revenue through taxation and with deciding on the amounts and purposes of government spending.
- The government's policy in regard to taxation and spending programs.
- Government spending policies that influence macroeconomic conditions. These policies affect tax rates and government spending in an effort to control the economy.
- Government policy for dealing with the budget-especially with taxation and borrowing
- The policy of a government in controlling its own expenditures and taxation, which together make up the budget
- Fiscal policy is the means by which a government adjusts its levels of revenue and spending in order to monitor and influence a nation's economy

Fiscal policy relates to raising and spending money in quantitative and qualitative terms- how much and how. The entire budget exercise with all the policies within it is the core of the fiscal policy.

As far as fiscal receipts are concerned, taxes, user charges (power, water, transport charges etc.); disinvestment proceeds; borrowings from internal and external sources are the main channels. All receipts are not earned and some are borrowed. What is earned is revenues and the rest are receipts. Receipts and expenditure are divided into revenue and capital accounts, though the Constitution in Art.112 talks of revenue and other expenditure and does not mention capital account explicitly.

Fiscal policy deals not only with the quantity but the quality of public finance as well. In other words, not merely how much is raised and spent but how has it been raised- is it raised by way of taxes or borrowings; are they excessive or irrational etc. Also, the way the finances so raised are used- productively for capital formation or for welfare or wastefully. Fiscal policy also sheds light on populist expenditure- spending without economic rationality and in a counter productive manner. For example, power subsidy for farmers.

Fiscal policy can achieve important public policy goals like growth; equity; sustainability; gender empowerment; education; promotion of small scale industries; encouragement to agriculture; location of industries in rural areas; labour -intensive growth; export promotion; development of sound social and physical infrastructure etc.

Art.112 of the Constitution mandates that expenditure be shown in revenue and other categories.

Plan and Non-Plan expenditure was shown in the budget till 2016-17 but was dropped since 2017-18 due to distortionary effects that we will see ahead. They are not constitutional terms.

A break up of the finances into revenue and capital streams, in general, is as follows:

- Revenue receipts (Revenue account) include: taxes and non-tax sources. Taxes are income tax, corporation tax, GST, basic customs duty etc; non tax resources include user charges for railways, power, transport etc; interest receipts on loans given; dividends; profits etc.
- Revenue account expenditure does not directly create assets: interest payments, defence; subsidies and public administration. Financial grants to states are also in this account as they do not create any assets for the central government. It is synonymous with maintenance and consumption expenditure as also welfare expenditure.

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The Finance Commission grants are given to the State Governments under the statutory provisions under Article 275(1) of the Constitution. Finance Commission - recommended grants under this Constitutional provision in relation to revenue deficit grants, Grants in aid for State disaster response funds and Grants in aid for the rural and urban local bodies.

- Capital account receipts are recoveries of loans and advances made by the Union Government to States, UTs and PSUs; fresh borrowings from inside the country and from abroad; disinvestment proceeds etc. As is clear from above, some of them are debt and some are non-debt.
- Capital account expenditure is loans made to States, UTs and PSUs; expenditure for asset creation in infrastructure and social areas; loans repaid etc.

Definitions of Deficits

Revenue deficit (RD) is the difference between the revenue receipts on tax and non-tax sides and the revenue expenditure. Revenue expenditure is conventionally considered synonymous with consumption and non-development, in general. But in the case of India, the social sector expenditure like on education, labour welfare, health, contributions to agriculture, social security etc on government – flagship schemes are in the revenue expenditure. When revenue deficit is zero, we can fund for consumption from government's own resources and not borrowing.

Effective revenue deficit (ERD)

An additional fiscal indicator, namely, effective revenue deficit, was introduced in the FRBM Act in 2012. Effective revenue deficit has been defined as the difference between "the revenue deficit and the grants for creation of capital assets".

Grants for creation of capital assets are defined as "the grants-in-aid given by the Central Government to the State Governments, constitutional authorities or bodies, autonomous bodies and other scheme implementing agencies for creation of capital assets".

This concept was devised to protect the part of revenue deficit that created capital assets like school and hospital buildings, irrigation works etc.

Government has abandoned fixing targets for the reduction and elimination of revenue deficit and ERD.

Fiscal deficit is the difference between what the government earns and its total expenditure. That is, the difference between what is received by the government on revenue account and all the non-debt creating capital receipts like recovered loans and disinvestment proceeds on the capital accounts; and the total expenditure. It amounts to all borrowings of the government in a given period which is a fiscal year normally. Fiscal Responsibility and Budget Management (FRBM) Act was amended in 2018 to fix fiscal deficit target at 3% for 2020-21.

Difference between Gross FD and Net FD: Total borrowings of the union government in a given fiscal year are the gross FD. We have to deduct the following from the gross FD to get net FD:

Loans to States, local Governments, central public sector enterprises etc.

Budget deficit considers only the difference between the total budgeted receipts and the expenditure, the amount that is printed by RBI and supplied to the GOI as credit. The concept was discarded in 1997 as it distorted accounting. It considered only the printed part of the deficit as deficit but overlooked the amount that the RBI borrowed from the markets (banks etc). Thus, budget deficit presented only a partial picture of government debt.

Fiscal Deficit mirrors the health of government finances most comprehensively and accurately unlike the budget deficit concept and so is the only deficit that is tracked to be rationalised by the government of India from 2018.

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Monetised deficit is the borrowings made from the RBI through printing fresh currency. It is resorted to when the government cannot borrow from the market (banks and financial institutions like LIC etc.) any longer due to inadequacy of credit available and so pressure on interest rates. It means infusion of fresh currency into the market. It was discontinued from 2006 as a part of the FRBM and since then RBI does not normally print to lend to the GOI.

Primary deficit is the difference between the fiscal deficit and the interest payments. The concept helps in assessing the progress of the government in its current fiscal control efforts. A new government is assessed for its fiscal performance on the basis of primary deficit as interest payments are a legacy. Rest of the FD can be rationalised and in fact brought down to a level where government may end up borrowing less than interest payments. It is called primary surplus. Later when all borrowing stop, interest payments are made from budgetary revenues though such a budgetary phenomenon may only be in remote future, if at all.

Deficit Financing

When government revenues are not adequate for financing its expenditure, it resorts to having the gap filled through printing of fresh currency by the central bank (RBI). It is called deficit financing. All governments face such budgetary gaps and unless they are filled by deficit financing, investment and welfare suffer. In fact, with government investment, private sector investment picks up as when a bridge or port is built by government the inputs are provided by the private sector- cement etc. Labour is also necessary. Thus, employment and consumption are facilitated. However, there are certain rules to be followed as otherwise it becomes inflationary with all the destabilising consequences.

When the Government has to spend more than what it can raise through tax, non-tax and other sources, it borrows from the market. It can not borrow above a certain amount from the market as it may be inflationary, push up interest rates and thus make it even more costly for the government to service the loan, and 'crowd out' private investment. Under such circumstances, Reserve Bank of India prints money and supplies credit though at a cost. It is called deficit financing.

The money printed by the RBI is called high powered money or reserve money or monetary base.

The beneficial contribution of deficit financing to India's economic development is manifold. First, in the early 1950s, our domestic savings ratio was less than 9 percent of GDP, and that constrained the investment and welfare activity of the government. Second, the capacity to raise non-inflationary sources of financing (taxes, small savings, genuine public borrowings, etc.) was highly limited. Third, external aid could supplement domestic funding only to a limited extent. Besides, it is better to source debt from inside than outside.

Fourth, foreign direct investment was discouraged as a source of investment and thus scarcity of investment resulted. Therefore, government had to itself take up investment even if it meant borrowing through monetization-printing.

There are two views on the matter. There are some people who regard deficit financing as essential for the purposes of development and welfare; as a healthy means of stimulating economy. There are those who regard any deficit financing as inflationary and a serious threat to the financial stability of the economy.

On balance it may be said that, if deficit financing is done prudently, kept within rational limits; laws like FRBM control the deficit; and the borrowed money is used productively, it is healthy.

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The viability and desirability of deficit financing, in short, depends on

- Extent of borrowing
- End use of the money borrowed.

How Much of Fiscal Deficit Is Right?

Fiscal deficit (FD) is an annual amount while what accumulates historically is the public debt-domestic and external together. To a limited extent, FD is important as the Government's ability to help growth and welfare increases. Government can always return the loans when its revenues improve due to tax buoyancy. However, FD becomes problematic when it overshoots a rational threshold. Sovereign debt crisis (country finds it difficult to service external debt contracted in foreign currency) is the result of unsustainably high debt.

Therefore, moderation of fiscal deficit is important.

Large deficits deprive the nation of sustainable economic growth- inter-generational equity is damaged as the next generation will have to pay higher taxes because the present generation is reckless and has heavy burden of debt.

Government liabilities- interest payments- increase and there is far less for development.

BOP pressures may mount if inflows drop due to the country being downgraded by rating agencies like Standard and Poor, Moody, Fitch etc. due to its macroeconomic instability caused by excessive borrowings. Therefore, FD must be moderated- they are desirable within limits but hurtful beyond the limits.

The above analysis applies to FD in normal times. But in abnormal times like since 2008-09 when the world crashed into the great recession impacting Indian economy negatively, FD was allowed to be increased for the fiscal stimuli which was necessary to arrest downturn in the economy and revive growth. FRBM allows such counter-cyclical expenditure. Even then, deficit should be incurred not for populist expenditure but to stimulate the economy.

Fiscal stimulus

Global recession impacted India and our economy was threatened with slowdown. Tax revenues were hit. There was a fall in demand. Corporate sector postponed investment. Threat to employment was real. Therefore, Government took recourse to the Keynesian solution of borrowing and spending. FRBM limits were set aside and the need of the hour was not prudence but stimulus. It is called pump-priming. The result is that fiscal deficit reached an abnormally high level- 6.8% in the year 2009-10.

Firstly, the Government provided three focused fiscal stimulus packages in the form of initially, indirect tax relief to boost demand and increased expenditure on public projects to create employment and public assets. Later some direct tax relief was also given.

Secondly, the RBI took a number of monetary easing and liquidity enhancing measures to facilitate flow of funds from the financial system to meet the need of consumers and producers. Lower rates and sumptuous liquidity was meant to tempt borrowers.

These measures were effective in preventing slowdown. The growth rate improved to 8.4 % for the next two fiscal years of 2009-10 and 2010-11.

The deficit was financed by raising internal debt through the RBI; and from Public Account surplus cash.

The unsustainably high fiscal deficit could not be continued for long and had to be rolled back to normal levels in a calibrated manner and it was embarked upon in since 2010-11.

FRBM Act

It was originally passed in 2003 and was amended later. FRBM was necessary to ensure that the government did not borrow beyond rational limits; borrowing for consumption has to be brought to zero over a period; only borrowing for asset creation was to be allowed; total internal debt of the GOI should be limited; RBI should not be the primary lender- that is RBI can not print to give credit to the government.

The original aim was to ensure all the above targets to be realised by 2008-09 but global great recession intervened and the targets have since not been feasible. Budget 2018-19 amended the FRBM Act to shift the target of 3% fiscal deficit-GDP ratio to end- March 2021. No target has been set for revenue deficit. The new statutory anchors relate to the general (centre and states) and Central government debt-GDP ratios that are to be reduced to 60% and 40% of GDP, respectively, by 2024-25, based on the recommendations of the report by the FRBM Review Committee headed by NK Singh.

When the FRBM Act limits government borrowing it applies to a cap on the level of guarantees that the Government stands as well and not only to the amount the government borrows.

FRBM Act was based on Art.292 of the Indian Constitution that gives power to Parliament to limit borrowing by the GOI on the security of CFI.

Under the FRBM Act, the following documents are to be laid in both the Houses of Parliament along with the Annual Financial Statement and Demands for Grants in the budget session :

1. Medium-Term Fiscal Policy Statement
2. Fiscal Policy Strategy Statement and
3. Macroeconomic Framework Statement

In 2012 the Act was amended to ensure that the following fourth document is to be laid in the session immediately following the budget session in which the above documents are presented in the Parliament: Medium Term Expenditure Framework Statement (MTEF).

MTEF presents a three-year rolling target for the expenditure indicators with specification of underlying assumptions and risks involved. The statement provides an estimate of expenditure commitments for various items viz. Education, Health, Rural Development, Energy, Subsidies and Pension etc.

The Medium-term Fiscal Policy Statement (MTFP) sets out three-year rolling targets for five specific fiscal indicators in relation to GDP at market prices

- Revenue Deficit
- effective revenue deficit
- Fiscal Deficit
- Tax to GDP ratio
- Total outstanding Debt as percentage of GDP at the end of the year.

FRBM act further mandates that on a quarterly basis, that Government shall place before both the Houses of Parliament an assessment of trends in receipts and expenditure.

Under exceptional circumstances, Government may be compelled to breach targets. In case of deviations, the Government would not only be required to take corrective measures, but the Finance Minister shall also make a statement in both the Houses of Parliament. Borrowing from the RBI through monetisation is permitted in exceptional situations like natural calamities.

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In a nutshell, FRBM was brought in for fiscal discipline; increase plan expenditure; reduce the amount of borrowings; meet consumption from government's own fiscal resources; leave the RBI with autonomy as far as money creation goes etc. New Zealand was the first country to enact a Fiscal Responsibility Act in 1994. A similar legislation, the Charter of Budget Honesty, was enacted in Australia. The UK, too enacted a Code for Fiscal Stability. The global recession from 2008 onwards has made the government breach the FRBM targets vastly. But fiscal consolidation since then has been on track and the target for FD in 2017-18 as mentioned above is 3.2% of GDP and to be made 3% by 2018-19.

Revenue deficit target abolition: Pros and cons

In 2018, Fiscal Responsibility and Budget Management (FRBM) framework was amended and the target for the RD was scrapped. The reason is that much of RD is for funding flagships like Ujjwala, Saubhagya, Bharatata etc. From 2018-19, only fiscal deficit will be targeted and should reach incrementally with annual targets at 3% of GDP by 2020-21. The criticism is that all the borrowings can be used for consumption if there is no target to zero the RD.

Twin Deficit Challenge

Budget deficit (fiscal deficit) and current account deficit (CAD) are together known as twin deficits. If they are not prudently managed, they can mutually damage each other. The explanation is as follows: CAD can grow when exports do not increase and imports do or when there are supply shocks like in 2018 when international crude prices went up rapidly and India is 85% dependent on crude imports.

The result: foreign inflows will slow and outflows will increase (capital flight) as the country may face serious difficulties in financing exports. Rupee will depreciate making the CAD problem even worse. When imports are made with costly rupee, it leads to inflation at home. Government has to subsidise goods and services to moderate inflation. Thus government borrowings mount and fiscal deficit breaches rational targets. That in turn makes foreign investors panic and leave the country making rupee lose even more value.

Thus, FD and CAD feed into each other and need to be managed very well.

Fiscal Consolidation

Fiscal consolidation means strengthening government finances. It essentially means reduce government annual borrowings and further reduce the historic cumulative public debt. Fiscal consolidation is critical as it provides macro-economic stability; cuts wasteful expenditure; can enable government to spend more on infrastructure and social sectors. Tax reforms, disinvestment, better targeting of subsidies and so on are the hallmarks of fiscal consolidation. Enactment of FRBM Act provides an institutional framework and binds the government to adopt prudent fiscal policies. Fiscal consolidation requires that centre and states both work for balancing their budgets.

In recent years, fiscal consolidation in India included the following reforms:

- Revenue reforms that include tax reforms like GST, corporate tax reform, wealth tax abolition, capital gains tax reforms ; rationalization of tax exemptions, improving efficiency of tax collection, and tax stability
- Capital side receipts were boosted through disinvestment and privatisation
- On the expenditure side, reform areas include rationalising subsidies through adoption of digital technologies and better targeting through Aadhaar; cutting out non-essential and unproductive activities, schemes and projects, allocation of resources to priority areas, reducing cost of services, rationalizing subsidies; reduction of time and cost overruns on projects, getting proper 'outcome' from output

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The reduction in fiscal deficit should not be achieved by a reduction in capital expenditure. It should be done by way of realisation of higher revenues and rationalizing revenue expenditure. Austerity measures may also be applied to cut down on administrative waste.

N.K. Singh Review Committee on FRBM

Five member FRBM Review Committee was set up in 2016 under the Chairpersonship of Shri N.K.Singh with terms of reference (ToR) that included comprehensive review of the existing FRBM Act in the light of contemporary changes, past outcomes, global economic developments, best international practices and to recommend the future fiscal framework and roadmap for the country. The committee submitted its report in 2017. It suggested-

- creation of a new Fiscal Council that will prepare multi-year fiscal forecasts for the central and state governments (together called the general government) and provide an independent assessment of the central government's fiscal performance and compliance with targets set under the new law.
- focus on public debt to GDP ratio- target of 60% debt to GDP by 2023 from the present level of about 68%-40% for the central government and 20% for state governments.
- adopting fiscal deficit as the key operational target at 3% of GDP for three years, between 2017-18 and 2019-20.
- prescribed a so-called glide path to these targets—steady progress towards them—and suggested that there be some flexibility in the deficit targets on both sides, downwards when growth is good and upwards when it isn't.
- to deal with unforeseen events such as war, calamities of national proportion, collapse of agricultural activity, far-reaching structural reforms, and sharp decline in real output growth of at least 3 percentage points, the committee has specified deviation in fiscal deficit target of not more than 0.5 percentage points. The committee said that if there is a sharp increase in real output growth of at least 3 percentage points above the average for the previous four quarters, fiscal deficit must fall by at least 0.5 percentage points below the target.
- For any deviations, the Centre would be expected to hold formal consultations with the three-member Fiscal Council.

State Development Loans (SDLs)

SDLs are debt securities auctioned by RBI to raise loans for state governments. They are like the GOI securities but there is a difference: central government issues both treasury bills and bonds while state governments issue only bonds or called SDLs. Bills have a maturity of less than one year and bonds one year or more. SDLs are eligible securities for SLR and LAF (repo) purposes, and are bought by banks, insurance companies, mutual funds, provident funds and other institutional investors.

WMAs, special WMAs and overdraft

Ways and means advances (WMA) are temporary advances made by RBI to centre and states under the RBI Act to bridge the short term mismatches between expenditure and receipts. Interest rate is the repo rate and if the government wants more than the allotted amount (overdraft), a penal rate- 2% extra is charged on the additional amount. There are two types of WMA – normal and special. While Normal WMA are clean advances without any security, Special WMA are secured advances provided against the pledge of government of India-dated securities. Central government is eligible for WMA while states can have special WMAs also.

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Zero Base Budgeting (ZBB)

When financial resources are scarce and the priorities are many, a method has to be worked out to select the most important ones. ZBB is one such. ZBB methodology was taken up first in 1987 in the Union Budget for some items. Many state governments also applied it, for example, Government of Rajasthan and Maharashtra. The Maharashtra Government renamed it 'Development-based budget'.

The name of ZBB comes from the fact that every year budget making starts from a base of zero and programmes are added according to their worth. Under the ZBB, a close and critical examination is made of the existing government programmes, projects and other activities to ensure that funds are made available to high priority items by eliminating outdated programmes and reducing funds to the low priority items. Governmental programmes and projects are appraised every year as if they are new and funding for the existing items is not continued merely because a part of the project cost has already been incurred. Programmes are discarded if the cost-benefit ratio is below the prescribed norms.

Zero-based budgeting runs contrary to traditional budgeting where the previous year's budget is taken as a base. It re-evaluates the entire budget.

ZBB as a resource planning and control technique and process yielded substantial benefits in the advanced countries like New Zealand, UK, Australia and Sweden in terms of efficiency gains, better resource-use, lower costs and finally surplus budgets, particularly in New Zealand.

However, the use of ZBB to human development programmes and poverty alleviation and employment generation programmes and other government flagships is limited and the results are cumulative and can not be assessed annually. For example, Ayushman Bharat, Saubhagya, Ujjwala etc. But they can always be improved.

The Economic Survey 2014 says that the expenditure on social schemes needs to be rationalised. "What is needed is a 'zero budgeting' approach with a revamp, reorganization, and convergence of schemes."

Crowding Out

Excessive government borrowing can lead to shrinkage of the liquidity in the market; forces the interest rates to go up; private investment is crowded out for two reasons: liquidity availability is less and the rates are high. Investment suffers and growth decelerates. The Government also may not spend the borrowed resources well to generate returns. It may spend on populist schemes. However, if the government deploys the funds well, it may have a 'crowding in' effect: the infrastructure built can have a multiplier effect on investment, jobs, tax collections and growth. For example, Bharatmala, the highway project.

Small Savings

Small savings instruments are Post Office Monthly Income Schemes and Time Deposits; National Savings Scheme; Indira Vikas Patra; Kisan Vikas Patra; Public Provident Fund and so on. They are aimed at promoting safe and long-term savings by individuals. They are called small savings because the amount saved is relatively small. They are initiated by the central Government but mobilized by the State Governments; and are deposited with and managed by the central government. As a reward for promoting savings, State Governments receive all such savings as loan- each state is lent what is collected from its territory at a slightly higher rate of interest than what the GOI pays to the saver.

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Small savings are a sizeable portion of the financial savings of the country. They contribute to the finances of the Government- federal and State- that is, they are an important source of borrowing for the government. These schemes have tax concession that enhances their attraction for the small savers. They also earn a rate of interest that is higher in comparison to what the banks offer. They are meant to be savings by low income and other groups but are open to all.

Small savings instruments in India are retailed through 1.53 lakh post offices of which about 1.29 lakh are in rural areas.

The National Small Savings Fund (NSSF), in the Public Account of India has all the small savings. Money in the Fund is invested in Central and State Government Securities.

The Fund is administered by the Government of India, Ministry of Finance (Department of Economic Affairs) under National Small Savings Fund (Custody and Investment) Rules, 2001, framed by the President under Article 283(1) of the Constitution.

States represented to the centre that they are not ready to borrow from the NSSF as the rates are much higher than the market. The government in 2017 exempted all but four States from mandatory borrowing from NSSF. It means that all other states except the four are not on-lent the savings mobilized. But the centre needs to keep up with these schemes to promote savings and offer attractive rates to senior citizens and such other needy. WHICH 4 STATES

Thus, what the states are not borrowing from NSSF, the centre takes and uses it to part fund the fiscal gap in the budget. The NSSF borrowings are serviced from CFI.

It will help the Centre lower its dependence on market borrowings through the RBI.

Budget Reforms

In recent years the following budget reforms were taken up for more efficiency, better synchronisation of public finance with general economy, cutting down populism etc. They are-

- Budget presentation preponed – Union budget was traditionally presented in the last week of February and passed by mid-May. However, since 2017-18, Union budget is being presented on February 1.
- The Railway Budget was presented separately since 1924 on the recommendation of committee led by Sir William Acworth. This was done because Railway revenue was high. But railway revenue had shrunk to 11.5 percent of general revenue. From 2017- 18 onwards, railway budget is merged with the general budget and there is no separate railway budget, for the government to take a holistic view.
- Plan and non-plan expenditure removed because it was creating distortions as we will see ahead.
- Shankaracharya committee on calendar for budget was set up to suggest what are the pros and cons of different budget calendars like presenting on January 1 or February 1 or July 1 or in November.

Plan And Non Plan Expenditure Classification And Its Unsustainability

In the Budget, receipts and expenditure are shown under revenue and capital accounts. Till 2016-17, each account of expenditure was subdivided into plan and non-plan. The former was for asset creation- physical, human and social. The latter was for maintenance of assets. Assets are dams, roads, power plants etc. While the intent was good, one important perverse effect was that assets created were not being maintained because maintenance expenditure would be classified as non-plan and public perception was that government was spending more on consumption/maintenance and less on capital formation. Thus assets were neglected. Also, human and social assets were classified as plan but under the revenue account. It created an opinion that revenue expenditure was mounting though in reality it was for flagship programmes. Therefore, from 2017-18, the budgetary distinction was dropped.

Public Debt

Government liabilities have been broadly classified as

- debt contracted against the Consolidated Fund of India (defined as Public Debt) and
- other liabilities in the Public Account

Public debt means the debt of the government. It includes government's internal debt and external debt. Internal debt essentially comprises of borrowings inside the country like market loans through government securities; and borrowing from the RBI through printing. Other Liabilities include liabilities on account of Provident Funds, small saving deposits etc. External debt means what the nation owes to foreign lenders- includes private sector borrowings too. However, public debt includes what the government owes to lenders inside and outside the country. That is, that part of national external debt which is contracted by the union government becomes the external debt part of public debt.

India's debt to GDP ratio, when the total outstanding liability –internal and external, is included as of March 2017, was 68.5%. Most of the public debt in India is contracted at fixed interest rates.

Generally, Government debt as a percent of GDP is used by investors to measure a country's ability to make future payments on its debt, thus affecting the country's borrowing costs and government bond yields.

External Debt

Annual Publication 'India's External Debt: A Status Report' prepared by the Department of Economic Affairs, Ministry of Finance, Government of India gives a detailed analysis of India's External Debt position. Sources of external debt are-

1. Multilateral
2. Bilateral

3. IMF

4. Export Credit

5. Commercial Borrowings

6. NRI Deposits (dollar)

7. Rupee Debt (Foreign portfolio investment {FPI} and NRI rupee deposits)

By the beginning of 2018, important dimensions of India's external debt stock were-

- India's external debt stock stood at about US\$ 515 billion.
- Long-term external debt accounted for 81 percent, while the remaining was short-term.
- The share of Government (Sovereign) and non-Government debt in the total external debt were 21.2 percent and 78.8 percent respectively.
- US dollar denominated debt accounted for 48.2 per cent of India's total external debt, followed by Indian rupee (37.3 percent), SDR (5.7 percent), Japanese Yen (4.6 per cent), Euro (3.2 per cent) and others (1.0 per cent)
- Commercial borrowings continued to be the highest followed by NRI deposits. Multilateral debt is at 12% and bilateral debt is at about 5%.

The value of the stock could change over time due to valuation effect. Valuation effect arises because external debt is denominated in different currencies, and the US dollar value which is the international unit for debt, fluctuates over time vis-à-vis other currencies.

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External Debt Management

The prudent external debt management policy of the Government of India continues to focus on monitoring long and short-term debt, raising sovereign loans on concessional terms with longer maturities, regulating external commercial borrowings through end-use, encouraging rupee denominated bonds like Masala bonds; and rationalizing interest rates on Non-Resident Indian deposits.

Rupee Debt

Rupee denominated debt refers to that part of India's total external debt that is denominated in India's domestic currency, the Rupee.

Unlike foreign currency denominated external debt like ECBs, NRI foreign currency deposits, FCCBs etc, in case of rupee denominated debt the currency risk (the risk arising from appreciation or depreciation of the nominal exchange rate) is borne by the creditor and not by the borrower. Borrower returns as much as he borrowed (as many rupees) with interest as fixed irrespective of the exchange rate. Thus, if the domestic currency appreciates vis-à-vis the foreign currency, the creditor stands to gain vis-à-vis the borrower since he receives more rupees than the current rate suggests.

In India, rupee denominated debt comprises the following categories-

- Rupee Debt; Includes the outstanding defense and civilian state credits extended to India by the erstwhile Union of Soviet Socialist Republics (USSR). The repayment is primarily through exports of goods to Russia.
- Rupee denominated Non-Resident Indian (NRI) Deposits.
- Foreign Portfolio Investors (FPI) investment in Government Treasury-Bills and dated securities and; in corporate debt securities (with such investments ceiling set by GOI annually). India is allowing FPI in government and corporate debt instruments with caution. It is necessary as domestic liquidity is inadequate and; even as it is invested and is returnable in the form of rupee, it comes as foreign currency into the country and thus forex reserves build up and rupee is rendered stable.

Sovereign debt crisis (SDC)

SDC is the term that describes the difficulties that a nation faces to service the loans it takes from foreign sources in foreign currency. Nations do not borrow from outside their country for use as domestic currency generally because domestic currency can always be raised from within through internal debt. External debt serves the purpose to finance imports, service external loan etc. But if a nation is reckless and uses foreign currency for internal purposes it runs into an SDC like Greece did few years ago. The difficulty arises in SDC that foreign currency can not be printed by the borrower and can only be earned by exports and other types of healthy foreign inflows.

Internal Debt

Internal debt includes loans raised by the government in the open market through treasury bills and government bonds and special securities issued to the RBI. The internal debt of the government also includes other liabilities like money collected by the government under small-savings schemes, provident funds etc.

Masala Bonds

Masala bonds are issued in global capital markets outside India by international financial institutions to raise money and lend to Indian companies. Masala is an Indian word for spices. It was used by the International Finance Corporation (IFC) to evoke the culture and cuisine of India. Other similar terms for international bonds are samurai (Japan) and dim sum (Chinese). The first Masala bond was issued by IFC in 2014 to lend to Indian companies. Later IFC for the first time issued green masala bonds and lent to Indian corporates. HDFC, NTPC and Indiabulls Housing are among Indian corporates which raised funds via this option. These bonds are traded on the London Stock Exchange (LSE).

The mechanics of the masala bonds are the following: the bond is issued to global investors by well rated international financial institution. Investors buy in foreign currency and are returned in the foreign currency with interest. The financial firm that borrowed converts the foreign currency into Indian rupees and lends to Indian companies on certain terms- period, interest rate etc. Thus, Indian companies take in rupees and return in rupees. When the Indian company services/returns the loan in rupees to the global financial firm, it is reconverted into foreign currency and used to service/return to the global investor who lent in foreign currency. Thus, Indian borrower is not touched by the volatility of the Indian rupee in forex market. For example, those who borrowed when rupee was Rs.65 per dollar in 2018, returned the same when rupee dropped to Rs.74. If they borrowed in dollars, depreciation of rupee would hurt as rupee weakened by 15% in 2018. Besides helping diversify funding sources, the cost of borrowing is lower than domestic markets. As masala bonds are denominated in rupees, foreign investors will be taking the currency risk.

NTPC was the first Indian company that issued corporate green masala bonds.

Masala bonds are a step to help internationalise the Indian rupee, make rupee convertible and also deepen the Indian financial system.

Before masala bonds, corporates have had to rely on avenues such as external commercial borrowings or ECBs. The challenge with the likes of ECBs is currency risk - they have to be taken as foreign currency loans and repaid similarly.

When the rupee was losing value in relation to dollar in 2018, one suggestion floated was that masala bonds should be issued to deter further loss.

NRI Bonds

To boost the foreign exchange reserves and reverse the slide of rupee exchange rate, GOI floated NRI bonds thrice so far since 1998 when it was done for the first time. RBI has to permit the same and implicitly stand guarantee, as the AAA credit rating of the RBI enables better terms for the country for these bonds. In 1998, the government floated \$5 billion worth of Resurgent India Bond (RIB) to withstand sanctions on India following the second round of Pokhran nuclear tests. They raised \$4.8 billion.

The second such bond offer was the India Millennium Deposit (IMD) worth \$5 billion, issued in 2000 with a five-year tenure. Foreign currency non-resident deposits (FCNR-B) special deposit worth \$34 billion was floated in 2013 and raised \$30 billion with a three-year maturity. These Bonds attract NRIs because they get higher returns.

Debt-GDP ratio

Public debt of a country in relation to GDP expresses this ratio. Public debt is sustainable within limits. That is, government can repay the loans only if they are limited. The limits are revealed by this ratio. However, the optimal ratio is not the same for all countries. It depends on the following factors-

- Size of the economy
- Growth rates of the economy
- Tax-buoyancy of the country
- Nature of government expenditure- productive or populist
- Internal-external debt ratio etc.

India's ratio is about 68%. US has 104%. Japan has about 230%. Each country has its own macroeconomic strengths and weaknesses and based on it viability is estimated. Internal debt is far more viable than external debt as the latter can only be gained by exports and healthy foreign inflows. The former can be printed though within limits as otherwise financial stability will suffer.

A country's sovereign rating partly depends on the ratio. Rating means the creditworthiness of the country in global markets. If the rating is good, there will be sizeable foreign financial inflows and the firms of the country can raise loans abroad at attractive terms.

Fiscal Drag

When the economy experiences inflation, there are automatic stabilisers that come up. One of them is fiscal drag. The sequence is as follows: when there is inflation because of rising demand, wages go up; those with higher wages pay higher direct taxes; disposable income comes down; demand moderates and so do prices. Since tax-related issue drags the prices down, it is called fiscal drag. In high-growth and high-inflation economies (overheated), fiscal drag acts as an automatic stabiliser, as it acts naturally to keep demand stable.

Fiscal Cliff

The term was in news few years ago. At that time, US President Barack Obama was rationalising tax rebates for US firms so as to consolidate the fiscal position. He wanted to cut down some of the tax concessions that earlier governments gave and also cut down the fiscal deficit- both are meant to strengthen government finances for macroeconomic stability. He embarked on cutting those concessions that were not growth-linked and thus outlived their utility. But the criticism was that two reforms being contemplated would slow down the economy which was growing well. That is, critics were of the opinion that the economy would fall from the cliff. Cutting tax rates and enabling investment and consumption is known as supply side economics. Classic example is the steep cut in the corporate tax rate by the US President Donald Trump. When India cut tax rates, it is only a rationalisation of the irrationally high rates earlier and is not supply side economics.

MONETARY AND CREDIT POLICY

Definitions:

- The strategy of influencing movements of the money supply and interest rates to affect output and inflation
- The actions of a central bank that determine the size and rate of growth of the money supply, which in turn affects interest rates.
- A macroeconomic policy tool used to influence interest rates, inflation, and credit availability through changes in the supply of money available in the economy
- An attempt to achieve broad economic goals by the regulation of the supply of money
- The regulation of the money supply and interest rates by a central bank in order to control inflation and stabilise currency
- Monetary policy is the process of managing a nation's money supply to achieve specific goals—such as constraining inflation, achieving full employment etc.
- Monetary policy is made by the central bank to manage money supply to achieve specific goals—such as constraining inflation, maintaining an appropriate exchange rate, generating jobs and economic growth. Monetary policy involves changing interest rates, either directly or indirectly through open market operations, setting reserve requirements, or trading in foreign exchange markets.

Monetary Policy

Monetary policy relates to making money available to the market at reasonable rates in adequate amounts at the right time to achieve:

- price stability
- accelerating growth of economy
- exchange rate stabilization
- balancing savings and investment
- Generating employment and
- financial stability

Credit policy is a part of monetary policy as it deals with how much and at what rate credit is advanced by the banks. Both are the functions of the central bank of the country.

Monetary policy can be expansionary or contractionary: expansionary policy increases the total supply of money in the economy by easing its availability by relaxing the rates (cheap money). A contractionary policy decreases the total money supply by increasing rates (dear money). Expansionary policy is used to revive economic growth while contractionary policy aims to reduce prices that have gone up due to excessive money supply.

Historically, in India, Monetary Policy was announced twice a year - a slack season policy (April-September) and a busy season policy (October-March) in accordance with agricultural cycles. However, since monetary Policy has become dynamic in nature, Reserve Bank of India decided to announce Bi-monthly Monetary Policy Statements- once every two months- from 2014 as recommended by Urjit Patel Committee.

The tools available for the central bank to achieve the monetary policy ends are the following-

• Liquidity adjustment facility(LAF)	• Open market operations
• Marginal Standing Facility(MSF)	• Quantitative easing
• Bank rate	• Intervention in the forex market and
• Reserve ratios	• Moral suasion
• SDF	

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LAF

Liquidity Adjustment Facility (LAF) was introduced by RBI in 2000. It is the window through which RBI adjusts liquidity (credit) in the market against the collateral of government securities. Banks need liquidity to meet their daily mismatches between need and availability. RBI helps them with a limited amount on a short term basis. RBI also needs to absorb the extra cash that banks have. When banks borrow under LAF, they do so at repo rate. When banks lend under LAF, RBI borrows at the reverse repo rate which is lower than the repo rate. All commercial banks (except Regional Rural Banks) and Primary Dealers (financial firm that help RBI sell and buy government securities) are eligible for it.

Ready Forward Contracts (Repos) are a transaction in which two parties agree to sell and repurchase the same security. Under such an agreement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date in future at a predetermined price.

Under the LAF, RBI lends on a short term basis to banks on the security of the government bonds (repo). Banks undertake to repurchase the security at a later date- over night or few days. RBI charges a repo rate for the money it lends.

Reverse repo is when RBI borrows from the market (absorbs excess liquidity) on the basis of securities and repurchases them the next day or after a few days. The rate at which it borrows is called reverse repo rate as it is the reverse of the repo operation. Reverse repo rate is 25 basis points (0.25%) below the repo rate. A basis point is 1/100th of a percentage point.

The Repo/Reverse Repo transaction can only be done in securities as approved by RBI (Treasury Bills, Central/State Govt. securities).

RBI uses Repo and Reverse repo as instruments for liquidity adjustment in the system.

Repo rate is known as policy rate and is used as signal to the financial system to adjust their lending and borrowing operations.

The government securities that banks and primary dealers use under the LAF are the securities that they have purchased over and above what they are mandated to purchase under the statutory liquidity ratio (SLR) requirement. (Read ahead).

MSF

In 2011, RBI introduced the Marginal Standing Facility to enable the commercial banks to borrow from the RBI at a penal rate when the amount allotted under the LAF is exhausted. The aim is to make more liquidity available if banks are ready to pay a higher rate of interest. It balances between the need for liquidity and regulation of the same.

RBI announces the policy rate- that is, repo rate. Reverse repo rate and the MSF are adjusted with a difference of 0.25% - reverse repo rate is that much less and MSF is that much more.

Bank Rate

Bank Rate is the rate at which RBI used to lend long term to commercial banks. Bank Rate is a tool which RBI used for managing money supply. Any revision in Bank Rate by RBI was a signal to banks to revise deposit rates. On introduction of LAF, Reserve Bank discontinued with long term lending. As a result, the Bank Rate became dormant as an instrument of monetary management.

RBI lends only short term under the LAF at repo rate. Thus, bank rate had no use. But it is there in the statute. So RBI used bank rate as a penal rate when banks breached their mandates- for shortfalls in meeting their reserve requirements, cash reserve ratio and statutory liquidity ratio.

When the RBI introduced MSF in 2011, which is also a penal rate, bank rate has been aligned with the MSF. The two rates are the same.

Base Rate and MCLR

Passing on the rate changes made by the central bank is crucial for growth, equity, inflation management etc. It is called monetary policy transmission. RBI introduced the concept of base rate in 2011 to ensure that each bank sets its own base rate below which it should not lend to anyone except in rare cases approved by the RBI. The reason behind the base rate was that if the best customers are lent at low rates, others like the small industry will be charged very high which runs against the principle of growth with equity. Also, such lending at very low rates because they are the best customers (large industry) defeats the purpose of monetary policy and comes in the way of its transmission. But over some years, it was found out that base rate system was not working well.

RBI introduced Marginal Cost of Funds Based Lending Rate (MCLR) system in 2016 for improving the monetary transmission. MCLR is based on current cost of funds while base rate was calculated on the basis of overall cost of funds. MCLR may ensure quicker transmission of RBI rate cuts to borrowers as after every rate change by RBI, the MCLR is bound to reflect it.

Uniform External benchmark

According to a decision taken by the RBI in December 2018, all new floating rate personal or retail loans (housing, auto) and floating rate loans to Micro and Small Enterprises (MSE) extended by banks from April 1, 2019, will be linked to one of the four benchmarks – Reserve Bank of India's policy repo rate, or 91 days Treasury Bill, or 182 days Treasury Bill, or any other benchmark market interest rate produced by the Financial Benchmarks India Private Ltd (FBIL).

The spread over the benchmark rate – to be decided by banks' discretion at the inception of the loan – will remain unchanged through the life of the loan, unless the borrower's credit assessment undergoes a substantial change and as agreed upon in the loan contract.

Banks are free to offer such external benchmark-linked loans to other types of borrowers as well.

In order to ensure transparency, standardisation, and ease of understanding of loan products by borrowers, a bank must adopt a uniform external benchmark within a loan category; in other words, the adoption of multiple benchmarks by the same bank is not allowed within a loan category.

On the other hand, for borrowers, it may lead to a more frequent resets on their equated monthly installments.

FBIL

An independent company named 'Financial Benchmarks India Pvt. Ltd. (FBIL)' was jointly floated in 2014 by the Fixed Income Money Market and Derivative Association of India (FIMMDA) and Foreign Exchange Dealers' Association of India (FEDAI) and the Indian Banks' Association (IBA) as a private limited company under the Companies Act 2013. Its aim is to develop and administer benchmarks relating to money market, government securities and foreign exchange in India.

Reserve Requirements

Fractional reserve banking is a global norm in which banks keep a fraction of the total deposits of the bank as reserves that are not to be lent to public. The reserve ratios are periodically changed by the RBI and aim at-

- Price stability
- providing loans to the Government (SLR)
- safety of banking operations
- management of liquidity- infusion and absorption under different conditions
- management of interest rates and
- checking speculation.

Under reserve requirements, there are two instruments: Statutory Liquidity Ratio (SLR) and Cash reserve ratio (CRR).

Statutory Liquidity Ratio (SLR)

It is the portion of time (fixed deposits) and demand liabilities (savings and current accounts) of banks that they should keep in the form of RBI approved liquid assets like government securities, cash and gold. Excess CRR balance is also treated as liquid assets for the purpose of SLR.

SLR aims at ensuring that the need for government funds is partly but surely met by the banks.

The assets allowed under the SLR obligation are-

- (a) Cash
- (b) Gold valued at a price not exceeding the current market price
- (c) "Statutory Liquidity Ratio (SLR) securities": Government of India bonds; Treasury Bills of the Government of India; State Development Loans (SDLs) of the State Governments; and any other instrument as may be notified by the Reserve Bank of India. Within the mandatory SLR requirement, some Government securities are classified as High Quality Liquid Assets (HQLAs) for the purpose of computing Liquidity Coverage Ratio (LCR) of banks. They help the banks remain liquid in difficult times.

The main objectives for maintaining the SLR ratio are the following:

- to control bank credit. By changing the level of SLR, the Reserve Bank of India can increase or decrease bank credit availability
- to ensure the solvency of commercial banks.
- to make the commercial banks to invest in government securities like government bonds so that government has adequate financial resources for its commitments
- changes in SLR signal to the economy on a long term basis unlike other instruments

SLR is a blunt instrument and was unchanged for more than a decade and half till the Lehman-induced global financial and economic crisis of 2008.

Banking Regulation Act, 1949 says SLR can vary between 0-40% of bank's deposits. RBI has, as a result, the freedom to reduce the SLR to any rate depending on the macro economic conditions below 40% the amendment was an enabling one.

LCR

After the global financial crisis of 2007, the Basel Committee on Banking Supervision (BCBS) proposed certain reforms to strengthen global capital and liquidity regulations with the objective of promoting a more resilient banking sector. Liquidity Coverage Ratio (LCR) was one of them. The LCR promotes short-term resilience of banks to potential liquidity disruptions by ensuring that they have sufficient high quality liquid assets (HQLAs) to survive an acute stress scenario lasting for 30 days.

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LCR norm aims to ensure that a bank maintains an adequate level of HQLAs that can be converted into cash to meet its liquidity needs for a 30 calendar day time horizon under a severe liquidity stress scenario. In 30 days, it is assumed that appropriate corrective actions can be taken.

Liquid assets comprise of high quality assets that can be readily sold or used as collateral to obtain funds in a range of stress scenarios. For example, cash, government securities etc.

When the RBI allows banks to use a portion of the government securities held by them under SLR mandate for LCR purposes, banks can avail of the repo funds and boost the liquidity.

Cash reserve ratio (CRR)

Under the RBI Act, 1934 the Reserve Bank, having regard to the needs of securing the monetary stability in the country, prescribes the CRR for banks without any floor or ceiling rate. Banks have to maintain minimum 90 per cent of the required CRR on a daily basis and 100 percent on an average basis during the fortnight. However, daily CRR required may be changed by RBI according to prevailing liquidity conditions. CRR is used for liquidity management and a monetary tool to regulate money supply. It is the portion of the bank deposits that a bank should keep with the RBI in cash form. CRR deposits earn no interest. The more the CRR, the less the money available for lending by the banks to players in the economy. If inflation is high, money supply needs to be taken out and so CRR is generally increased. But in a regime of moderate inflation, low CRR is in place. CRR is governed by the provisions of Section 42 of the Reserve Bank of India Act, 1934.

CRR is medium to short term liquidity management tool unlike the SLR which is long term tool. Normally, RBI relies on signaling its intent through the policy rates of repo and reverse repo. RBI uses open market operations as well for liquidity management on an ongoing basis.

Incremental CRR

RBI at times uses more than one rate for CRR. CRR is applied at one rate for all deposits but at another rate for deposits collected in a certain period. For example, post-demonetisation, RBI imposed 100% incremental CRR for deposits collected between September 16 and November 11 by scheduled commercial banks. The aim was to prevent the banks from lending such huge amounts of money that can trouble the economy, banks and the consumers as well. For rest of the deposits, CRR at that time was retained at 4%.

SLR vs CRR

Both Cash Reserve Ratio (CRR) and SLR are instruments in the hands of RBI to regulate money supply in the markets. Both manage liquidity. But they are used for different purposes. CRR has a short and medium term relevance while SLR is a long term tool. SLR enables banks to earn money while CRR does not earn any interest. CRR is maintained in cash form with central bank, whereas SLR is held as govt. securities etc and kept with the banks themselves.

Standing Deposit Facility

RBI Act was amended in 2018 to enable the introduction of the standing deposit facility (SDF). The need for the SDF arose during and immediately after demonetisation when the liquidity in the market- money with banks- expanded astronomically. Since they were not voluntary deposits, they could not be lent. If they are lent, that will be inflationary in an unprecedented manner and banks would be in danger. Therefore, RBI had to sterilise the excess money from the market (absorb the excess) by selling government securities to the banks. But the scale of sterilization (absorption of excess cash in the market that can inflate the economy) being unusually large, it could be done only with government permission and special government securities which took time in coming. Normal LAF window was a very small one in such

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conditions. In the meanwhile RBI banned the lending of the entire amount collected as deposits between two dates (points of time) by imposing 100% incremental CRR on those deposits collected in the given period. The absence of an instrument like SDF was felt. RBI recommended to the government to create statutory space for it. It allows banks with extra liquidity to deposit with the RBI for an interest which is the reverse repo rate. This will considerably strengthen the conduct of monetary policy as it will provide the RBI the wherewithal to absorb exceptionally large expansion of liquidity. This additional instrument in the hands of the RBI can address episodes such as demonetisation and surges of capital inflows.

Open Market Operations (OMO)

OMOs of the RBI can be described as outright purchase and sale of government securities in the open market (open market essentially means banks and financial institutions) by the RBI in order to influence the volume of money and credit in the economy. Purchase of government securities injects money into the market and thus expands credit; sales have the opposite effect- absorb excess liquidity and shrink credit. Open market operations are RBI's most important and flexible monetary policy tool. Open market operations do not change the total stock of government securities but change the proportion held by the RBI, commercial and cooperative banks.

Market Stabilization Bonds

For normal liquidity management, there are open market operations of the RBI when the RBI sells and buys G-secs as the market conditions demand. But when the need to absorb huge amounts of cash arises, for example post-demonetisation in 2016, normal OMOs do not work. Similar was the condition since 2004 for some years when India started attracting foreign currency inflows of unprecedented magnitude. When foreign currency comes into the country, it gets converted into rupees and enters in the economy. It needs to be absorbed by the RBI or such excess of rupee will inflate the economy. In 2004, RBI floated large amount of Government securities as a part of the Market Stabilization Scheme, to absorb excess liquidity from the market. The excess liquidity (rupees) is the result of RBI buying dollars from the market. MSS is a sterilization effort of the central bank. The normally available government securities are not enough for the RBI to suck out the huge rupee supply (printed money) that was created for buying dollar. Therefore, the MSS was started.

Quantitative Easing

The term quantitative easing describes an unconventional form of monetary easing used to stimulate an economy. It involves the central bank buying financial instruments which in ordinary times are not accepted for OMOs- for example, the housing market securities that were discredited in the USA since 2008. It is a step that is taken after the interest rate reduction to very low levels and similar downward adjustment of reserve ratios like CRR fail to induce any positive change. It involves printing fresh currency and buying debt paper that is otherwise substandard thus flushing the market with huge money to de-risk lending as rates and supply of money ease to unprecedented levels.

Federal Reserve of the US (US' central bank like the RBI for India) used quantitative easing to overcome the liquidity crisis since the fall of Lehman Brothers in 2008 September when many banks went bankrupt and credit froze. It worked as US came out of recession.

EU, Japan and Britain also used the technique of QE to shore up growth.

When the QE was tapered (gradually ended), India and other countries expressed resentment as foreign currency inflows into India went down with implications for our forex reserves and the rupee exchange rate. The resentment is called 'taper tantrums.' But India did not suffer as our growth rates were high; forex stock is impressive; and our relatively high interest rates were found to be attractive to foreign investors; our capital market also was doing well on its own.

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Liquidity Trap

A liquidity trap is a situation when rates and reserve requirements are lowered to stimulate demand but it does not impact on reviving demand and growth. There are no takers for bank credit. It happens in times of recession that is getting worse. There are deflationary expectations and the economy can be faced with the problem of short-term interest rates reaching or nearing zero. This makes the monetary policy ineffective. To come out of liquidity trap, QE was attempted first in the USA and later in other countries. Otherwise, recession can turn into depression.

It is called the Zero Lower Bound (ZLB). It is seen in a recessionary economy when the short-term nominal interest rate is at or near zero (liquidity trap) which limits the central banks options to revive the economy with the tools available to it. The above mentioned instruments at the disposal of the RBI are the quantitative tools that made a difference to the overall liquidity in the market.

Qualitative tools

There are qualitative tools too with which the total quantum of liquidity is not changed but intersectoral allocation can be regulated. For example- the Bank may feel that speculators or the big industrialists are getting a disproportionately large share in the total credit, causing various disturbances and inequality in the economy, while the small-scale industries, consumer goods industries and agriculture are starved of credit.

Selective credit controls

Under selective credit controls, RBI encourages flow of credit to certain types borrowers and discourages bank credit for certain other purposes. It can be done by setting limits on credit availability; charging high or low interest; or margin requirement. Explanation for the selective credit controls is:

Margin Requirement: Lending to a select sector may be accompanied by having to set aside a certain percentage of money for safety. When banks have to keep aside some money (margin) whenever they lend to the specified sectors, it hurts them with blocked funds. Thus, the credit flow to such sectors comes down as intended. In case the flow of credit has to be increased, the margin requirement will be lowered or removed.

Rationing of Credit: Under this method there is a maximum limit to loans and advances that can be made to a particular sector which the commercial banks cannot exceed. RBI fixes ceiling for specific categories.

Both these tools can be imposed for discouraging hoarding and black-marketing of certain essential commodities by traders etc by giving them less credit.

Moral Suasion

Central banks at times use their informal and moral power to make the financial system, especially banks to adopt a certain behavior- lower interest rates or lend to small businesses etc. It is not a rule that the bank enforces but a point made to persuade in a meeting or increased severity of inspections, appeals made in a press conference etc.

Interest Rates and their importance

Interest rates are the rates offered to money that is deposited in the banks; invested in bonds etc. Savers want higher interest rate while investors want the cost of credit to be low. There has to be a balance. The determinants of interest rates are:

- **Inflation-** the higher the inflation, the higher the interest rates because money in circulation keeps demand and prices high and so needs to be brought into banks which is possible if an attractive rate of return is given.

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- Need for growth : lower interest rates reduce cost of credit and facilitate investment and consumption
- Promotion of savings
- Government's need to borrow: the magnitude of government's borrowing programme also determines interest rates. The more the borrowing, the higher the interest rates.
- If rates are attractive, foreign money flows in. For example, interest rates on NRI deposits are kept high to attract their dollar deposits under the FCNR (B).

As a part of economic reforms in 1990's, interest rates were deregulated so that banks can adjust rates quickly according to market conditions; financial innovations should be facilitated; competitive rates can be good for savers and investors; global alignment is possible more dynamically; etc. RBI however, uses repo rates and CRR adjustments to influence interest rates.

Interest rates are arrived at in two ways: fixed and floating. If they are offered together (when they co-exist), it is called flexible interest rate regime. Floating interest rates are linked to an underlying benchmark rate. In other words, the interest rate offered 'floats' in relation to the interest rate of a government security instrument of similar maturity (5 years or 10 years maturity etc) as determined by the market. That is, floating rates of interest are basically market driven rather than 'fixed'. Fixed rate is regardless of market conditions. For example, the small savings instruments in post offices offer fixed rate. Savings account in commercial banks offer fixed rate.

Negative Interest Rates

Interest rates are generally positive- that is, when money is lent, it is returned with additional amount that is the interest amount. But there are two ways of seeing interest rates

1. Nominal interest which is unadjusted to inflation and
2. Real interest rate which is adjusted to inflation. If inflation rate is 5% and the interest rate is 4%, the real interest rate is minus 1%. That is, negative interest rate. But a 4% rate which is nominal is a positive rate. In other words, real interest rates can be negative, when nominal interest rates are below inflation. When the government influences rates to be low, it is called financial repression and can lead to real interest rates being negative. There is "negative interest rate policy" (NIRP) being practised by leading central banks for years now. It is a negative, sub-zero, central bank interest rate for the reserves that are kept with it by banks.

Commercial banks have accounts with the central bank as the central bank is a bankers' bank. When they deposit their excess of money in their central bank accounts, generally they get paid for it. But in the NIRP regime, it is the reverse. NIRP is an instrument of unconventional monetary policy to encourage lending by making it costly for commercial banks to hold their excess reserves at central banks. Thus, NI is a rate when lender pays the borrower. A negative interest rate can be described as a "tax on holding money". Such policy can be associated with recession or very slow economic growth and deflation. NIRP is in effect taxing banks for exceeding their reserve requirements - as an expansionary monetary policy measure. It makes lending by banks cheaper as banks will not keep their excess reserves in a central bank deposit account due to negative returns. They have to lend it. Further, there is competition among banks to lend their excess reserves and that also will push rates down.

Demonetisation

Demonetization is the government action that divests a currency unit of its status as legal tender. On 8 November 2016, the Government of India announced the demonetisation of all Rs.500 and Rs.1,000 bank notes. Those with these notes had to deposit them in the bank and exchange them for new notes.

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The Indian government had demonetised bank notes on two prior occasions—once in 1946 and then in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. Demonetisation under the two occasions was done by an ordinance while the 2016 decision was an executive decision.

Pros and cons of Demonetisation

If demonetisation is implemented well, it can have many benefits-

1. It can attack black money
2. Since black money is used for funding terrorism, gambling, human trafficking and speculation in real estate, gold and other social evils, there are positive effects in these areas also.
3. Formalise and digitalise economy with many advantages
4. Tax net will widen (more people will file returns) giving government enough fiscal means for welfare expenditure
5. Helps in minimising use of cash which, when it happens voluntarily, has benefits

If demonetisation is not implemented well, it can lead to-

1. inconvenience caused to people in depositing the invalid notes as well as the time it takes to have their money from the bank
2. logistical nightmare in a large economy like ours
3. cost of printing new currency
4. cash is a very miniscule part of black economy and unless accompanied by a multipronged strategy, demonetisation may not succeed fully.

Two cases of demonetisation are illustrative.

European Monetary Union consists of those countries of the European union that adopted a common currency- euro. When euro appeared physically in 2002, national currencies like German mark, Italian lira and French franc were no longer valid and so were demonetised, withdrawn and were exchanged for euros. In this case, demonetisation was necessary for monetary integration and its aims: reduction of transaction costs, emergence as a global reserve currency in competition with USD etc.

In 2015, the Zimbabwean government demonetized its dollar to tackle hyperinflation which went to unimaginable levels due to currency expansion mainly. In place of the Zimbabwean dollar, eight regional and global currencies have been declared as legal tender.

Urjit Patel Committee

An expert committee was appointed to examine the existing monetary policy framework of the Reserve Bank of India (RBI) in 2014 under Urjit Patel. It suggested-

- inflation targeting, the target for inflation being set at 4 per cent with a band of +/- 2 per cent around it;
- the nominal anchor should be defined in terms of headline CPI inflation, which closely reflects the cost of living and influences inflation expectations relative to other available metrics;
- fiscal deficit as a ratio to GDP (gross domestic product) is to be brought down;
- monetary policy decision-making should be vested with a monetary policy committee (MPC) headed by Governor of the RBI

Indian Financial Code (IFC)

The Financial Sector Legislative Reforms Commission was constituted in 2011. The commission was set up to review the legal and institutional structures of the financial sector in India and modernize them. The commission recommended Indian Financial Code to replace the bulk of the

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existing financial laws. IFC proposes changes in the way monetary policy is made and public debt is managed etc. Indian Financial Code (IFC) suggested, like the Urjit Patel panel, an MPC to take rate decisions by a majority vote.

Monetary Policy Committee (MPC)

Monetary policy is assuming critical role in economic growth and all the developmental goals that are a part of it including equity: consumer loans, corporate investment, government borrowing, savings, economic growth, price stability and financial stability. It demands that decisions be taken collectively by a high powered committee.

In 2016, GOI amended the RBI Act to create Monetary Policy Committee (MPC). MPC was set up after the agreement between Government and RBI giving RBI the additional responsibility of inflation targeting: Monetary Policy Framework Agreement 2015.

By this amendment, it was written into the preamble of the RBI Act that the primary objective of the monetary policy is to maintain price stability, while keeping in mind the objective of growth and to meet the challenge of an increasingly complex economy.

MPC is a six-member body headed by the RBI Governor that fixes the policy rate (repo rate) The MPC replaces the system where the RBI governor, with the aid and advice of a technical advisory committee had complete control over monetary policy decisions.

It has three members from the RBI- Governor, the RBI Deputy Governor in charge of monetary policy, one official nominated by the RBI Board; and three independent members to be selected by the Government. The three central government nominees of the MPC appointed by the search cum selection committee will hold office for a period of four years and will not be eligible for re-appointment. RBI Act prohibits appointing any Member of Parliament or Legislature or public servant. The MPC meets at least four times a year. The MPC takes decisions based on majority vote (by those who are present and voting). In case of a tie, the RBI governor will have the second or "casting" vote. It is a casting vote in the sense that it breaks a tie. The decision of the Committee would be binding on the RBI.

Functions of the MPC: Under the Monetary Policy Framework Agreement, the RBI will be responsible for containing inflation targets at 4% (give or take 2%) in the medium term. Central Government determines the inflation target in terms of the headline (unadjusted) Consumer Price Index, once in every five years in consultation with the RBI. RBI would have to give an explanation in the form of a report to the Central Government, if it failed to reach the specified inflation targets for three consecutive quarters. It shall, in the report, give reasons for failure, remedial actions as well as estimated time within which the inflation target shall be achieved. Further, RBI has to publish a Monetary Policy Report every six months, explaining the sources of inflation and the forecasts of inflation for the coming period of six to eighteen months.

MPC decides the changes to be made to the policy rate (repo rate) so as to contain the inflation within the target level specified to it by the Central Government. Minutes of the MPC meeting are published by RBI after 14 days. In addition, subsequent to the MPC meeting, RBI has to publish a document explaining the steps to be taken by it to implement the decisions of the Monetary Policy Committee.

The government may, if it considers necessary, convey its views, in writing, to the MPC from time to time. There are four advantages of monetary policy formulation by a committee -

- First, a committee can represent different viewpoints and studies show that collective wisdom is better than an individual's.
- Second, spreading the responsibility for the decision can reduce the internal and external

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pressure that falls on an individual.

- Third, a committee will ensure broad monetary policy continuity when any single member including the Governor changes.
- Fourth, It leads to institutionalising the process of monetary policy formulation which is vital given that the RBI has a clear inflation target by a statute

Monetary Policy Framework Agreement

RBI and Government of India signed the Monetary Policy Framework Agreement in 2015 which made inflation targeting the statutory responsibility of RBI. As a result, Reserve Bank of India (RBI) Act, 1934 was amended for giving a statutory support to the Monetary Policy Framework Agreement and for setting up a Monetary Policy Committee (MPC).

Monetary Policy Transmission

Monetary policy changes – in rates and reserve ratios- are aimed at bringing about desired effects in growth of the economy through demand management; prices; credit availability; asset prices like stocks and real estate; and consumption. The effectiveness of the policy, that is how well it is transmitted depends on many factors of which adequate data for the policy is one. Timely data is another. India which has hundreds of millions of people who are financially excluded has a structural bottleneck.

There are other imponderables too, to transmission. If banks are sitting on bad loans, they tend to charge higher interest rate even if the RBI reduces the rate as we see in India. If the government policies are not conducive, transmission is difficult. For example, if government gives loan waivers, raises MSP for farmers etc. it infuses money into the market that inflates, which the RBI may not be able to manage even if it reduces rates. If the fiscal deficit of the government is relatively high, interest rates are likely to stay high normally even if the RBI reduces them. External factors that are important include monetary policies of US (QE), rate hikes in the US, currency manipulation by countries like China etc. Global supply shocks in commodities are another factor.

Reserve Bank of India

The central bank of the country is the Reserve Bank of India (RBI). Reserve Bank of India Act, 1934 that came into effect in 1935 provides the Statutory basis of the functioning of the bank. It was established on the basis of the recommendations of the Hilton Young Commission. RBI when it was set up was privately owned.

There is a short history to the RBI as it exists today. The Imperial Bank was formed in 1921 by amalgamating the Presidency Banks of Bombay, Calcutta, and Madras. It functioned as commercial bank and also as central bank till RBI was set up in 1935 when the RBI took over the central banking duties. Reserve Bank of India was nationalised in the year 1949. In 1955 Imperial Bank became SBI by an act of parliament. The general superintendence and direction of the Bank is entrusted to Central Board of Directors that has: the Governor and four Deputy Governors, one Government official from the Ministry of Finance, ten nominated Directors by the Government to give representation to important sections in the economic and social life of the country, and four nominated Directors by the Central Government to represent the four local Boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi. The RBI Act 1934 says that the capital of the Bank shall be five crores of rupees. Government is the sole owner of the RBI.

RBI's Functions

The Reserve Bank of India Act of 1934 entrusts all the important functions of a central bank to the Reserve Bank of India. Functions of RBI are

- monopoly on the issue of banknotes

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- setting the official interest rate (taken over by the MPC)
- the Government's banker
- bankers' bank
- Lender of Last Resort
- manages the country's foreign exchange and gold reserves
- regulation and supervision of the banking sector

Bank of Issue

Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government.

Legal tender and fiat money

A short introduction is necessary. Legal tender is any currency declared legal by a government. It may be backed by metal like gold or silver or may not be. In the latter case, it is fiat money. The value of fiat money based on macroeconomic variables like inflation and demand and supply.

Gold standard

It is a type of monetary system in which money printed by the central bank is pegged to the availability of gold; currency can be returned to the central bank for a certain value of gold. Gold standard ensured that excess money supply was prevented and holders of currency felt safe that their holdings retained value as they could be exchanged for a definite amount of gold.

RBI and Printing Currency

The amount of money RBI could print is linked to the availability of gold & foreign exchange reserves of Rs. 200 cr, of which Rs. 115 cr. should be in gold to be able to issue currency. Both these assets being liquid, RBI would be able to infuse or absorb liquidity as conditions demanded.

In the current economy, RBI prints for the following reasons-

1. replace the soiled notes
2. print notes with better security features
3. print to infuse money into the economy as economy grows and demand rises
4. lend to the government (stopped monetizing deficit since 2006)
5. buy foreign currency and gold in the market.

In the final analysis, printing is related to the needs of the monetary economy and reflects on the monetary and fiscal discipline.

Seigniorage

It is the difference between the face value of a currency note or coin, and its actual production cost. The difference is the surplus of the RBI and it is transferred to the GOI as dividend.

Higher denomination notes earn higher profits. Coins cost as much to produce as they are valued.

The issue of RBI dividend dominated headlines post-demonetisation as it was assumed that a sizeable portion of the old notes rendered invalid would not be returned to the banking system and RBI did not have to honour so much and that could be considered profit and could be handed over to the GOI. But almost all the invalid notes were returned.

The event was remonetisation and not demonetisation. The entire money invalidated was revalidated through new notes. Therefore, there was no question of new seigniorage. In fact, there were additional costs to printing that reduced the dividend otherwise available.

Banker to Government

Reserve Bank of India is the Government banker, agent and adviser. The Reserve Bank is agent of Central Government and of all State Governments in India. The Reserve Bank has the obligation to transact Government business, to receive and to make payments on behalf of the Government and to carry out their other banking operations. The Reserve Bank of India helps the Government - both the Union and the States to raise loans. The Bank makes ways and means advances (WMA) to the Governments. It acts as adviser to the Government on all monetary and banking matters.

Banker's Bank

Banks are required to maintain a portion of their demand and time liabilities as cash reserves with the Reserve Bank. For this purpose, they need to maintain accounts with the Reserve Bank. They also need to keep accounts with the Reserve Bank for settling inter-bank obligations, such as, clearing transactions of individual bank customers who have their accounts with different banks or clearing money market transactions between two banks, buying and selling securities and foreign currencies. In order to facilitate a smooth inter-bank transfer of funds, or to make payments and to receive funds on their behalf, banks need a common banker. By providing the facility of opening accounts for banks, the Reserve Bank becomes this common banker, known as 'Banker to Banks' function.

Lender of last resort

As a Banker to Banks, the Reserve Bank also acts as the 'lender of the last resort'. It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank. The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of the bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

Banks may face short-term or temporary liquidity crises which arise out of mismatches between assets and liabilities. Banks try to fill the gaps by going to the call money market (Refer the chapter on money market). Call money markets function normally when some banks or others have excess and can lend to others. But if the entire market has a liquidity crisis, the temporary need may be felt by the entire banking system. RBI as a lender of last resort steps in to bailout the banks in need through the repo facilities. (solvent means having assets in excess of liabilities and is able to pay its debts.)

Controller of Credit

The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit advanced by banks in India and also the rate of it. It can do so through the variety of instruments available to it like repo rate; OMOs; reserve requirements etc. All its monetary policy tools have a bearing on this function directly or indirectly.

Agent and Adviser of the Government

The RBI acts, as the financial agent and adviser to the Government. It renders the following functions:

- As an agent to the Government, it accepts loans and manages public debts on behalf of the Government.
- It issues Government bonds, treasury bills, etc.
- Acts as the financial adviser to the Government in all important economic and financial matters.

RBI as the debt manager of the Government

The Reserve Bank manages public debt on behalf of the Central and the State Governments. It involves floating of bills and bonds, payment of interest and repayment of these loans.

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RBI as National Clearing House

In India RBI acts as the clearing house for settlement of banking transactions. This function of clearing house enables banks to settle their interbank claims easily. Further it facilitates the settlement economically. It essentially means the inter-bank cheque clearing settlement.

Custodian of Foreign Reserves

Reserve Bank of India has the responsibility to act as the custodian of foreign exchange reserves. It takes up operations in the forex market to stabilize the exchange rate of rupee and ensure that there is no speculation and there is order. To be able to do so effectively, it holds forex reserves which it buys from the market which includes foreign currency assets, gold and IMF's SDRs. Since 2008 when dollar stability came under question, RBI has been increasing SDR and gold in its holdings for greater security. Such diversification and hedging of risk is being done by all central banks.

Supervisory Functions

The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, setting reserve ratios etc. They are:

- Granting license to banks.
- Inspect banks.
- Implementation of Deposit Insurance Scheme whereby all deposits upto Rs. one lakh are insured.
- Periodical review of the work of commercial banks.
- Giving directives to commercial banks.
- Control the non-banking finance corporations.
- Ensuring the health of financial system through on-site and off-site verifications
- Banking Regulation (Amendment) Act, 2017 enables the GOI to authorise the RBI to issue directions to banks to initiate insolvency resolution process to recover bad loans.

Promotional Functions

RBI performs a variety of developmental and promotional functions. The Reserve Bank promotes banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialised financial agencies to promote savings, and to provide general finance and agricultural finance. NABARD was set up in 1982. It has an important role in facilitating microfinance for financial inclusion. Further, its innovations include banking correspondent model for rural banking.

Debt Management Office (DMO)

In recent years, there has been a debate whether there should be a separate Public Debt Management Agency (PDMA) that manages the internal and external liabilities of the Central Government and renders advice. PDMA manages the issue and trading of Government securities and undertakes cash management for the government.

As of now, RBI manages the market borrowing programmes of Central and State Governments. External debt is managed by the GOI. DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates External Commercial Borrowing guidelines and policies. Supporters of the idea of PDMA say-

- Establishing a debt management office would consolidate all debt management functions in a single agency and bring in holistic management of the internal and external liabilities.

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- It is further argued that there is a conflict of interest between setting interest rate and raising loans for the government. RBI has to manage inflation for which the rates have to be kept high when the prices are high. But being a debt manager, it has to borrow at lower rates of interest for the GOI.
- As a regulator of banks, as in India, there is another aspect to the conflict of interest: it may set the SLR high for banks to hold more of the government bills and bonds mandatorily. It in turn can prevent development of the corporate bond market as bank deposits are used up in buying government securities.
- Jahangir Aziz panel went into the question of establishing a Debt Management Office(DMO) and suggested an independent public debt management office. Dr Raghuram Rajan chaired Committee on Financial Sector Reforms (2009) which also favoured it. Justice B. N. Srikrishna chaired FSLRC or Financial Sector Legislative Reforms Commission report (2013) also recommended setting up the independent "Public Debt Management Agency (PDMA).

There are arguments against the idea of DMO as well -

- Firstly, RBI says that in countries such as India, given the large size of the government borrowing programme, the sovereign debt management is much more than merely an exercise in resource-raising, as it could impact interest rates, systemic liquidity and even loan growth through the crowding out of private sector loan demand. Only central banks have the necessary expertise, wherewithal and multifunctional perspective which an independent debt agency, driven by narrow objectives, will not be able to do.
- Secondly, there is a larger conflict of interest if DMO is set up as it could function as an arm of the ministry of finance, when the government is the owner of the majority of banks in India and the banking sector is the dominant player for government market borrowing.
- Thirdly, since the RBI has been replaced as a rate setting agency with the MPC, the said conflict of interest question has been resolved and so the idea of DMO is to that extent redundant.

As an interim arrangement for a full-fledged agency for managing public debt to be called as Public Debt Management Agency (PDMA), the government in 2016 set up Public Debt Management Cell (PDMC) at RBI's Delhi office.

RBI's role in economic and financial stability

The main responsibility of a central bank is to maintain macroeconomic stability and financial stability. Macroeconomic stability refers to achieving stable and sustainable growth and keeping prices stable, i.e., low and stable inflation. Financial stability is defined in terms of the ability of financial institutions like banks and insurance companies to facilitate and enhance economic processes, manage risks, and absorb shocks. They can do so when they discharge their basic functions effectively like financial intermediation (acceptance of public money and lending it well) and the arrangement of payments. Financial stability, thus is, when the financial system is resilient and financial crisis is prevented.

To achieve economic stability, central banks use the tools of monetary policy.

To deal with financial stability, central banks' main instrument is provision of liquidity, called "lender of last resort" (LAF).

RBI also depends on regulation and supervision for financial stability. By setting prudent rules and principles and inspecting and monitoring banks' adherence to these rules and principles, the central bank aims at healthy and robust banking and financial system.

Across the world, we have been witnessing financial panics or 'bank runs' (depositors want to withdraw all their money due to doubt about the solvency of the bank) and failure of one bank may lead to failure of others leading to threats to financial and economic stability.

As "lender of last resort", central bank, in periods of panics bails out banks and NBFCs for larger goal of financial stability.

RBI And Bitcoin

Bitcoin is a worldwide private cryptocurrency and digital payment system. It is the first decentralized digital currency, as it works without a central repository or single administrator. It was developed under the name Satoshi Nakamoto and released as open-source software in 2009. The system is peer-to-peer, and transactions take place between users directly, without an intermediary. These transactions are verified by network nodes and recorded in a public distributed ledger called a blockchain.

The legal status of bitcoin varies from country to country - some countries have allowed its use and trade, others have banned or restricted it.

The Reserve Bank of India is in control of fiat currency which is the legal status given to a currency issued by the central bank. Non-fiat crypto-currencies like bitcoins were initially not approved by the RBI.

But RBI had talked of possible "black money" risks from virtual currencies like bitcoins and that they are "susceptible to misuse" by terrorists and fraudsters for laundering money. It expressed concerns that bitcoin could be a Ponzi (financial fraud) scheme. Bitcoins can be inflationary and thus RBI should have a role in regulating it.

Reserve Bank of India's (RBI) instructed banks not to deal with entities that deal in cryptocurrencies in 2018. Earlier too, RBI had cautioned the cryptocurrency users, traders and holders of digital currencies. GOI is thinking of floating a cryptocurrency of its own.

Autonomy for RBI

Powers of RBI are statutorily laid down in the RBI Act 1934. RBI being the architect of the monetary policy requires autonomy to be effective. Advocates of central bank independence argue that a central bank being a group of professionals should be autonomous to manage money, credit and exchange rate dynamics in the globalizing economy. It helps check populist pressures and schemes that the political leadership may be tempted to indulge in financial repression (keep rates low to suit government and corporates) even as the inflation is high. It can resist the pressure if it has autonomy.

John Maynard Keynes while giving his opinion to Hilton & Young Commission which recommended the setting up RBI in 1926 said: "I conceive a central bank as independent of the government though ultimately dependent on the State in general interest." Hilton Young Commission itself said: "Banks, especially Banks of Issue, should be free from political pressure, and should be conducted solely on lines of prudent finance."

Others believe that the elected governments should have the final say within which RBI should be autonomous as government is democratically elected.

The arguments in favour of autonomy are:

- monetary and economic stability can be best achieved if professional Central bankers with the long term perspective are given charge.
- without such autonomy, government tends prevail with its profligate policies of automatic monetization, lower rates, indiscriminate lending and so on
- The arguments against are:
- democratic systems are run with Parliament and Cabinet making all important policies
- monetary policy is an integral policy of the overall economic policy and so RBI has to subordinate itself to the larger objective.

Section 7 of the RBI Act 1934

Section-7 of the Reserve Bank of India Act, 1934 reads:

1. "The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest".
2. "Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Bank."

The prevalence of the government over the opinion of the RBI is to, if at all, take place on two conditions being followed:

1. After consultation with the Governor; and in
2. Public interest

Section 7(1) of RBI Act was not a part of the original 1934 Act but was amended at the time of nationalization of the RBI in 1949, to empower the Centre to issue directions to central bank in public interest.

RBI is held accountable through consultations; to the Parliamentary committees; to the parliament through the Finance Minister; and to the judiciary.

Conventionally, RBI and GOI coordinated in public interest. Autonomy of the RBI as a professional body was respected an unwritten law. Section 7 of the RBI Act was never invoked.

It may be suggested that there should be a collegium to appoint the Governor and the Deputy Governors so that the autonomy of the RBI becomes so much more an article of faith.

The recent measures to make RBI independent are-

- no automatic monetization since 1997
- FRBM Act says RBI can not print money to supply credit to the government from 2006.
- RBI Act amended in 2006 to give it more power for reserve requirement management regarding caps on CRR

RBI: Assets, Capital and Dividend

The RBI functions according to the Reserve Bank of India Act of 1934. Chapter 4, section 47 of the Act, titled "Allocation of Surplus funds" lays down that profits (surplus) made by the RBI from its operations should be transferred to the GOI.

The RBI earns its profits through its open market operation; LAF operations; forex market interventions; seigniorage etc. When what it costs the RBI is deducted from the gross profit, net is arrived at and that is called surplus. Cumulatively built up surpluses are together its assets which runs into lakhs of crores of rupees. RBI used to transfer part of the surplus to GOI as dividend and keep the rest as capital. It is meant to build financial credibility and inspire stakeholder trust.

When the RBI chooses not to transfer all the surplus as dividend, its motive is

1. If it is 'overcapitalised', its rating will improve and so it can borrow at lower costs. It enjoys AAA rating while India has BBA rating
2. Such huge inflows into the economy through the government will be inflationary unless sterilized
3. Sterilisation costs in terms of interest payments are exorbitant and put further pressure on the fiscal condition, macroeconomic stability and BOP.

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GOI may differ. GOI says-

1. RBI holds much higher capital as a percentage of its total assets (around 28%) compared to countries such as the US, the UK, France and Singapore.
2. RBI's assessments of capital requirements and terms for the transfer of its reserves to the government is based on a very conservative assessment of risk and needs to be revised. As a result, RBI has over-estimated its capital reserves requirements. So part of it can be transferred to GOI as dividend.

But RBI's answer is: each country has its own structural requirements in view of its uniqueness and so we can not emulate advanced countries.

Money Supply

Money supply as a term indicates the total value of monetary assets available in an economy at a given point of time. It includes:

- currency and coins in circulation
- demand & time deposits of banks
- post office deposits and such related instruments.

Monetary aggregates

The Reserve Bank of India defines the monetary aggregates as a measure of the amount of money in circulation within a country. RBI adopts four of them-

- M1 (Narrow Money) = Currency with public + Demand deposits with the Banking system (current account, saving account) + Other deposits with RBI (deposits from foreign central banks etc)
- M2 = M1 + Deposits of post office savings accounts
- M3 (Broad Money) = M1 + Time deposits with the banking system
- M4 = M3 + All deposits with post office.

It is important that the RBI should keep track of the money supply in different ways so that it can estimate growth, investment, inflation, consumption etc.

RBI uses monetary tools like repo, reverse repo, CRR, SLR to manage money supply in the economy.

FSDC

There are many financial products that involve more than one regulator. They have in the past created friction among the financial regulators. Also, India's financial system is becoming diversified and complex and needs a body that has all the financial regulators and is headed by the Union Finance Minister. That is the reason for setting up the Financial Stability and Development Council in 2010 as was first mooted by Raghuram Rajan Committee in 2008. The global economic crisis was primarily triggered by unregulated financial system and so GOI saw the need to regulate the financial sector for stability.

FSDC aims to strengthen and institutionalise the mechanism of maintaining financial stability, financial sector development, inter-regulatory coordination along with monitoring macro-prudential regulation of economy. FSDC replaced the High Level Coordination Committee on Financial Markets (HLCCFM). A sub-committee of FSDC was set up under the chairmanship of Governor RBI to discuss and decide on issues relating to financial sector and stability including inter-regulatory coordination.

Its Chairperson is the Union Finance Minister and its members are:

- Governor Reserve Bank of India (RBI)

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- Finance Secretary and/ or Secretary, Department of Economic Affairs (DEA)
- Secretary, Department of Financial Services (DFS)
- Chief Economic Advisor, Ministry of Finance
- Chairman, Securities and Exchange Board of India (SEBI)
- Chairman, Insurance Regulatory and Development Authority (IRDA)
- Chairman Pension Fund Regulatory and Development Authority (PFRDA)
- Joint Secretary (Capital Markets), DEA, will be the Secretary of the Council
- The Chairperson may invite any person whose presence is deemed necessary for any of its meeting(s).

Responsibilities

- Financial Stability
- Financial Sector Development
- Inter-Regulatory Coordination
- Financial Literacy
- Financial Inclusion
- Macro prudential supervision of the economy including the functioning of large financial conglomerates
- Coordinating India's international interface with financial sector bodies like the Financial Action Task Force (FATF), Financial Stability Board (FSB) and any such body as may be decided by the Finance Minister from time to time.

Financial Stability Board (FSB)

The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system. It was established after the G20 London summit in 2009. The Board includes all G20 major economies and is based in Basel, Switzerland. It aims at addressing vulnerabilities and developing and implementing strong regulatory, supervisory and other policies in the interest of financial stability. India is an active Member of the FSB having three seats in its Plenary represented by Secretary (EA), Deputy Governor-RBI and Chairman-SEBI. The FSDC Secretariat in the Department of Economic Affairs coordinates with the various financial sector regulators and other relevant agencies to represent India's views with the FSB.

Macro Prudential Analysis

In the wake of the 2008 financial crisis that started in the USA, central banks across the world became acutely aware of the need to assess the health of the financial system, essentially banks, to estimate the stability of the financial institutions. Central banks have adopted macroprudential analysis to detect vulnerabilities in the financial system. This involves essentially stress tests. Stress tests evaluate large banks to determine whether those institutions have enough capital to withstand significant declines in asset prices, a deep recession, and a slowdown in global economic activity.

Macroprudential analysis is designed to indicate how resilient an economy is.

INFLATION: CONCEPTS, FACTS AND POLICY

Inflation means a persistent rise in the average price of goods and services. If prices rise moderately, it is a positive development as it shows there is growth in the economy. But if prices rise steeply, it hurts almost the entire economy without any benefits- growth; budgetary balance; welfare; reduces the purchasing power of money; impoverishes the poor disproportionately more as a greater proportion of their incomes are needed to pay for their consumption; reduces savings; pushes up interest rates; dampens investment; leads to depreciation of currency thus making imports costlier which feeds into inflation further. In other words, the entire macroeconomic stability rests on inflation if it reaches unsustainable levels. Therefore, the government policies aim at growth with price stability- which is moderate inflation on a long term basis.

Depending upon the rate of growth of prices, inflation can be of the following types:

Creeping inflation is a rate of general price increase of upto 4% a year. It is largely positive from a systemic perspective as it shows there is growth and so is referred to as price stability. It is a deterrent to deflation. It is considered good for the economy as producers and traders make reasonable profits encouraging them to invest.

Trotting inflation is when creeping inflation increases.

If not controlled, trotting inflation may accelerate into a **galloping inflation** which may be around 8-10% a year.

If it aggravates, galloping inflation can aggravate to **"runaway" inflation** which may change into a hyperinflation.

Hyperinflation is when prices are "out of control". That is, a monthly inflation rate of 20 or 30% or more- 'an inflationary cycle without any tendency toward equilibrium'. Hyperinflation is the result of reckless fiscal policy that creates excess money through deficit financing. It may also be caused due to war when fiscal resources and civilian production bases are diverted for military purposes. Social upheavals also can destabilize production to cause abnormal increases in prices.

If it aggravates, it leads to monetary collapse: money loses its value and either barter (exchange of goods and services without money mediating) may become popular or a foreign currency will become the dominant medium of exchange.

It must be noted that rates of growth of prices that are attached to the above mentioned terms are not of universal application. The tolerance levels differ from country to country. Developed countries have far lower tolerance levels compared to developing countries.

Other related concepts are:-

- Deflation: when prices grow at a rate that is less than zero. That is, if an item that was sold for Rs.10 is being sold for less than Rs.10 on a persistent basis, it is called deflation. If such drop in prices takes place in the general, it is called deflation. Deflation increases the value of money which allows one to buy more goods and services than before with the same amount of currency.
- Disinflation: It is the reduction of rate of inflation. It is the rate of growth of prices that is slowing but prices are increasing. If the inflation rate is not very high, disinflation can result in deflation. It is the opposite of reflation which is return of inflation. Government policy should aim at disinflation if the prices are high but not otherwise.
- Stagflation: It is a combination of inflation and rising unemployment due to recession. It comes from the two words- stagnation and inflation. It is a macroeconomic condition when the inflation

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rate is high, the economic growth rate slows or economy goes into de- growth (recession) and unemployment rises. Standard policy interventions will not work. For example, if rates are lowered to boost growth, inflation will rise even more eating into growth and causing unemployment. In the 1970's, US economy went into stagflation as global oil prices shot up. In 2018, there are comments indicating that due to rising oil prices, there could be stagflation.

- Reflation: which is when inflation returns after a spell of deflation and recession thus showing that growth is back: US and EU after the great recession (2007-09) when growth was revived.

- Open Inflation: One of the primary responsibilities of the government is to ensure affordability of goods and services. Governments subsidise goods and services to keep them inexpensive. For example, kerosene, food, transport etc. The inflation that results when the government does not suppress it with subsidies and monetary policy is called open inflation.

- Suppressed Inflation: Inflation is too big a risk for the economy for the government to allow it to continue unchecked. Therefore, fiscal and monetary actions are taken to manage it at a moderate level. That is called suppressed inflation. It is named so because, the problem of inflation is only managed and not resolved. It may reemerge if fiscal policies change- reduce subsidies etc.

- Headline Inflation: Headline inflation is a measure of the total inflation. It is an unadjusted number. It is the overall inflation as it is reported. Headline inflation is what consumers experience. It is best understood when contrasted with core inflation given below.

- 'Core' or 'Underlying Inflation': Core or underlying inflation measures the long-run trend in the general price level. Temporary effects on inflation are factored out to calculate base inflation. For this purpose, certain items are excluded from the computation of core inflation. These items include: changes in the price of fuel and food and the processed food part of manufacturing. The reason is they are volatile, being subject to short-term fluctuations and are seasonal in nature like food items. Thus, core inflation eliminates transitory effects. The main argument here is that the central bank should effectively respond to the demand side: for example, the money available in the market, demand for credit and so on and not the supply shocks like energy and food. Headline inflation on the other hand includes the official rate of increase in prices that excludes no item in the basket. Headline and core inflation are calculated both at the wholesale and consumer levels. CPI (Combined, that is rural and urban) headline inflation is considered when inflation is being targeted in the country by the RBI since 2015.

Measures of Inflation

GDP deflator

It is the most comprehensive measure of inflation as it reports the change in prices of all domestically produced final goods and services in an economy. The GDP deflator is not based on a fixed market basket of goods and services but applies to all goods and services domestically produced and thus is the most useful. It is not used for decision making in the short term as the statistics are available with a long time lag.

Cost of living index

A certain standard of living requiring a specific set of goods and services (basket) is defined and the basket is tracked for price changes in relation to affordability. The cost of living is the cost of maintaining such predefined standard of living.

Producer Price Index (PPI)

PPI measures the average change in the price a producer receives for his goods/services sold in the domestic market/exports either as they leave the place of production called Output PPI or as they enter the production process called Input PPI. The output PPI reflects prices of goods and

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services received by the producers exclusive of any tax on product, transport and trade margin, i.e., the prices are measured at basic price captured at the level of ex-factory, ex-mine, ex-firm, ex-service provider etc. The basic price would however include any taxes/ subsidies on production. That is, input production may have involved paying taxes but inputs themselves are taken at base prices for PPI. Producer price inflation measures the increase in prices of inputs like raw materials, wages, rupee exchange rate if imports are involved etc. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry set up a working group on the PPI in 2014 under the chairmanship of B.N. Goldar to outline the timeline for launch of the PPI series and it submitted its report in 2017.

Wholesale Price Index (WPI)

Wholesale is the sale of goods to anyone other than a consumer. Wholesale can be new and used goods to retailers, to industrial, commercial, institutional or professional users, or to other wholesalers. Wholesale prices need to be tracked to monitor inflation levels. Wholesale price index does it.

PPI and WPI differ as follows: WPI includes logistics, cost of credit, warehousing costs, transportation costs, margins, risk considerations etc and so is more.

Consumer Price Index (CPI)

Consumer price index measures the changes in prices paid by the consumer at the retail level. It can be for the whole economy or group-specific- for example, CPI for industrial workers etc as in India.

Causes of inflation

Demand-pull inflation

This is commonly described as "too much money chasing too few goods". It is inflation caused by increase in demand due to increased private and government spending. It involves inflation rising as real gross domestic product rises and unemployment falls. For example, food inflation related to protein items have been high-priced for many years in India as demand has shot up due to consumption patterns in India shifting due to increase in incomes. Demand-pull inflation is also due to money supply increasing when interest rates come down and easy and cheap credit pushes up prices. Wage inflation is another example.

Cost-push inflation

When the cost of production goes up, it leads to cost-push inflation. For example, higher prices for inputs; higher cost of capital due to higher interest rates; in India, monsoon failure and damage to production; international commodity prices go up, for example, crude or food or metals. It is also referred to as "supply shock," caused by reduced supplies due to increased prices of inputs, for example; crude prices globally had gone up in 2018 causing supply constraints which meant higher costs of production and so higher prices.

Structural inflation

A type of persistent inflation caused by deficiencies in certain conditions in the economy such as a backward agricultural sector that is unable to respond to people's increased demand for food and remains unproductive, inefficient distribution and storage facilities leading to artificial shortages of goods, backward technology and the resulting under-productivity is also a structural source of inflation. Infrastructural bottlenecks – roads, ports etc causing wastage of goods and creating shortages. Food inflation witnessed for a decade in India till mid-2010s was structural in nature as the preference for protein foods is far-ahead of its supplies and this is a phenomenon driven by income rise.

Other causes-

- Speculation in the commodity exchanges.
- Cartelization of producers: when producers come together and manipulate the prices in the market for the goods or services that they produce for their own profits. For example, Competition Commission of India (CCI) had imposed penalties in 2016 on 10 cement companies and their trade association i.e. Cement Manufacturers Association (CMA) for cartelisation in the cement industry that drive up prices through manipulation.
- Hoarding: accumulation of huge quantities of goods and releasing them into the market in conditions of scarcity at higher prices is also a cause of inflation. From time to time government raids wholesale traders and forces them to release their hoarded stocks to ease prices. For example, major onion traders in Lasalgaon and surrounding areas in Nashik district of Maharashtra, one of the largest onion markets in the country. Essential Commodities Act, 1955 aims to check hoarding, among other things. In 2014, GOI included onions and potatoes for one year under the ECA to curb hoarding. GOI imposed limits on the quantity of onions and potatoes that individuals and wholesale traders could stockpile. It empowered state governments to take measures to prevent hoarding.
- Imported inflation: when a country that depends on imports of goods sees inflation due to international prices rising or due to exchange rate depreciating. For example, crude price rise in 2018.

High Inflation Hurts

If inflation is high in an economy, the following problems can arise-

- Low income groups are particularly hurt
- People on a fixed income (e.g. pensioners, students receiving scholarships) will be worse off in real terms due to higher prices and same income as before
- Impact of inflation on exports depends on many factors and also the sector. It may discourage exports as domestic sales are attractive due to higher prices. Inflation may erode the external competitiveness of our products if it leads to higher production costs such as wage increases, and higher interest rate. It may also stimulate exports if the rupee depreciates as a result of domestic inflation being relatively high. However, if exports are import-intensive, advantage of depreciation may be neutralised.
- Inflation can drag-down growth as investment climate turns unfriendly due to low savings rate and high interest rates that deter consumption.
- Not only does inflation discourage saving and thus hit investment. It also skews savings pattern in favour of unproductive assets like gold and commodities as inflation may be higher than interest rates and yield is negative.
- Inflation tax is a hidden tax. It is the financial loss in the value of money incurred by holders of cash. Another way of seeing it is: when the government wants to tax people, they resist it. But the government needs the money. So it prints and releases the money into market and that inflates the economy which means people pay more for the goods and services they consume. The end result is that the tax that they did not pay is paid as prices rise.
- Government fiscal deficit may go up as the need to subsidise is more to make goods and services affordable which can create macroeconomic instability.

Inflation usually is associated with growth because when there is demand for goods and services prices rise- higher incomes and more demand and so more inflation. Supply generally lags demand as investors have to make sure that the demand is sustainable as otherwise additional growth may have to live with underutilization of capacities. There is thus inevitable inflation in a growing economy. But as we have seen above, inflation can result without growth as well.

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It can be argued that a low level of inflation is necessary for wages to go up. It further helps the economy keep off deflation which can otherwise set off a recession. Besides, inflation at a moderate level is an incentive to the producer. Some see mild inflation as "greasing the wheels of commerce."

Losers: Everyone loses when prices rise beyond the zone of tolerance- more than 4% generally. Individuals on fixed incomes, retirees, all creditors (who lent at fixed rate of interest.), to name a few.

Gainers: Individuals whose incomes rise faster than inflation, debtors (who pay back at fixed rate of interest).

Deflation

Deflation is invariably associated with recession when economic growth is negative. That is, economy is producing less than what it produced.

When an economy experiences deflation, demand from businesses and consumers to buy products goes down because they expect to pay less later as prices fall further. With crashing demand, producers can not sell and go bankrupt, unemployment rises reducing demand further. That causes deflation to become even more aggravated. It makes it more expensive to service existing debts. As debt becomes unserviceable, the risk of default and bankruptcy rises too and banks become reluctant to lend as their own NPAs rise.

The way to deal with deflation is by pump priming the economy in the Keynesian way. There are fiscal and monetary responses. Fiscal remedies to deflation:

- Tax cuts to boost demand from consumers and businesses
- Increase government spending on infrastructure projects that boost the return on private investment
- Monetary response is:
 - Lowering interest rates to encourage demand for credit
 - Printing more currency to boost money supply

India did not ever face deflation at the retail level but in 2014 and 2015, for 14 consecutive months, Wholesale Price Index (WPI) inflation was in the negative.

Price Stability and Optimal Inflation

All consumers want lower prices. Price stability according to the Monetary Policy Framework Agreement 2015 is inflation rates at 4%, plus or minus 2% on a medium term basis. That will help public to have clear expectations of prices for the future and behave predictably. When there is clear guidance to inflation expectations, there is no panic buying that inflates more by creating scarcities; nor panic selling that can deflate.

Low levels of prices and negative inflation (deflation) may be of short term comfort to the consumer but are not desirable from a longer term view.

Consumer may want negative inflation as it helps him afford goods and even save. That is possible when supplies outstrip demand on a sustainable basis which is not possible as the producer incurs losses.

Hypothetically, negative inflation is also possible if government subsidises goods and services steeply but producers will object to that. Besides, that is also not possible fiscally as deflation hurts fiscal receipts and on top of it, subsidies bill will damage the fiscal position even more.

Lastly, consumer will not be benefited if prices fall due to recession-driven deflation as it may hurt his own job and business prospects in the medium run.

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Therefore, we can aim at inflation that is in the positive territory that augurs well for economic well being for all- producers and consumers alike. Too much inflation hurts from all sides. Too little is no incentive for growth. There has to be price stability at a moderate level of inflation. But the question remains how much of inflation will be good for the economy- growth, welfare and stability wise. In India, Reserve Bank of India and Government of India signed a Monetary Policy Framework Agreement in 2015 which says that the objective of monetary policy framework is mainly to maintain price stability, while keeping in mind the objective of growth; and contain consumer price inflation within 4 percent with a band of (+/-) 2 percent. This level of inflation is considered optimal from growth, stability, fiscal consolidation, foreign trade and welfare perspectives.

GDP, Potential GDP and inflation

Potential output ("natural gross domestic product") can be linked to inflation. Potential GDP is the highest level of real gross domestic product that can be sustained over the long term without creating instability. If GDP exceeds its potential, inflation will accelerate and if GDP falls below its potential level, inflation will decelerate as suppliers attempt to utilize the existing idle capacity by cutting prices.

Inflation and Corruption

The link is as follows-

- through black money , demand rises and so do prices
- hoarding not being checked will create artificial scarcities
- commodity prices being manipulated through speculation in commodity exchanges
- tax evasion limits government capacity to subsidise and stabilize prices

Philips's Curve: The inverse relationship between rate of inflation and rate of unemployment is shown in the Phillips curve. Price stability has a trade-off against employment.

Inflation Targeting

Inflation targeting focuses mainly on achieving price stability as the predominant objective of monetary policy. Under it, a number or range is set to be achieved by the central bank. We follow this policy in India since 2015. The advantages of inflation targeting are the following-

- promotes transparency in the conduct of monetary policy as the objective is clear
- increases the accountability of monetary authorities because the benchmark is a statutory fact
- inflation expectations are managed well.

When we choose a range of price level for RBI to achieve, called flexible inflation targeting framework, it is helpful because it increases chances of effectiveness.

Critics however argue that in pursuit of price stability, growth and credit supply are unduly being compromised with.

Indices of Inflation in Detail

Inflation as we have already seen is measured at the producer, wholesale and consumer (retail) levels. It is measured at the sectoral (food) and general economic level. It may be used for a specific group (industrial workers) or the whole country. Changes in the price levels at the wholesale and retail level are tracked by various price indices in India- WPI and CPI. Different CPIs exist for different consumer groups.

All price indices use a particular year as a "base year". That means that rises or falls in prices are measured with reference to the price in that year. For example, the base year used for the Wholesale Price Index is 2011-12 from the fiscal year 2017-18. Wholesale prices of all products in the basket with their respective weightages in that year add up to 100. If, in the base year, the

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wholesale price of gur was Rs.2/kg, and rose by 50 paise the following year, it would mean that the wholesale price index for gur would rise to 125. But the movement of an index is based on the average of price movement of all the goods in the basket and not just one article. The goods in the WPI basket have different weightages.

Ideally the same base year should be used for all indices but different base years are used for different price indices due to convenience, data availability, logistics etc.

WPI

WPI provides estimates of inflation at the wholesale transactions level for the economy as a whole. This helps in timely intervention by the Government to check inflation, in particular inflation in essential commodities, before the price increase spills over to retail prices. WPI is used as deflator for many sectors of the economy for estimating GDP by CSO. It is also used to deflate nominal values of production in Index of Industrial Production (IIP). Global and domestic investors track WPI for their investment decisions.

The WPI is published by the Economic Advisor in the Ministry of Commerce and Industry, with a month lag. The various commodities taken into consideration for computing the WPI can be categorized into primary articles, fuel and power, and manufactured goods. Primary articles include food articles, non-food articles and minerals. In the fuel, power, light and lubricants, electricity, coal mining and mineral oil are included. The manufactured goods category encompasses food products; beverages, tobacco and tobacco products, wood and wood products, textiles, paper and paper products, basic metals and alloys, rubber and rubber products and many others.

WPI has an All India character. The inflation rate is calculated on point to point basis: the price of a good at one point of time in the year is compared to the same point of time in the next year. It thus respects seasonality factor. For example, October prices of a year with October prices of another year.

There are a number of agricultural commodities, especially, some fruits and vegetables, which are of a seasonal nature. Such seasonal items are handled in the index in a special manner. When a particular seasonal item is not available in the market and its prices are not quoted, its weight is distributed over the remaining items and new seasonal items, if any, in the concerned sub-group.

The accuracy of WPI is unsatisfactory even after the introduction of the revised series in 2017. Services such as education, telecom, rail and road transport, health care, postal, banking and insurance, for example, are not part of the WPI basket. Neither are the products of the unorganised sector that are estimated to constitute about 35 per cent of the total manufactured output of the country. The index thus falls well short of being a broad based indicator of the price level even in its construction.

New Wholesale Price Index (WPI)

The Government periodically reviews and revises the base year of the macroeconomic indicators to capture structural changes in the economy and improve the quality, coverage and representativeness of the indices. The base year of All-India WPI was revised from 2004-05 to 2011-12 by the Office of Economic Advisor (OEA), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry to align it with the base year of the CSO for Gross Domestic Product (GDP) and Index of Industrial Production (IIP). The revision entails changing the commodities in the basket and assigning new weights to the commodities. For the new series with base 2011-12=100, Working Group was chaired by Late Dr. Saumitra Chaudhuri. WPI basket does not cover services.

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In the new WPI basket, the number of items was increased from 676 to 697. It enhanced the number of quotations from 5482 to 8331 (shops from where price information was collected). New definition of wholesale price index does not include taxes in order to remove impact of fiscal policy. This also brings new WPI series closer to the concept of Producer Price Index and is in consonance with the global practices. Further for the first time a Technical Review Committee has been set up to recommend appropriate methodological intervention to continuously improve coverage, quality and timeliness of the WPI.

The new series also present separate 'WPI Food Index' which along with CPI Food Price Index published by CSO would help monitor the food inflation effectively. The seasonality chart of the Fruits and Vegetables Sub-group under the Food Articles has been updated in the new series. For example, tomato price index will now be available around the year as against eight months in the earlier series. Cauliflower was earlier available only for six months but now it will be available for eight months in year.

Consumer Price Index (CPI)

Consumer Price Index (CPI) measures changes in the prices of goods and services purchased by households. The CPI measures price changes by comparing, on a point to point basis, the cost of a fixed basket of commodities like the WPI. Sub-indexes are computed for different categories and sub-categories of goods and services, being combined to produce the overall index with weights reflecting their shares in the total of the consumer expenditures covered by the index. CPI can be used to index (i.e., adjust for the effect of inflation) the real value of wages, salaries, pensions, for regulating prices etc.

The dearness allowance of Government employees and wage contracts between labour and employer are based on this index.

Over the years, CPIs have been widely used as a macroeconomic indicator of inflation, and also as a tool by Government and Central Bank for targeting inflation and monitoring price stability. CPI is also used as deflators in the National Accounts along with WPI.

Consumer price index numbers were known as "Cost of Living Index Numbers" prior to 1955. Cost of living index is a broader term which includes not only changes in prices but several other factors like change in consumption habits and standard of living.

Presently the consumer price indices compiled in India are:

- CPI for Industrial workers CPI (IW)
- CPI for Agricultural Labourers CPI (AL)
- Rural Labourers CPI (RL)
- CPI All India (Urban)
- CPI All India (Rural)
- CPI All India (Combined)

There was another CPI called the Urban Non-Manual Employees (UNME) but was discontinued.

For Industrial Workers (CPI-IW), a basket of 370 commodities is tracked; for Agricultural Labourers (CPI-AL), it is a basket of 60 commodities. The baskets and the weightages to each item have been determined on the basis of surveys of consumption patterns. All-India figures declared are averages. Each commodity is given a specific weightage, which differs from one index to another index. For example, the CPI-AL gives greater weightage to foodgrains since a greater proportion of the agricultural labourer's expenditure would go toward foodgrains.

In the organised sector, CPI-IW is used as a cost of living index. It is the responsibility of the Ministry of Labour to compile and release the data on the CPI for Industrial Workers and the data on the CPI for aural /agricultural labourers.

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The base years for the above CPIs are:

- Consumer Price Index Numbers for Industrial Workers on base 2001=100
- Consumer Price Index Numbers for Agricultural Labourer on base 1986-87=100,
- Consumer Price Index Numbers for Rural Labourer on base 1986-87=100.

New CPI Series 2015

The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation in 2015 revised the Base Year of the Consumer Price Index (CPI) from 2010=100 to 2012=100 and brought in many methodological changes due to change in the consumption pattern from 2004-05 to 2011-12. Changes are the following in the weighing diagram (groups, items and weights)-

- The number of Groups, which was five in the old series, has now been increased to six. 'Pan, tobacco and intoxicants', which was a Sub-group under the Group 'Food, beverages and Tobacco', has now been made as a separate Group. Accordingly, the Group 'Food, beverages and Tobacco' has been changed to 'Food and beverages'.
- Egg, which was part of the Sub-group 'Egg, fish and meat' in the old series, has now been made as a separate Sub-group. Accordingly, the earlier Sub-group has been modified as 'Meat and fish'.
- Sample size for collection of house rent data for compilation of House Rent Index, which was 6,684 rented dwellings in the old series, has now been doubled to 13,368 rented dwellings in the revised series.

In the new CPI index, weight of food and beverages is 45.86% and weight of fuel and light segment is 6.84%.

Price data are collected from selected towns by the NSSO and from selected villages by the Department of Posts.

New CPI reflects the realistic picture of the prices of consumer goods and services because of the following reasons:

- CPI (Rural): prices are collected from 1,181 selected village markets covering all districts of the country for rural areas and from 1,114 urban markets of 310 selected towns of urban areas; From each district, atleast two villages were selected.
- these markets are equally distributed over different weeks of a month to capture price variations during the month;
- only transaction prices, that is prices actually paid by the consumers, are collected for compilation of indices;
- the items having significant share in the overall consumption expenditure of the households, including the Public Distribution System (PDS) items and the items consumed by majority of the households are included in the basket
- CPI(Urban): All cities/towns having population (2001 Population Census) of more than 9 lakh; and all state/UT capitals not covered therein were selected and other towns were selected randomly.

The entire process of data validation is carried out using electronic mode of communication. Two independent web portals for Rural and Urban Price Data have been developed by the National Informatics Center (NIC).

The Consumer Price Index is released every month on 12th day.

The Reserve Bank of India (RBI) started using CPI All India combined as the sole inflation measure for the purpose of inflation targeting.

Difference between WPI and CPI

WPI measures price rise at the wholesale level. CPI on the other hand measures price rise at the retail level. There is a difference between the two in terms of prices. The difference is due to a number of factors-

- Two indices are calculated with different baskets, commodities and weights. Food inflation is reflected more in CPI as its weight is much more in CPI than in WPI.
- Services are not there in the WPI basket.
- A substantial portion of the difference is due to the middlemen between the wholesaler and the consumer. Each one has his own margins to make.
- While wholesale prices are about the same throughout the country, consumer prices vary from region to region; and rural to urban due to the change in consumer preferences for certain products, supplies and purchasing power.
- Taxes levied by states comprise an important component of the variation in prices of many products.
- Logistics also adds to the consumer price.

Why the two diverge is because of the number and nature of ingredients of the baskets; weights attached; taxes add to CPI; logistical and other extra costs; middlemen;

Take the food group for example. CPI Food group has a weight of 39.1 per cent as compared to the combined weight of 24.4 percent (Food articles and Manufactured Food products) in WPI basket. Similarly weights of the major petroleum products such as petroleum and High Speed Diesel also vary significantly. The CPI basket consists of services like housing, education, medical care, recreation etc. which are not part of WPI basket.

A sizeable proportion of WPI basket represents manufacturing inputs and intermediate goods like minerals, basic metals, machinery etc. whose prices are influenced by global factors but these are not directly consumed by the consumers and are not covered by the CPI basket. Thus when the prices of these goods change, CPI need not capture them except with a long time lag in a reduced manner. The divergence is greater with the new WPI series as it excludes indirect taxes.

Relevance of the two indices of WPI and CPI

The WPI is useful for industrialists as they purchase commodities whose presence in the WPI is significant. They also purchase at the wholesale price. The CPI basket does not include machinery, chemicals, and so on. Secondly, the price of electricity in the CPI is the consumer tariffs, not the industrial tariffs.

CPI All India (Combined) is the most dependable index for the consumer and RBI uses it for inflation targeting.

Price index for services

In India, the services sector accounts for about 55 percent of the GDP. But the WPI does not include services. CPI does. Certain services such as medical care, education, recreation and amusement, transport and communication are included in the new CPI series. But, some major services such as trade, hotels, financing, insurance, real estate and business services are not covered.

Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry constituted an Expert Committee to render technical advice for development of Service Price Index (SPI) and its related issues in 2010. The Committee is chaired by Prof. C. P. Chandrasekhar.

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Food Price Indices

There are food indices for WPI and CPI as mentioned above.

CFPI

The Central Statistics Office (CSO) first released Consumer Food Price Indices (CFPI) for three categories - rural, urban and combined - separately on an all India basis with effect from 2014. It is a part of the statistics released by the CSO in new CPI series- rural, urban and combined. Consumer Food Price Index (CFPI) covers food products consumed by a specified population group in a given area with reference to a base year which is 2012.

FAO Food Price Index

Globally, food price index is released by Food and Agriculture Organization of the United Nations. The FAO Food Price Index is a measure of the monthly change in international prices of a basket of food commodities. It consists of the average of five commodity group price indices (Cereal, Vegetable Oil, Dairy, Meat and Sugar) weighted with the average export shares of each of the groups for 2002-2004 which is the base year with a value of 100.

Residex

RESIDEX, the country's first official housing price index (HPI) was launched in 2007 by National Housing Bank and was revamped in 2015 and expanded to 50 cities spread over 18 States and UTs. NHB RESIDEX enables the policy makers, banks, housing finance companies, builders, developers, investors, individuals, etc., to track the movement of housing prices across different cities in India on quarterly basis. NHB RESIDEX helps buyers and sellers to check and compare prices before entering a transaction. They can also analyse the price trends across different cities. The base year is 2012-13 and data sources are: data from banks and home finance companies and market surveys.

House Price Index (HPI) of Reserve Bank of India (RBI)

The Reserve Bank compiles quarterly house price index (HPI) (base: 2010-11=100) for ten major cities. Based on these city indices, an average house price index representing all-India house price movement is compiled. These indices are based on the official data of property price transactions collected from registration authorities of respective state governments.

Collection of Statistics Act, 2008

Collection of Statistics Act, 2008 was made to bring in new rules aimed at improving data collection.

Under the new Act, Government is given power to levy higher penalty for not sharing data and tougher punishment will be imposed in cases where manipulation of data is involved. The new penalty scheme will ensure that data collection is done on time. It will increase the accuracy of the data. The Act also makes wilful manipulation or omission of data a criminal offence. This penalty will also apply if a company prevents or obstructs any employee from collecting data. The Collection of Statistics Act, 2008, gives powers to the government to classify any statistics as "core statistics" and also determine the method to collect and disseminate the same. Core statistics generally include national income, money and banking, demography, social and environment sectors.

Growth-Inflation Trade Off

With high growth, economy overheats. As growth creates more employment, incomes and demand, prices rise. Overheating of the economy means demand overshoots supply and there is high pressure on prices.

As prices rise, the central bank intervenes and raises rates to cool investment and consumption demand and so price rise is moderated. Repo rate- the policy rate- is the tool along with CRR and OMOs available to the central bank as signals to the economy that it is ready to act to soften

prices - partly because the poor suffer disproportionately and partly because high rate of inflation can derail the medium and long term growth.

Such intervention by the central bank has a dampening impact on growth as higher interest rates prevent easy borrowing and thus demand slackens.

The primary official goal of the RBI is to moderate and stabilize prices as the inflation targeting framework of 2015 February mandates.

Thus, growth and inflation are intimately connected- one being traded for the other depending upon where the growth situation stands.

As prices stabilise, rates are lowered and demand and growth resume and a new and higher base is set for the growth process. Growth and inflation do have a trade off but that is only in the short term. As Dr. C. Rangarajan says, growth is a marathon while overheating and slow down are temporary pauses to gain greater strength.

Further, unless the RBI raises the policy rates with inflation going up, there is a danger of banks failing to attract deposits as real interest rates become negative and savings may be diverted to unproductive assets like gold with serious consequences- inside and outside for the economy.

Government Steps to Control Inflation

The Government has taken a number of short term and medium term measures to improve domestic availability of essential commodities and moderate inflation. It has procured record food grains and kept foodgrain buffer stock to intervene in the market to keep the prices at reasonable level. A Strategic Reserve of 5 million tonnes of wheat and rice has also been created to offload in the open market when prices are high. This is in addition to the buffer stock built by FCI for food security through the fair price shops.

The price situation is reviewed periodically at high-level meetings such as the Cabinet Committee on Prices (CCP).

Fiscal Measures

- Reduced import duties on food items
- Subsidising food under the Food Security Act 2013
- Reducing indirect taxes: GST adjustments

Administrative Measures

- Ban on exports of food items
- Dehoarding
- Jan Aushadi shops for cheaper medicines
- Ayushman Bharat for free medical and health services
- Monetary Measures Repo rates were kept high to make credit dearer.

Other Measures Taken To Control Inflation

- Advising states to allow free movement of fruits and vegetables by delisting them from the APMC Act
- Banning of export of all pulses
- Zero import duty on pulses and onion
- Empowering States/UTs to impose stock limits in respect of onion, pulses, edible oil, and edible oilseeds under the Essential Commodities Act

Inflation risks to the economy late 2018 stem from-

- Global crude prices
- Rupee depreciation
- Higher MSP announced by the government
- Fiscal deficit target not being adhered to.

TAXATION

The core of government's fiscal policy is the power to collect taxes and use them for public purposes. The power of fiscal policy to generate economic growth and equity comes from the privilege to tax and spend. Tax is a payment compulsorily collected from individuals or firms by government. A direct tax is levied on the income or profits of an individual or a company respectively. The word 'direct' is used to denote the fact that the burden of tax falls on the individual or the company paying the tax and can not be passed on to anybody else. For example, income tax, corporate tax, wealth tax etc. An 'indirect' tax is levied on manufacturing and sale of goods or services. It is called 'indirect' because the real burden of such a tax is not borne by the individual or firm paying it but is passed on to the consumer. Excise duty, customs duty, sales tax etc. are the examples. Goods and Services Tax (GST), for example, an indirect tax, is paid by the consumer to the seller and the seller in turn pays to the government.

Importance of taxation for the Government, economy and society

Taxation has revenue and non-revenue aims. The revenue it fetches helps government in meeting its growth goals through investment. Taxes provide funds that can accomplish-

- Provision of public goods
- National security
- Enforcement of law and order
- Redistribution of wealth through progressive taxation system
- Economic infrastructure — roads, ports etc
- Social infrastructure like education, health etc
- Social security measures like insurance, pensions, unemployment benefits
- Reduce economic inequality
- Provide basic minimum to all through a scheme like Universal basic Income(UBI). If tax collections are adequate
- If tax collections show buoyancy, government's need to borrow is reduced and thus macroeconomic stability can come about
- To modernize the economic system like GST
- Promote savings
- Promote micro, small and medium enterprises(MSME)
- Boost exports by making exports free of the GST burden
- Protect domestic production by raising the import duties selectively

Taxation in India

India has an elaborate federal Constitutional scheme for imposition, collection and appropriation of taxes. The central government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like customs and excise duties and service tax. In 2017, however, excise duties and service tax were integrated into the Goods and Services Tax (GST) for most products. States are a part of GST though they have residuary power to levy Value added tax (VAT) on goods like petroleum products, tax on liquor etc. States also have the power to levy direct taxes like tax on agricultural income.

Since 1991, the tax system in India has undergone substantial rationalization- reduced rates and slabs and better administration. Tax system has been simplified also to boost "Ease of doing business." Some of the tax reforms made are:

- Broadening the tax base to include services, fringe benefits, stock and commodity market transactions etc.
- Reduction in customs and excise duties. Peak customs rate is today 10% which is imposed on

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- 90 per cent of non-agricultural industrial goods
- Lowering of corporate tax rates to 25% over a four year period from 2015
- Wealth tax was abolished in the Union Budget (2016-2017) and integrated into the highest income tax bracket
- Rationalizing the personal income tax rates and slabs starting from 1997 'dream budget'
- GST from 2017
- Use of technology for quicker processes
- Simpler procedures for greater compliance
- Safe harbor rules on transfer pricing
- Revamping the double tax avoidance treaties with many countries like Mauritius to prevent Base erosion and profit shifting (BEPS)
- Clear-cut General anti-avoidance rules (GAAR)
- Stringent action against black money holders through disclosure schemes which have very little amnesty component eg- Income Disclosure Scheme (IDS) 2016 and severe monetary penalty as in Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) so that they pay adequate tax

Tax Reforms in India

Since the beginning of the last decade as a part of the economic reforms programme, the taxation system in the country has been subjected to consistent and comprehensive reform.

The need for the tax reforms arises from the fact that-

- tax resources must be maximised
- international competitiveness must be imparted to the Indian economy
- transaction costs must be reduced
- the high-cost nature of Indian economy needs to be corrected so that compliance increases, equity improves and investment flows

On the direct tax front, the reforms are the following:

- Reduction and rationalization of rates
- Simplification of procedures
- Strengthening of e-administration
- Widening of the tax base
- Exemptions are gradually being withdrawn.
- Corporate tax reforms since 2015
- Wealth tax abolished in 2015
- GAAR
- DTAA corrected

Indirect Taxes

- Reduction in the peak tariff rates- 10% is the peak customs duty today
- The number of slabs has come down drastically
- GST etc

Direct and Indirect Tax Ratio

Total tax revenue of the Government of India includes both direct & indirect taxes. Direct taxes come from the relatively well off as it is a progressive tax where the richer a person/firm, the more it has to pay. It has equity built into it. Direct taxes like income tax are also 'automatic stabilisers' – when the economy grows, there is inflation, wages rise, people move into higher tax brackets and pay more taxes which reduces their spending on goods and services thus stabilizing prices. They help in stabilising economic cycles without explicit government action.

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Indirect taxes on the other hand largely do not differentiate between the rich and the poor though there is a progressive element there as well as there are exemptions and there is a hierarchy of slabs; and the luxury goods attract a higher GST and basic import duty. But on many essential goods, there is tax and the poor pay it. Indirect taxes also contribute to inflation and may dent savings and demand. Thus, they are relatively anti-growth and anti-equity. In India, the relative contribution has been evolving as follows as mentioned in the Reserve Bank of India (RBI) Handbook of Statistics on Indian Economy released in September 2017:

In 1985-86, the indirect tax revenue was more than 4 times that of the direct tax revenue. The share of indirect taxes in the total tax revenue was 83% compared to the 17% share of direct taxes in 1985-86. The reason was that rich were very few in the country and indirect taxes were easy to collect. In 30 years since then, the share of both has more or less become equal. In 2016-17, share of direct taxes was 48% in the total tax revenue compared to the 52% share of indirect taxes. In the 8 years between 2007-08 and 2014-15, the share of direct taxes in the total tax revenue was more than the share of indirect taxes. In 2009-10, the share of direct taxes was close to 60%, the highest ever till date. Starting again in 2015-16, the share of indirect taxes has overtaken the share of direct taxes.

In this context, it should be noted that when the overall tax collections of both the Centre and the States are taken into account, nearly two-third of total tax collected is accounted for by indirect taxes, implying that the tax structure in the country continues to be regressive.

While collections from direct taxes have risen in absolute terms, their contribution to India's total tax revenue has fallen in percentage terms. Also, direct taxes have been growing at a slower pace than indirect taxes.

The reasons for the surge in indirect taxes:

- service tax base increased and also the rate. With GST in force since 2017, there are different service tax rates going up to 28% basic and steep cess on it while in the pre- GST model, service tax was collected at 15%.
- Better compliance with GST- more firms are registering and paying taxes
- There was also a temporary reason related to global crude prices falling when Government Of India found an opportunity and need to increase the excise duties on petroleum products steeply.

Tax to GDP ratio

When the economy grows, personal incomes rise and so do corporate profits and consumption of goods and services. All of them add to tax collections and thus the Tax: GDP ratio increases. It is called tax buoyancy. GOI's gross tax collections (total amount that it collects which includes the share of States and UTs) reached its highest level of 11.6 per cent in 2017-18. According to the budget estimates, this would rise further to 12.1 per cent in 2018-19. When we add the taxes and duties of States and local bodies, India's tax-to-GDP ratio becomes 16.6%. Gross tax collections of GOI will statistically come down from 2017-18 as states are collecting their own GST. Other countries have different ratios: In 2015, tax revenue (including social contributions) in the EU-28 stood at 40.0 % of GDP, and accounted for around 89 % of total government revenue. Tax to GDP ratio in BRICS countries is: - Brazil (35.6%), South Africa (28.8%), Russia (23%), and China (19.4%). Some countries, like Sweden, have a high tax-to-GDP ratio (as high as 54%). USA's is 25.4%. France has a tax to GDP ratio of 45% while Denmark is at 48.6%. Most developed countries have a higher per capita income and therefore the ability to pay higher taxes.

The relatively low ratio in India is because we are a developing country; there is a large informal sector; agricultural income is exempt; there are so many other tax exemptions (tax expenditure); parallel economy; and also, tax machinery does not have sufficient capacity.

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Low ratio handicaps the state from spending on social sector and infrastructure. India spends on an average about 3.4 percentage points less vis-a-vis comparable countries on health and education.

Since 2016-17, formalization of economy has gathered momentum with demonetization and GST. There are more people filing tax returns; more digital payments; those evading tax earlier can not do so any more as the government relies on big data garnered from demonetization. GST makes compliance higher due to input tax set off.

Due to demonetization, as many as 1.26 crore new taxpayers were added in 2016-17. The I-T department launched Operation Clean Money to clamp down on unaccounted money funnelled into bank accounts, post-demonetisation.

Thus, the rising tax-GDP ratio can be attributed to-

- rationalisation of the tax rates
- more economic activity (GDP growth)
- broadening tax base (more taxable economic actions)
- better enforcement; and
- better compliance.

Number of Taxpayers

In India, a large section of people come from agriculture, BPL and micro and small enterprises who are not liable to pay tax as their income falls below the exemption limit. Due to Tax Deduction at Source (TDS), many more people are paying tax even though many of them may not be filing their tax returns. That is, not everyone who pays tax files returns. Equally, not everyone who files returns pays tax. Many file returns to show that they have no taxable income.

The government added millions of new taxpayers in recent years. In March 2014, the number of Income Tax returns filed was 3.8 crores. In 2017-18, this figure grew to 6.86 crores. The effective number of taxpayers (taxpayers among filers and those who did not file returns but paid tax by tax deduction at source, TDS- essentially employees) increased in the same period. This is expected to significantly boost the government's tax revenue. Similarly, with GST, more firms are registering and paying taxes. GST was implemented from 1st July, 2017. In the first year, the number of registered assesses increased by 72.5%. The original 66.17 Lakh assesses has increased to 114.17 Lakhs.

It has a collateral benefit for the direct tax collections also.

Broadening Tax Base

Tax base encompasses all that is taxed- incomes, profits, manufacture, sale, import etc. While vertical equity demands that rich are taxed harder and luxury goods as well, horizontal equity demands that all transactions except the very essential ones be taxed. The more the transactions that are taxed, the larger the base. Since 1991, government has been broadening the base starting from 1994 when the service tax was introduced. Following have been the steps-

- STT
- CTT
- Fringe benefit tax
- MAT
- GAAR
- Limitation of benefit clause in the DTAA's
- Demonetization
- Transfer pricing and APAs
- GST

- Expanding the coverage of provisions relating to Tax Deduction at Source (TDS) to more transactions
- Quoting of permanent account number (PAN) made compulsory for many transactions so more people can be brought into tax net

Tax Amnesty Schemes

There are people who do not comply with the tax laws, that is, they evade taxes. Governments make amnesty schemes for them to come clean by paying taxes at the current rates or any other rate which is beneficial to the assessee even as the government collects tax revenue that can be used for the socio-economic development of the country. It is called tax amnesty scheme. Those who comply with such a scheme are not taken up criminally. Some schemes do not have any penalty. Some have it, the latter being disclosure schemes essentially where the amnesty part is minimal (amnesty means not being criminally proceeded against). The schemes that were launched in 2016 are mainly disclosure schemes: IDS 2016 and PMGKY.

IDS 2016

Income Declaration Scheme, 2016 was an amnesty scheme that was a part of the 2016 Union budget to unearth black money and bring it back into the system. It provided an opportunity to income tax and wealth tax defaulters to avoid litigation and become compliant by declaring their assets, paying the tax on them and a penalty.

Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

It is an amnesty scheme launched by the Government of India in December 2016 on the lines of the Income declaration scheme (IDS), 2016 launched earlier in the year. It provided an opportunity to declare unaccounted wealth and black money in a confidential manner and avoid prosecution after paying tax, interest and a fine.

While the rationale is appealing for the amnesty schemes, they carry a moral hazard: those who do not pay, continue not to pay and those who did, may be demotivated.

Operation Clean Money 1 and 2

Income Tax Department (ITD) initiated Operation Clean Money 1 and 2 in the year 2017. It involved e-verification of large cash deposits made during 9th November to 30th December 2016. Data analytics were used for comparing the demonetisation data with information in Income Tax Department databases. People who were identified for tax collection were those with cash transactions that did not appear to be in line with the taxpayer's profile. I-T department used information received from banks to identify persons whose tax profiles were found to be inconsistent with the cash deposits made by them during the demonetisation period.

Direct Taxes Code (DTC)

The Direct Taxes Code (DTC) is a proposal by the Government of India (GOI) to simplify the direct tax laws in India. DTC aims to introduce new provisions and revise, consolidate and simplify the structure of direct tax laws in India into a single legislation. DTC is expected to replace the Income-tax Act, 1961 and other direct tax legislations.

Many changes have already been brought about in the direct tax regime in the country in the last few years:

1. Wealth tax was abolished
2. In 2018-19, long term capital gains tax (LTCG) was introduced on certain equity gains
3. GOI presented a plan to reduce the corporate tax rate from 30% to 25% in four years to make India's tax rates globally competitive

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4. Reduction in corporate tax rate for MSMEs from 30% to 25% to make them more competitive
5. General Anti Avoidance Rules (GAAR)
6. Place of Effective Management (PoEM) rule as a test to determine residency for tax benefit purposes
7. Changes in DTAA's.

In the 2017 Rajaswa Gyan Sangam, PM mentioned the need to overhaul the direct taxes framework.

Capital Gains Tax

It is a tax on the gains made from buying and selling assets like land, shares etc. If the gain is made in the assets held for over three year (one year for shares and mutual funds), it is called Long Term Capital Gains (LTCG) and taxed. Short Term Capital Gains tax is always more to encourage investment as distinct from speculation. Till 2018-19, long term capital gains (LTCG) arising from transfer of listed equity shares were exempt from tax. Union Budget 2018-19 reintroduced the LTCG tax on equity investments-shares and related. The budget legislated to tax long-term capital gains exceeding '1 lakh at the rate of 10 per cent without allowing the benefit of any indexation. All gains up to 31st January, 2018, however, are grandfathered. (Grandfathering means new laws will not apply). The gains from equity shares held up to one year will continue to be taxed at the rate of 15 percent on short term capital gains.

Cost inflation index (CII) is the index for the inflation rate in the country. Central Board of Direct Taxes (CBDT) issues this index every year. If indexation benefit is given for LTCG, the inflation cost is added to the purchase price and the resulting amount is deducted from the sale price to get the amount on which the tax is calculated. Put differently, the inflation cost is deducted from the gains and the rest is taxed.

Inverted Duty Structure

Normally, there should be lower tax on import of raw material so that it can be imported and processed (value added) to produce the final product that can be sold at home or exported. That helps "Make in India". It also promotes exports. Higher import duty likewise, on finished products discourages their import thus protecting domestic manufacturers; saving the country of precious foreign currency; and creates employment in the country. It is clear thus, inverted duty structure is low import duties on the raw materials and intermediates than on the finished product. It puts the domestic manufacturers at a disadvantage making them uncompetitive within the domestic market and in global markets.

The examples are: India levies one of the highest duties on import of raw materials and one of the lowest duties on import of finished rubber goods. This inverted duty structure is leading to a surge in import of finished goods. Of the total import of finished goods, 80-90 per cent is avoidable as domestic rubber manufacturing units have the capability to meet the demand. Low import duties on rubber products rendered mandatory under the negotiated FTAs (free trade agreements) have led to indiscriminate imports in the country.

Reducing the customs duty on raw material for the pharmaceutical, electronic and automobile sectors is important for the same reason.

FTAs may lead to inverted duty structure with duties for final products being lower from FTA partners compared to duties for the raw materials imported from non-FTA countries. Government remedied many such anomalies.

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Tax Expenditure

Tax expenditure refers to revenue forgone as a result of exemptions and concessions (direct and indirect tax). Government has been presenting a statement on tax expenditure in the parliament since 2006-07 Union Budget. The revenue foregone due to tax incentives in 2015-16 is estimated at nearly 6 lakh crore. Such exemptions have been justified for promoting balanced regional growth; dispersal of industries; neutralisation of disadvantages on account of location; and incentives to priority sectors, including infrastructure. They are also given to the middle class to build houses; senior citizens for their relief; women for buying houses etc.

Since the amount is large and so many of the incentives may have lost their utility and need, it is suggested that some should be dropped. They should be subject to a sunset clause (should operate for a limited time), as tax exemptions often create pressure groups for their perpetuation. While some may be justified as they enhance investment and generate more taxes for the government, others are not.

Such exemptions and concessions can distort resource allocation and stunt productivity. They also result in a multiplicity of rates, legal complexities, classification disputes, litigation etc. If these exemptions are rationalized, they can help the government spend more on social infrastructure and also help reduce the fiscal deficit.

However, some such incentives are necessary. For example, the Start Up policy that gives breaks for such firms.

Tax Havens

There are countries or states within countries where tax rates are either zero or very low for some items like income or capital gains etc. They are called Tax Havens. Individuals and firms find them attractive for that reason. Such low/nil rates are a result of global competition to attract capital and is a sovereign decision and so is legal. For firms and persons to do business with such countries may also be equally legal if the respective laws permit.

But the problem that arises is as follows: Most countries either tax at normal rates or high rates so that they can spend on infrastructure and poor. If capital flies from such countries, their tax base shifts and their governments can not spend on public and merit goods. The important features of a tax haven are—

- nil or nominal taxes;
- tax information is not shared with foreign tax authorities
- no requirement for a substantive local presence.

Bermuda, Panama, Ireland, Singapore, the Cayman Islands, Monaco, Luxembourg and Hong Kong are among 45 territories blacklisted by the Organisation for Economic Co-operation and Development (OECD) and threatened with punitive financial retaliation for being tax havens.

Panama and Paradise Papers

The Panama Papers are millions of leaked documents of lakhs of offshore entities that contain personal financial information about wealthy individuals and public officials dealing in shell corporations that were used for illegal purposes, including fraud, tax evasion, and evading international sanctions.

Paradise Papers is a similar set of confidential electronic documents that were leaked. They are called paradise papers because the firms that were laundering were located in 'tax paradises.'

Base Erosion and Profit Shifting (BEPS)

As seen above, there are so many wealthy individuals global firms that undertake financial activities by registering in countries or states within countries where there are enormous tax advantages. There are two types of BEPS:

1. Some companies that shift base by registering in tax havens are the globally renowned ones like Apple, Facebook, Amazon, Nike, Uber etc. It is called BEPS which refers to tax planning strategies that exploit gaps in tax rules to artificially shift profits to low or no-tax locations where there is little or no real economic activity. It means, a company shifts its headquarters to a jurisdiction like Mauritius or Ireland where tax rates are low, only to 'avoid' taxes. Most often it is a legal process for which global firms exist to assist. It thus represents a case where the tax base is being eroded when profits of firms are shifted to havens. Hundreds of billions of dollars of tax revenue is lost by the governments of the countries where these companies actually carry out their economic activity. It can have a moral hazard: when taxpayers see MNCs legally avoiding taxes, it weakens voluntary compliance by all taxpayers.
2. The other type is through shell companies. It may be legal or illegal money that is invested but the proceedings are not reported to the domestic tax authorities as they are of questionable basis. Most of the companies through which money is invested and laundered are shell companies- companies that have no real business and exist only on paper to show profits and losses that are fictitious. These details are captured under BEPS.

Tax abuse not only weakens efforts to fight poverty but also weakens the fiscal base needed for sustainable economic development.

OECD has a BEPS inclusive framework in which many countries are participants including India. It consists of measures ranging from common approaches which will facilitate the convergence of national practices and best practices. The Inclusive Framework on BEPS brings together over 100 countries and jurisdictions to collaborate on the implementation of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Package.

United States Foreign Account Tax Compliance Act (FATCA) is a similar example. The Foreign Account Tax Compliance Act (FATCA) is a 2010 United States federal law requiring all non-U.S. ('foreign') financial institutions (FFIs) to search their records for customers from U.S. and to report the assets and identities of such persons to the U.S. government. India agrees with it.

G20 also discussed and devised strategies for common fiscal laws and practices.

India suffers from BEPS due to double taxation avoidance agreements (DTAA) being misused, transfer pricing issues etc. India modified its DTAA with Mauritius to tackle the BEPS issues.

Double Taxation Avoidance Agreement (DTAA)

In the age of globalization when investors from one country go to every other country where profits can be made, there is a need to ensure that there is no double taxation. That is, if profits made by the investor of one country in another country are taxed in both the countries, it is a disincentive to financial integration and also spells unfairness. Double taxation internationally is the collection of tax by two or more countries on the same declared income or profit or sale. DTAA's are signed between countries affected to avoid double taxation. DTAA's are both fair as well boost investment and growth.

For instance, interest on NRI bank deposits attracts 30 per cent TDS (tax deduction at source) normally. But under the DTAA's that India has signed with several countries, tax is deducted at only 10 to 15 per cent. Many of India's DTAA's also have lower tax rates for royalty etc.

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Favourable tax treatment for capital gains under certain DTAA's such as the one with Mauritius encouraged substantial foreign investment into India. Mauritius accounted for \$93.65 billion or one-third of the total FDI flows into India between 2000 and 2016. It was also a preferred route for foreign portfolio investors. But the problem is DTAA's led to round tripping: Indian money goes out to come back through the DTAA countries to avoid paying taxes. Even foreign companies which are not genuinely resident companies take DTAA route for their investments only for tax avoidance purposes. They are called "mailbox companies". This leads to loss of tax revenue for the country.

India has DTAA's with about 88 countries.

DTAA with Mauritius, Singapore and Cyprus amended

The three DTAA's were amended to ensure that no misuse is made.

It can be exemplified with the Mauritius case. In 2016, India and Mauritius signed a Protocol to amend the 1982 India-Mauritius Double Taxation Avoidance Agreement (DTAA). It applies equally to the India-Singapore DTAA. The 2016 protocol says that India has the right to tax the capital gains in India for investments coming from Mauritius from 2017. Investments made before 1 April 2017 have been grandfathered (investors continue to enjoy the benefits) and will not be subject to capital gains taxation in India. Where such capital gains arise during the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50% of the domestic tax rate of India. However, the benefit of 50% reduction in tax rate during the transition period shall be subject to the Limitation of Benefits Article, that is, only genuine investors can avail of them. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.

Limitation of benefits

DTAA's should be used for the right purposes. Therefore, DTAA's contain an article intended to prevent "treaty shopping." Treaty shopping is when different DTAA's have different levels of concessions, choosing the DTAA that offers the best terms for maximum gains. Those who are not genuine residents of the country in the DTAA benefit thus. The limitation of benefits articles deny the benefits of the tax treaty to those who are not genuine residents based on certain tests.

Under the India-Mauritius Limitation of Benefits (LOB) rules: The benefit of 50% reduction in tax rate during the transition period from 1st April, 2017 to 31st March, 2019 shall be subject to LOB Article, whereby a resident of Mauritius will not be entitled to benefits of 50% reduction in tax rate, if it is a shell company, that is, if its total expenditure on operations in Mauritius is less than Rs. 27,00,000 in the immediately preceding 12 months.

Otherwise, DTAA's can lead to round-tripping and money laundering activities.

This LOB clause will have the effect of bringing substance to companies which want to be tax resident in Mauritius.

General Anti Avoidance Rules (GAAR)

There are firms and individuals who either minimize tax payment or completely avoid it by taking advantage of the rules in the book. But government says that it is not acceptable as the entire event is planned only to avoid taxes as was done by the Vodafone when it signed the deal outside the country with Hutch and put up a corporate veil for the operation just to avoid paying taxes. Even while on the face of it, it is legal, GOI applied the doctrine of "look through" and not "look at" and ordered them to pay tax as tax avoidance in this case is tax evasion and not tax planning. There were no clear rules for the GOI order and there was a demand that there be clear General Anti-Avoidance Rules (GAAR) rules.

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As a result GOI made the rules framed by the Department of Revenue under the Ministry of Finance.

GAAR is an anti-tax avoidance rule. It came into operation from 1 April 2017. It allows tax officials to deny tax benefits, if a deal is found without any commercial purpose other than tax avoidance. Thus, it seeks to prevent tax evasion in the guise of tax planning.

It applies to transactions made specifically to avoid taxes as detailed above. Investments made up to March 31, 2017 were not subjected to GAAR. It is to be applied on those claiming tax benefit of over Rs 3 crore.

The proposal to apply GAAR will be vetted first by the Principal Commissioner/Commissioner of I-T and at the second stage by an Approving Panel headed by a judge of High Court. Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner.

The rules are aimed at improving transparency in tax matters and help curb tax evasion.

Place of Effective Management (PoEM)

To determine the residential status of foreign companies, the Finance Act 2015 introduced the concept of place of effective management or PoEM. If a company's place of effective management is India, it will be treated as an Indian resident and its global income will be taxable in India. The aim of PoEM is to target shell companies.

PoEM Guidelines issued by CBDT say that the guidelines provide for determination of the place of effective management for an entity and if it is in India, Indian tax laws shall apply. Thus, Indian shell companies showing global income can not escape taxation in India.

Tax Information Exchange Agreements (TIEA)

The purpose of Tax Information Exchange Agreements (TIEA) is to promote international cooperation in tax matters through exchange of information.

They provide for the exchange of information relating to a specific criminal or civil tax matter under investigation. In simple terms, the tax departments of one State may assist that of the other State, with information which may be utilized in collecting the due share of taxes of the latter State, as per its laws and procedure. India has TIEAs with many countries.

The nature of information varies from agreement to agreement. Such agreements help in cases like Panama papers (2016) when Indian names were listed as operating as shell-companies in Panama. Panama has been the one of the most popular domicile for the anonymous shell companies controlled by the powerful.

Convention on Mutual Administrative Assistance in Tax Matters

It was developed jointly by the OECD and the Council of Europe. The Convention is the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance. It facilitates the entering into bilateral tax information exchange agreements between state parties who are members of it. G20 favours it. About 126 countries and parties, including India joined the Convention. It represents a wide range of countries including all G20 countries, all BRICS, all OECD countries, and an increasing number of developing countries.

Transfer Pricing and APA

Transfer pricing has become an important part in the BEPS issue.

If a subsidiary company sells goods to a parent company or vice versa, the price of those goods paid by the parent to the subsidiary or the opposite within the country or internationally, is the transfer price.

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India adopted Transfer Pricing Code recently. The need for the Code is because of the profit shifting practices followed by the MNCs. For example, an MNC has a subsidiary in India and elsewhere. It sources from and supplies to the subsidiaries in all the countries. The goods and services are same but the prices are shown differently depending upon the tax rates in the countries. The corporate tax rates are high in India. Therefore, the price of goods sold by the MNC to Indian subsidiary is shown higher in India to show less profit and thus less tax outgo. Thus, transfer pricing is generally done in a way as to show high profit in countries where the corporate tax rate is low and low profits/losses where the rate is high. Therefore, transfer pricing norms need to be rationalised so that the tax revenues that are due to the government are not eroded. Tax evasion and money laundering has to be checked by tightening the transfer pricing regime. The solution is advance pricing agreements (APA).

The Indian code prescribes that income arising from international transactions or specified domestic transactions between associated enterprises should be computed having regard to the arm's length price and not 'sweetheart' price that can mean base erosion. An arm's length price for a transaction is what the price of that transaction would be on the open market.

An APA refers to an agreement between the taxpayer and the tax authorities on the pricing of an existing or proposed transaction between related parties. APA enables the taxpayers and the revenue authorities to interact, negotiate and come to a conclusion on the pricing of the transaction in question. If the taxpayer and the revenue authorities agree to a particular price, they may enter into an agreement, which would be valid for a period of five years. If, however, for some reason, they do not reach a consensus, they may not sign the agreement. It helps avoid disputes with the tax authorities over transfer pricing. The APA scheme, which was introduced in 2012, tries to provide certainty to taxpayers in transfer pricing by specifying the method of pricing and setting the prices of international transactions in advance. It applies to foreign MNCs and Indian companies as well.

Tobin Tax

James Tobin, an economist, proposed in 1972 a worldwide tax on all foreign exchange transactions- when foreign capital enters a country and when it leaves. The aim is to check speculative flows. Long term investment – generally FDI, will not suffer as it does not invest for speculative (short term) reasons like FIIs.

Tobin justified the tax on two grounds: First, it would reduce exchange rate volatility and improve macroeconomic performance. Second, the tax could bring in revenue to support for development efforts or exchange rate stabilization.

The defining characteristic of a Tobin tax is that the tax is levied twice- once when one acquires foreign exchange, and again when one sells the foreign exchange.

The South East Asian currency crisis (1997) is partly attributed to the 'dynamics of hot money' (portfolio investments or FII flows). That gave further justification for the Tobin tax.

Tobin tax can be imposed only if all the countries accept the proposition. Otherwise, FIIs can go to countries where the tax is not imposed.

India does not prefer it as we need foreign inflows as we are a CAD country and don't have a surplus. In the EMU, there is a proposal to see a micro tax levied at 0.1% on share and bond transactions, and 0.01% on deals involving complex securities such as derivatives. It is called the Financial Transaction Tax. The FTT, or "Tobin tax" as it is also known is a "Robin Hood tax", - collected from speculators and used for rescuing the financial system when there is such a need. India has a similar tax though not for the same purpose- securities transaction tax (STT) and commodities transaction tax (2015).

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Due to currency volatility and stock market shocks in China in 2015-16, there is a proposal that Tobin tax be imposed. China may be able to afford such a tax as FII exposure is limited in China and it has huge surpluses of forex reserves.

India can not afford Tobin tax as we need foreign currency. We need to contain volatility by other means like - encouraging FDI and relatively limiting FPI though FPI is also very important for liquidity in capital market.

Pigovian Tax

The Pigovian tax is imposed on transactions that have a negative externality. For example, pollution. Externality means impact of one person's actions on the well being of an outsider (bystander or third party). For example, the seller and consumer of cigarettes together will harm the third person with the smoke. Also, exhaust fumes from automobiles. Positive externality refers to a good effect on the third party. For example, restoration of historic buildings, research into new technologies, libraries etc. Carbon tax is one example in the context of the need to discourage fossil fuels and encourage renewable sources due to climate change threat. Supreme Court in 2015 imposed an 'Environment Compensation Charge' (ECC) on commercial vehicles entering Delhi.

Carbon tax (called Clean Environment Cess from 2017) is levied in India since 2010 at the rate which is Rs.400 per tonne on Coal, Lignite and Peat in order to finance and promote clean environment initiatives, funding research in the area of clean environment or for any such related purposes. It is imposed on coal produced in India or imported into India. This is in line with the principle of "polluter pays".

In many countries carbon taxes are levied also on other fossil fuels like petroleum, natural gas etc.

Goods and Services Tax (GST)

India's indirect tax system has been transformed with the introduction of Goods and Services Tax (GST) in 2017. It removed many defects in the earlier system which was characterised by-

- Multiplicity of taxes and duties
- Cascading effect
- Steep inter-state variations
- Irrational exemptions
- Too many slabs
- Tax evasion
- Inefficient use of resources due to the above

GST is necessary

GST is needed to forge a common domestic market and attract investment. Eliminating a multiplicity of existing indirect taxes would simplify the tax structure, bring more firms into 'tax net' as there is incentive to pay taxes due to the attraction of input tax credits and thus create tax buoyancy to enable government to consolidate the fiscal system and provide for greater resources for social sector. By lowering business costs and transaction costs, it would boost economic growth and bring India in line with practices in many developed economies. Reducing production costs would make exporters more competitive. Black money and evasion will reduce as GST is transparent.

GST is a comprehensive, multi-stage, destination-based tax that is levied on value addition. It combines many indirect taxes and duties into a single consolidated tax. It provides set off for tax paid on inputs which removes cascading (tax on tax). Total burden of the tax is exclusively borne by the domestic consumer. Exports are not subject to GST.

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The term multi stage requires elaboration. Each final commodity is produced through a process of value addition in many steps of value addition from raw material stage to the final sale to the consumer. Value addition is not only physical but also by way of storage, distribution and sale. At every stage tax is paid and under GST that is returned (credited) when it is shown that value is further added and the good resold. Every purchaser of a good or service has to pay tax but if he purchased for production and can show that it is an input for value addition, he can claim the tax he paid back. That is by way of reducing the amount he paid on the inputs from the tax that he collects on what he sells. Only consumer pays tax. All others have it credited to them. That is how cascading effect is removed.

Destination based means that goods are taxed where they are sold to the consumer and not where they are made. That is, if goods are made in Gujarat and sold in Telangana, they are taxed in Telangana where the consumer pays it. The manufacturing state gains by its prosperity which creates a big market for its own goods and services within its own geography. Its apprehensions about losses are taken care of by the central government's commitment to compensate and also by a portion of the IGST that the centre levies and shares with it.

Both Centre and States will simultaneously levy GST on the same value added. The amount is also the same. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter- State supply of goods and services.. Proceeds of IGST will be apportioned between the centre and States.

With the 101 CAA 2016 being in place, the centre passed laws to levy CGST and IGST. Similarly, all states passed law on SGST. These laws specify the rates of the GST to be levied, the goods and services that will be included, the threshold of the turnover of businesses to be included, etc.

There is a short history to the GST of 2017. In 2002 union excise duties were renamed Central Vat (Cenvat) when value added became the base for tax. VAT was introduced (earlier name was sales tax) at the state level in 2005. When states called their sales tax as Vat, centre reverted to the earlier name of excise duty to prevent confusion. The earliest form of Vat was however introduced in 1986 in the form of Modvat- modified VAT, that included set off for a few commodities only and was confined to excise duties only.

Alcohol, petroleum, real estate and electricity do not come under GST.

GST and Revenue Neutral Rate

An important issue in the Goods and Services Tax was the rates of central and state GSTs to be levied. Tax rates should be "revenue neutral". This implies that the rates set under the new GST regime are such that they get the same revenue as the pre-GST regime. That is, the rates are not meant to lead to revenue loss or gain. However, over time the revenue productivity is expected to increase due to better compliance; higher levels of efficiency; and increased productivity of the economy due to its rationality and transparency.

Estimation of revenue-neutral rate requires consensus on the exemption list, number of tax rates to be levied and the list of goods and services to be included in different rate categories.

There are three terms in this field:

- Standard rate is what applies to most goods and services.
- Fitment rate is the rate that applies to each class of goods and services (which is the tax bracket in which they fall).
- Revenue neutral rate is the rate that brings the same revenue as the pre-GST regime.

GST and Fiscal Autonomy Issues

Constitution was amended to usher in the GST as there was no GST in the Constitution. It was also to enable the Centre and the states to impose tax on the same base of goods and services. Currently, the states cannot impose tax on services. They also can not impose tax on manufacturing of goods. Centre cannot levy sales tax.

States feel that their fiscal autonomy is being eroded for the following reasons-

- they are surrendering the power to tax sales
- they can not change rates according to their fiscal needs as was acutely felt in Kerala when floods ravaged the state in late 2018
- all states can not have the same rates as it violates respect for federal diversity
- centre may not compensate the states fully
- The position of states is rejected on the other points for the following reasons-
- centre is also surrendering and sharing its powers regarding service tax and union excise duties
- states are free to tax sin goods like liquor and also the petroleum products
- GST council takes all decision where states are in majority; vote of each state has the same value

Thus, there is mutual surrender of powers to a uniform national taxation system where both gain. Apprehensions of loss of fiscal autonomy by states and central dominance are misplaced. This is a quintessential case of cooperative federalism and is an example of pooled (shared) sovereignty.

Constitution (101st) Amendment Act, 2016

The Act amended the Constitution to introduce the goods and services tax (GST). Consequently, the GST subsumed various central indirect taxes including the Central excise duty, additional excise duties, service tax, additional customs duty (CVD) and special additional duty of customs (SAD), etc. It also subsumed State Value Added Tax (VAT) sales tax, central sales tax, entertainment tax, octroi and entry tax, purchase tax and luxury tax, etc.

Central and State government powers for GST- CGST and SGST : It inserts a new Article 246A in the Constitution to give the central and state governments equal and parallel powers to make laws on the taxation of goods and services.

Integrated GST (IGST): However, only the centre may levy and collect GST on supplies in the course of inter-state trade or commerce and imports. The tax collected would be divided between the centre and the states in a manner to be provided by Parliament, by law, on the recommendations of the GST Council.

Tax slabs under the GST 2017

The government has categorised items in five major slabs for different goods and services - 0%, 5%, 12%, 18% and 28%. Cesses may be imposed on the items under the highest slab of 28% .

GST Council: The President must constitute a Goods and Services Tax Council within sixty days of this Act coming into force. GST council examines issues relating to goods, services tax and make recommendations to the Union, and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government.

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Composition of the GST Council

The GST Council is to consist of the following three members:

- (a) the Union Finance Minister (as Chairman)
- (b) the Union Minister of State in charge of Revenue or Finance,
- (c) the Minister in charge of Finance or Taxation or any other, nominated by each state government.

Functions of the GST Council -

These include making recommendations on:

- taxes, cess and surcharges levied by the centre, states and local bodies which may be subsumed in the GST;
- goods and services which may be subjected to or exempted from GST;
- model GST laws, principles of levy, apportionment of IGST and principles that govern the place of supply;
- the threshold limit of turnover below which goods and services may be exempted from GST;
- rates including floor rates with bands of GST;
- special rates to raise additional resources during any natural calamity;
- special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand;
- Any other matters relating to the goods and services tax, as the Council may decide.

GST Council shall recommend the date on which the GST be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.

Resolution of disputes: The GST Council may decide upon the modalities for the resolution of disputes arising out of its recommendations.

Compensation to states: Parliament shall, by law, provide for compensation to states for any loss of revenues, for a period which may extend to five years or less. This would be based on the recommendations of the GST Council.

GST and federalism

GST is a classical instance of cooperative federalism. Both the centre and states had to forego some of their earlier constitutional powers for the historic compromise.

Empowered Committee of State Finance Ministers headed by a state finance minister led the states while negotiating the GST since the beginning of the year 2000. Gradually, Cenvat and Vat were introduced and later GST came about. Under the GST regime, the Centre & States will act on the recommendations of the GST Council for harmonisation of GST laws across the country.

Main Constitutional Changes

1. Art.246A

2. GST Constitution Amendment Act omits Entry 92 and 92C from the Union List and Entry 52 and 55 of the State List of the Seventh Schedule.

- 92 of Union list – Taxes on the sale or purchase of newspapers and on advertisements published therein.
- 92C of Union List – Taxes on services
- 52 of State List – Taxes on the entry of goods into a local area
- 55 of State List – Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

All the above four are now a part of GST.

Art.246A had to be introduced as GST is a unique subject and can not be accommodated in the existing 3 Lists in the Seventh Schedule.

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GST (Compensation to States) Act, 2017

One of the apprehensions of some states from the beginning was that they might make losses when GST comes into force, at least initially. The grounds are clear.

It is a destination-based tax, so is viewed as being to the advantage of the consuming states and to the detriment of the producing states like Maharashtra, Tamil Nadu, Gujarat, Haryana, and Karnataka. The latter wanted a suitable compensation formula. States demanded full compensation for five years and the Centre agreed.

As per the GST (Compensation to States) Act, 2017, loss of revenue to the States on account of implementation of Goods and Services Tax is payable during the transition period of 5 years. The same Act says that financial year 2015-16 is to be taken as the base year for calculating compensation amount. The projected nominal growth rate of revenue subsumed for a state during the transition period shall be 14% per annum.

Government needs extra revenue to compensate the states, and so the GST Council allowed centre to impose additional cesses for five years on certain goods over and above the highest tax bracket of 28%. These goods on which cess will be levied include tobacco products, coal, motor vehicles, which include all types of cars, personal aircraft, and yachts. These additional cesses, however, will be removed after five years and the states incurring losses would have to find alternative sources of revenue.

The percentage of the additional cess changes from good to good. Both intra-state and inter-state supplies of goods or services would attract GST cess over and above the applicable CGST, SGST, and IGST rates.

Clean Environment Cess of GOI India's carbon tax which was a source of funding clean energy projects and to combat climate change and which was collected - Rs. 400 a tonne on domestic and imported coal - to make up the National Clean Energy Fund, will go into the GST Compensation Fund, according to Goods & Services (Compensation to States) Act, 2017, in a schedule.

Dual GST

India adopted a dual GST model, meaning that taxation is administered by both the Union and State Governments. Being a federal country, both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. A dual system satisfies the urge for autonomy by both the Centre and States. Dual GST threw up the challenge of taxpayers interface with tax administration and thus cross-empowerment was worked out.

GST and Cross-empowerment

The cross-empowerment model allows taxpayers to restrict their interaction to a single tax authority for central GST, state GST and integrated or IGST. The division of GST taxpayers between the centre and states will be done horizontally with states getting to administer and control 90% of the assessee below Rs 1.5 crore annual turnover, and the remaining 10% coming under the Centre. The Centre and states will share control of assessee with annual turnover of over Rs 1.5 crore in 50:50 ratio and thus each taxpayer will be assessed only once and by only one authority.

Anti-profiteering clause of GST

GST Act provides that it is mandatory to pass on the benefit due to reduction in rate of tax or from input tax credit to the consumer by way of commensurate reduction in prices. If the firms do not pass it on, they are liable for penal action. GST rules prevent entities from making excessive profits by not passing on such reliefs.

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Since the GST, along with the input tax credit, is eventually expected to bring down prices, a National Anti-profiteering Authority (NAA) is to be set up to ensure that the benefits that accrue to entities due to reduction in costs is passed on to the consumers. Also, entities that hike rates inordinately, citing GST as the reason, will be checked by this body.

Once the registered entity, which has profited illegally, is identified, it can be asked to reduce prices if it has hiked prices too much. If price reduction due to GST rate relief has not been passed on to customers, the firm can be told to return to the customer the sum equivalent to the price reduction along with 18 percent interest from the date the higher sum was collected. It can impose penalty on the profiteer or cancel its registration.

National Anti-Profiteering Authority (NAA)

The National Anti-Profiteering Authority shall be a five-member committee consisting of a Chairman who holds or has held a post equivalent in rank to a Secretary to the Government of India; and four Technical Members who are or have been Commissioners of State tax or central tax. Additional Director General of Safeguards shall be the Secretary to the Authority.

The Authority will determine the method and procedure for determining whether the reduction in rate or the benefit of input tax credit has been passed on by the seller to the buyer by reducing the prices.

The Authority will exist for 2 years from the date on which the Chairman enters upon his office unless the Council recommends otherwise. The GST Council will constitute a Standing Committee and a state level Screening Committee on Anti-profiteering. Standing Committee comprises of officers of the State and Central Government as nominated by it.

The anti-profiteering body has a tenure of 2 years only. It will be wound up after two years as body is only required initially when tax rates change under the new tax regime.

GSTN

Goods and Services Tax Network (GSTN) is a Section 8 (under new companies Act, not for profit companies are governed under section 8) company. It was incorporated in 2013.

Initially, Government of India held 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together held another 24.5%. Balance 51% equity was with non-Government financial institutions. However, 27th meeting of the GST Council in 2018 decided that the GSTN will be a 100% government company with central and the state governments holding a 50% stake each in the entity by acquiring the 51% stake held by private entities. GSTN was set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for the implementation of Goods and Services Tax (GST). The Authorised Capital of the company is Rs. Ten crores. Besides, GST being a destination based tax, the inter-state trade of goods and services (IGST) would need a robust settlement mechanism amongst the States and the Centre. This is possible only when there is a strong IT Infrastructure and Service backbone which enables capture, processing and exchange of information amongst the stakeholders (including taxpayers, States and Central Governments, Accounting Offices, Banks and RBI).

GST And Petro-Products

Petroleum products are not included in the GST. That is, taxes paid on them are not treated as eligible for input tax credit and set off.

Taxes constitute more than 50% of the price consumers pay for petrol and diesel. States, which charge VAT are reluctant to move away from the present tax regime unless the Centre promises compensation. Different states have different rates of VAT. It's the GST Council, the highest decision-making body of the indirect tax regime, that has the final word on the inclusion of petroleum products.

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Under GST, even if petrol and diesel are charged at the highest slab of 28%, states will stand to lose considering they will only get 14% of it — much lower than the present rate of VAT. Today, states have freedom to change the VAT on petrol and diesel. But under the GST, this flexibility will go.

101st Constitution amendment, laying the GST framework, is applicable to the Himalayan state of J and K only when their legislature passes it and they saw the benefits of it and passed such a resolution.

GST Benefits Small Entrepreneurs And Small Traders

The pre-GST threshold prescribed in different State VAT Acts, below which VAT is not applicable, varied from State to State. A uniform State GST threshold across States is desirable. Under the provisions of the GST, traders with an annual turnover less than 20 lakh are exempt for the Goods and Services Tax. For northeast it Rs.10 lakh. This raising of threshold will protect the interest of small traders. A Composition scheme for small traders and businesses has also been introduced under GST. Composition Scheme is a simple and easy scheme under GST for small taxpayers who can avoid tedious GST formalities and pay GST at a fixed rate if the turnover is less than a certain specified amount.

Both these features of GST will adequately protect the interests of small traders and small scale industries.

Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

- a. It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them.
- b. The compliance cost and compliance effort would be saved for such small traders.
- c. Small traders get relative advantage over large enterprises on account of lower tax incidence.

HSN Code in GST

Harmonized System of Nomenclature, or HSN, was developed by the World Customs Organization (WCO) with the vision of classifying goods from all over the World in a systematic and logical manner. It is a six digit uniform code that classifies more than 5,000 products and is accepted worldwide. These defined rules are used for taxation purposes in identifying the rate of tax applicable to a product in a country. It is also used to determine the quantum of product exported or imported in and out of a country. It is a crucial feature to analyze the movement of goods across the World. HSN is adopted in more than 200 countries, covering 98% of the goods in the World. It is by far, the best logical system of classification and identification adopted in International Trade. HSN helps in identifying the applicable rate of GST on different products as per GST rules.

Laffer Curve

Developed by Arthur Laffer, this curve shows the relationship between tax rates and tax revenue collected by governments. The Laffer curve has been debated in the country since 1997-1998 when the Union Budget reduced rates and slabs in the income tax regime in the country.

Minimum Alternative Tax (MAT)

Normally, a company is liable to pay tax on the income computed in accordance with the provisions of the Income Tax Act, but the profit and loss account of the company is prepared as per provisions of the Companies Act. There were large number of companies who show book profits as per their profit and loss account (according to the Companies Act) but do not pay any tax by showing no taxable income as per provisions of the Income Tax act. Although the

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companies show book profits and may even declare dividends to the shareholders, they do not pay any income tax. These companies are popularly known as Zero Tax companies. In order to bring such companies under the income tax act net, MAT was introduced in 1996. They are required to pay MAT at 18.5% of the book profit.

Book profit is profit which is notional: when assets appreciate, their value in the book goes up but the same is not realized as they are not sold. It is also called unrealized gain or unrealized profit or paper gain or paper profit.

Rajaswa Gyan Sangam

The Central Board of Direct Taxes (CBDT) and the Central Board of Indirect Taxes and Customs (CBIC) have been holding annual Conferences of senior officers for a number of years. In 2016, for the first time, a joint Conference of the two Boards was held under the umbrella of "Rajaswa Gyan Sangam". Same was held in 2017 too.

The objective of the Conference is to enable a two-way communication between the policy-makers and the senior officers in the field offices with a view to increase revenue collection and facilitate effective implementation of law and policies. Issues arising in implementation of policies and strategies to achieve targets in core functional areas are discussed. Such issues inter alia include HR issues, Litigation Management, Strategies for Revenue Maximisation, Tax Evasion, Taxpayer Services, GST and Reforms and Modernisation.

Some Tax Related Terms

Dividend Distribution: Tax Companies giving dividend have to pay tax on the amount distributed as dividend.

Withholding Tax: It means withholding of tax from certain payments including interest, salaries paid to employees, professional fee, payments to contractors etc at the time of making the payment. It is the same as TDS.

Presumptive Tax: It is the estimated income method of assessment for certain categories of businesses. Presumptive taxation involves the use of indirect means to ascertain tax liability which differs from the usual rules based on the taxpayer's accounts. It is used to indicate that there is a legal presumption that the taxpayer's income is taxable to a certain extent.

The reason for the presumptive tax may be that in a number of businesses the assessee does not maintain books of accounts or the books of accounts maintained are irregular and incomplete. It was introduced in India in the early nineties for traders but was withdrawn as the success rate was low. For example, composition scheme in the GST for small businesses.

Wealth Tax: When income accumulates into wealth, it gets taxed after a point. Union Budget 2015-16 abolished wealth tax and instead levied an additional surcharge of 2 per cent on individuals with taxable income of Rs 1 crore and above.

Securities Transaction Tax (STT): It is a tax on the value of all the transactions of purchase of securities that take place in a recognised stock exchange of India. It is meant to make up revenue loss from the abolition of long term capital gains tax.

Commodities Transaction Tax (CTT): It is a tax similar to Securities Transaction Tax (STT). CTT aims at discouraging excessive speculation of commodities.

Fringe Benefit Tax (FBT): Fringe benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees singly. They are taxed in the hands of the employer who may or may not pass it on to the employee. Examples are transport services for workers and staff, gym, club, etc. Consequent to abolition of fringe benefit tax in 2009, certain benefits taxed earlier as fringe benefits in the hands of the employer would now be taxable as perquisites in the hands of the employees.

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Perquisites: They are benefits in addition to normal salary to which employee has a right by virtue of his employment. To put it simply, 'perks' as they are called colloquially, are benefits generally in cash/kind, received by an employee by virtue of his employment. Perks are taxable as a part of salary as per the India income tax laws and includes:

- the value of rent-free accommodation
- the value of any concession in the matter of rent respecting any accommodation provided etc
- car
- club membership
- travel

Tax-incidence: It shows the entity on whom tax is imposed. It is different from the tax burden as the latter refers to the one who actually bears it- the consumer in the case of indirect taxes. For direct taxes, both fall on the same entity. Tax on petrol is paid by the consumer while the seller is officially responsible to deposit with the government.

Tax Base: The value of goods, services and incomes on which tax is imposed. When we speak of the tax base being broadened, they mean a wider range of goods, services, income, etc. has been made subject to a tax. In the case of income tax, the tax base is taxable income. Some kinds of income are excluded from the definition of taxable income, such as savings. For sales tax, the tax base is the value/volume of items that are subject to tax; essential goods, for example, are not part of the tax base.

Tax Shelters: Any technique which allows one to legally reduce or avoid tax liabilities. It is a way in which the taxpayer can invest his income in a particular kind of investment that gives tax concessions.

Tax planning, avoidance and tax evasion: There are provisions in the law that allows one to save and invest in a manner that leads to reduction in taxable income. If these provisions are used for reducing tax liability, it is called tax avoidance. It is lawful to take all available tax deductions. It is the same as tax planning for tax mitigation.

Tax evasion, on the other hand, is a punishable offence. Tax evasion involves failing to report income, or improperly claiming deductions that are not authorized. It creates black money.

But as mentioned earlier in the chapter, certain types of tax avoidance can be considered evasion as in the case of Vodafone.

Hidden taxes: These are taxes that are concealed in the price of articles that one buys. Hidden taxes are also referred to as implicit taxes. The most well-known form of the hidden tax is the indirect tax. Examples of hidden taxes are import duties.

Consumption Tax: It is a tax on spending on goods and services. Consumption taxes are indirect, such as a sales tax or a value added tax.

Proportional, progressive and regressive Tax: An important feature of tax systems is whether they are proportional tax (the tax as a percentage of income is constant over all income levels), progressive tax (the tax as a percentage of income rises as income rises and also taxes at a higher rate on luxury goods), or regressive tax (the tax as a percentage of income falls, as income rises). Progressive taxes reduce the tax incidence on people with smaller incomes, as they shift the incidence disproportionately to those with higher incomes.

Specific duty: Weight or quantity or number is the basis for taxation.

Ad Valorem: A Latin term meaning "according to worth," referring to taxes levied on the basis of value. VAT on petroleum products is ad valorem that is as prices rise, tax charged also rises. Luxury goods attract ad valorem tax.

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Compound duties: They are a combination of value and other factors based on which tax is imposed.

Excise Duty: Excise duty is a tax on manufacture and is levied on the manufacture of goods within the country.

Customs Duty: When goods are imported or exported, customs duty is imposed and collected by the Union Government. Peak customs duty today is 10%.

Negative income Tax: Subsidy is a negative income tax. It is a taxation system where income subsidies are given to persons or families that are below the poverty line. The government sends financial aid to a person who files an income tax return reporting an income below a certain level. It is advocated by economist Milton Friedman in 1962. Universal Basic Income (UBI) is one such.

Tax Buoyancy: It refers to the percentage change in tax revenue with the growth of national income. That is, growth-based increase in tax collections.

Tax Elasticity: Tax elasticity is defined as the percentage change in tax revenue in response to the change in tax rate and the extension of coverage. Buoyancy, on the other hand is the response to economic growth when the base increases but there is no change in the rate.

Tax Stability: It means no frequent changes and there is continuity of policy in a predictable and transparent manner. Although revenue from different taxes varies from year to year, revenue stability is desirable because it makes it easier for a government to build a credible spending and borrowing plan for the year ahead. Taxes whose revenue is relatively stable contribute to overall revenue stability. Market players also can plan better.

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BANKING SYSTEM IN INDIA

A bank is a type of financial intermediary as it mediates between the savers and borrowers. It does so by accepting deposits from the public and lending money to businesses and consumers. Its primary liabilities are deposits and primary assets are loans.

There are many types of banks in India.

I. Commercial banks

- Domestic public sector banks
- Domestic private sector banks
- Foreign banks
- Regional Rural Banks
- Payments banks
- Small Finance Banks

II. Co-operative banks

III. Land Development banks

IV. Investment banks/Merchant banks

V. Development banks

Commercial bank is one that takes demand deposits- current account and savings account- from people.

Cooperative banks also take demand deposits from people. But the nature of cooperative banks is different. Cooperative banks are owned by their customers and follow the cooperative principle of one person, one vote. Cooperative banks serve an important role in the Indian economy- rural areas and urban areas. They are registered under the Cooperative Societies Act, 1912. They are regulated by the Reserve Bank of India under the Banking Regulation Act, 1949 and Banking Laws (Application to Cooperative Societies) Act, 1965.

Investment banks deal with firms primarily and so are called merchant banks (more in the Chapter on Capital market).

Land Development Banks (LDA) were originally called Land Mortgage Banks. Presently they are called State Co-operative Agriculture and Rural Development Banks (SCARDBs). They provide long-term finance required by the agriculturists for the purchase of agricultural machinery like tractors for land improvement etc. Such a credit need is generally not met by commercial banks and co-operative banks because of their short-term deposits.

Development banks provide long-term finance and support to the sectors of the economy where the risks may be higher and these sectors and sub sectors can not access loans from commercial banks adequately. Examples are Small industries and development bank of India (SIDBI), MUDRA Bank or Micro Units Development and Refinance Agency Bank, National Housing Bank (NHB) etc. Except commercial and cooperative banks, no other bank mentioned above accepts demand deposits (cheque-able deposits, that is, deposits from where money can be withdrawn by issue of cheques).

Commercial banks

Commercial banks in India include-

1. Scheduled commercial banks
2. Non-scheduled commercial banks.

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The scheduled commercial banks are those which are included under the 2nd Schedule of the Reserve Bank of India Act, 1934. They are regulated under Banking Regulation Act, 1949 and satisfy two conditions under the Reserve Bank of India Act-

- paid-up capital and reserves of an aggregate value of not less than Rs 5 lakh
- it must satisfy RBI that its affairs are not conducted in a manner detrimental to the depositors.

The scheduled commercial banks enjoy certain benefits like approaching RBI for financial assistance; and correspondingly, they have certain obligations like maintaining certain reserves as prescribed by the RBI etc.

There are only 3 non-scheduled commercial banks operating in the country with a total of 9 branches. Local Area Banks are Non-scheduled commercial banks in India.

Scheduled banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks.

Currently, India has 21 public sector banks that include SBI and the IDBI Bank. Public sector banks hold over 70 percent of total assets of the banking sector. Share of public sector banks in total deposits is at 76.6 percent.

State Bank of India

State Bank of India has its roots in the 19th century, when the Bank of Calcutta later renamed as the Bank of Bengal, was established in 1806. The Bank of Bengal was one of three Presidency banks, the other two being the Bank of Bombay and the Bank of Madras. All three Presidency banks were amalgamated in 1921 and became Imperial Bank of India. GOI nationalized the Imperial Bank of India in 1955 and the new bank was named as the State Bank of India.

There were Seven regional banks of former Indian princely states. SBI acquired the control of all seven banks in 1960. They were renamed, prefixing them with 'State Bank of'. These seven banks were State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Indore (SBN), State Bank of Mysore (SBM), State Bank of Patiala (SBP), State Bank of Saurashtra (SBS) and State Bank of Travancore (SBT). All of them and Bharatiya Mahila Bank were merged with State Bank of India with effect from 1 April 2017.

After the acquisition of subsidiary banks by the SBI, subsidiary banks have ceased to exist. Therefore, parliament passed the State Banks (Repeal and Amendment) Act of 2017 to amend the State Bank of India (SBI) Act of 1955 to remove references related to subsidiary banks.

The plans for merging associate banks started in 2008 when SBS merged with SBI. The next year, SBI-Indore merged. The merger of other subsidiaries was done in 2017. It makes SBI one of the top 50 banks in the world. The combined entity is expected to enhance the productivity, mitigate geographical risks, increase operational efficiency and drive synergies across multiple dimensions while ensuring increased customer satisfaction.

Post merger, the bank will rationalise its branch network by relocating some of the branches to maximise reach. This will help the bank optimise its operations and improve profitability. Integration of treasuries of the associate banks with the treasury of SBI will bring in substantial cost saving and synergy in treasury operations.

Bank Nationalisation

The next major nationalisation of banks took place in 1969 when the Government of India nationalised an additional 14 major banks and again in 1980 GOI nationalised six banks. The objectives behind nationalisation were:

- To break the ownership and control of banks by a few business families and thus to prevent the concentration of wealth and economic power

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- To make banks a part of socio-economic planning
- To extend banks to rural and unbanked areas
- To mobilize savings from masses from all parts of the country,
- To cater to the needs of the priority sector like weaker sections and poverty alleviation, agriculture, MSMEs etc
- From class banking to mass banking

Banking sector reforms from 1991

Banking sector occupied a central place in the economic reforms and structural reforms that India conducted from 1991. The need arose due to deteriorating bank performance that was visible in-

- Lack of profitability
- High SLR and CRR
- No credit discipline as there were loan melas when loans were liberally given without any merit
- Lack of competition as there were hardly any private domestic and foreign banks
- Directed and concessional lending for populist reasons
- Administered interest rates

The reforms to set the above problems right were-

- Interest rates were deregulated to make banks respond dynamically to the market conditions. Even savings bank deposit rates were deregulated in 2011
- VRS for better work culture and productivity
- Floor and cap on CRR were removed and floor on SLR was removed in 2006
- Near level playing field for public, private and foreign banks in entry
- Basel norms adopted for safe banking
- FDI upto 74% is permitted in private banks
- Differentiated banking so as to cater to the unbanked and also leverage technology to reach the unreachable- for the last mile access to the remotely located
- Bank consolidation through merger
- Indradhanush comprising banking sector reforms for professionalization and strength

The above reforms are meant to achieve the following objectives:

- To make banks competitive and profitable
- To strengthen the sector to face global challenges
- Sound and safe banking
- To help banks technologically modernize for customer benefit
- Make available global expertise and capital by relaxing FDI norms
- Inclusive banking

Narasimham Committee

Banking sector reforms in India were conducted on the basis of Narasimham Committee reports I and II (1991 and 1998 respectively), primarily the first report. **The recommendations of Narasimham committee 1991 are:**

- No more nationalization
- Create a level playing field between the public sector, private sector and foreign sector banks
- Select few banks like SBI for global operations
- Reduce Statutory Liquidity Ratio(SLR) as that will leave more resources with banks for lending to businesses
- Reduce Cash Reserve Ratio(CRR) to increase lendable resources of banks

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- Rationalize and better target priority sector lending as a sizeable portion of it is wasted and also much of it is turning into non-performing assets (NPAs)
- Introduce prudential norms for better risk management and transparency in operations
- Deregulate interest rates
- Set up Asset Reconstruction Company (ARC) that can take over some of the bad debts off the banks and financial institutions and restructure them on profitable lines

Most of these reforms are implemented:

- SLR and CRR are drastically reduced
- Divestment in public sector banks led to their listing on the stock exchanges and their performance has improved
- Private banks have been given licenses
- SBI's associate banks have merged with SBI to scale up the operations
- ARCs are functioning

Bank Loans: Good and Bad

All loans given by banks are classified as either standard or substandard loans.

Standard Assets: These are performing assets which are being serviced- repayment of principal at the interest rate that is agreed upon- as per the contract.

Substandard Assets or NPAs

When the borrower pays neither the interest nor the principal for a specified period of time, the loan is said to be non-performing. When a loan is classified as NPA it goes through several phrases as the repayment gets delayed. If the borrower does not pay dues for 90 days, the loan becomes an NPA and it is termed as "Special Mention Account". If this loan remains SMA for a period less than or equal to 12 months, it is termed as Sub-standard Asset.

A sub-standard asset requires a provision of 15 per cent on secured portion and 25 per cent on the unsecured exposure. After 12 months as Sub-Standard Asset, it gets classified as Doubtful Asset 1 (DA1) and requires a provision of 25 per cent on secured portion and 100 per cent on the unsecured portion.

Once the account crosses one year as DA1, it becomes Doubtful Asset 2 (DA2-1 to 3 years) and requires a provision of 40 per cent on the Secured portion and 100 per cent on the unsecured portion.

Once it crosses three years, it becomes Doubtful Asset 3 (DA3) and requires 100 per cent provision irrespective of the availability of security. It is a loss making asset, in other words. Unsecured loans such as clean loans, educational loans attract 100 per cent provision even at DA1 stage.

Accounts classified as fraud need not go through all these stages and will require 100 per cent provision as soon as it is classified as NPA. Such provisions have to be made out of the profits thus, eroding the bottom line.

Stressed Assets

When an asset shows weakness and is likely to become an NPA, it is considered a stressed asset. RBI allows it to be prevented from becoming an NPA by restructuring: making terms of loan softer by rescheduling the repayment period, lower interest rate, pumping additional assistance etc. They are classified as standard assets. RBI mandated the banks to make additional disclosures regarding restructured loans, which includes the number of proposals received, and the amount involved etc.

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Nearly 11 percent of the total loans given by all the banks became bad loans by 2018. Over 90 percent of these are of public sector banks. The figure is more if we include all troubled loans including reported bad loans, restructured assets, written off loans and bad loans that are not yet recognized.

NPAs can occur for a variety of reasons:

- Bad lending practices
- Slowdown in economy
- Power distribution companies (discoms) could not repay due to government's populist policies of supplying power free or at a very concessional rate
- Steel companies are running losses due to competition from imports
- Infrastructure companies could not get clearances due to environmental reasons, natural calamities, business cycle
- Willful defaulters due to crony capitalism

High levels of NPAs means-

- banks' profitability diminishes
- precious capital is locked up
- cost of borrowing will rise as lendable assets shrink
- stock prices of banks will go down and investors will lose
- investment in economy suffers
- if banks have to close down, employees and depositors lose
- budget comes under pressure as bailouts have to be given

What Is Being Done -

- provisioning
- Capital adequacy norms according to Basel 3
- SARFAESI Act
- ARCs
- foreclosure
- one time settlement
- interest waiver
- writeoffs/writedowns
- debt recovery tribunals
- IBC
- Banking Regulation Act 2017
- Recapitalization bonds

Corporate Debt Restructuring, Sustainable Structuring of Stressed Assets or S4A, Strategic Debt Restructuring were practised before the IBC came into effect in 2017 but were abolished by the RBI.

Foreclosure means taking over by the lender of the mortgaged property if the borrower does not conform to the terms of mortgage.

Securitization is converting the documents that are the basis for a loan, into a security and selling it in the market.

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SARFAESI Act

To expedite recovery of loans and bring down the non-performing asset level of the Indian banking and financial sector, the government in 2002 called the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI). It gave unprecedented powers to banks, financial institutions and asset reconstruction/securitization companies. It allows banks and other financial institutions to auction residential or commercial properties to recover loans. Banks are allowed to take possession of the collateral property and sell it without the permission of a court. The law allowed the creation of asset reconstruction companies (ARCs) and enabled banks to sell their non-performing assets to ARCs. In 2016, the law was amended to make the process more expeditious.

Asset Reconstruction Company (ARC)

Non-performing assets (NPAs) are essentially productive assets which, if turned around, would not only create additional jobs but also contribute to national output. For this to happen, timely interventions, transparent price discovery and right management were required. ARCs are one solution.

Asset Reconstruction Companies under SARFAESI Act can buy NPAs from banks and other financial institutions. Reserve Bank of India (RBI) provides license for ARCs and regulates them. ARCs being the specialized agencies have NPA resolution as the core activity.

Narasimham Committee on Banking Sector recommend them in its reports by way of creation of an "Asset Recovery Fund" to take the NPAs off the lender's books at a discount.

ARCs have been set up to provide a focused approach to NPA resolution issue by-

- Monetising the NPAs
- Cleaning up the balance sheets of banks
- Freeing the financial system to focus on their core activities and
- Facilitating development of market for distressed assets

As per RBI, ARC performs the following functions:-

- Acquisition of financial assets
- Change or takeover of Management / Sale or Lease of Business of the Borrower
- Rescheduling of Debts
- Settlement of dues payable by the borrower

GOI made various legislative and regulatory changes that created an enabling and supportive operational environment for ARCs and for takeover of stressed assets. These include higher ceiling of 100 per cent for FDI in ARCs, exemption from stamp duty, enabling trading of security receipts etc. As a result, a number of new ARCs have come up.

If ARCs succeed, it could pave the way to a virtuous cycle of fresh investments, new jobs and additional demand.

Insolvency and Bankruptcy Code (IBC) 2016 provides opportunity for asset reconstruction companies.

Asset Quality Review (AQR)

In addition to the annual inspection of bank books done by the Reserve Bank of India (RBI) a special inspection was conducted in 2015-16 called Asset Quality Review (AQR). It involves a small sample of loans being inspected to check if asset classification was in line with the loan repayment and if banks have made provisions adequately. Most of the large borrower accounts were inspected to check if classification was in line with prudential norms. The RBI believed that

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asset classification has to be done effectively and that banks should not resort to ever-greening of accounts, that is, lend to the loanees who are in the NPA category to enable them artificially to repay and thus to show them to be standard loans. Banks were postponing bad-loan classification. Investors were also facing uncertainties as guidance by banks on bad loans was not proper. The impact of the AQR: banks have classified AQR-identified accounts (which were termed as stressed assets) as NPAs which resulted in an increase in provisioning thus making banking operations relatively safe.

PCA

RBI as the agency in charge of financial stability and banking in general, has to prevent crises. Therefore, it adopted a prompt corrective action (PCA) framework which is invoked when certain risk thresholds are breached. The risks are related to asset quality, profitability, capital and levels of NPA. If the limits specified are crossed, RBI will instruct the banks to follow remedial measures.

Prompt Corrective Action norms allow the regulator (RBI) to place certain restrictions such as halting branch expansion and stopping dividend payment on banks. It can even cap a bank's lending limit to one entity or sector. Other corrective action that can be imposed on banks include special audit, restructuring operations and activation of recovery plan. Banks' promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA.

The PCA framework is applicable only to commercial banks and not extended to co-operative banks and non-banking financial companies (NBFCs).

Stress Tests

Banks are exposed to a variety of risks- market, credit, liquidity etc- which need to be assessed continuously. Based on the assessment banks can be prescribed certain rules to help them cope well. Its need was amply demonstrated when the great recession took place in 2008. A stress test is a simulation of a financial or economic crisis to determine the ability of a bank to deal with it. RBI undertakes such stress tests in India. Following tests are usual:

- If stock markets plunge
- If rupee swings severely
- If inflation gallops or deflation occurs
- If growth crashes
- If global commodity prices swing severely

Safety of Banks And Basel Norms

Banks lend to different types of borrowers and each carries its own risk. They lend the deposits of public as well as money raised from the market- equity and debt. The intermediation activity exposes the bank to a variety of risks. Cases of big banks collapsing due to their inability to withstand are many. Therefore, banks are recommended to keep aside a certain percentage of capital as security against the risk of non-recovery.

Prudential Norms

For the safety of banking operations, they need to follow prudential norms. Prudential norms relate to-

- income recognition
- asset classification
- provisioning for NPAs
- capital adequacy norms (capital to risk-weighted asset ratio, CRAR).

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Income must be recognised only when realised; assets must be classified and provision must be made. Certain capital should be set aside from profits, equity and debt as a security against risks. Thus, income recognition, asset classification, provisioning norms and capital adequacy are inter-related and aim at safe banking.

Prudential norms make the operations transparent, accountable and safe and serve two primary purposes: bring out the true position of a bank's loan portfolio and help in prevention of its deterioration. Basel committee provided the norms called Basel norms to tackle the variety of risks that banks face.

Basel Norms

The Basel Accords - Basel I, Basel II and Basel III - are issued by the Basel Committee on Banking Supervision (BCBS). They are called the Basel Accords as the BCBS maintains its secretariat at the Bank for International Settlements (BIS) in Basel, Switzerland and the committee normally meets there.

The aim of the Basel Accords is to ensure that banks and other financial institutions have enough capital to meet their obligations to depositors and other stakeholders and absorb unexpected losses. Capital is basically profits that accumulate as reserves, debt and equity.

Basel I

In 1988, the Basel Committee on Banking Supervision (BCBS) published a set of minimum capital requirements for banks. These were known as Basel I. It focused almost entirely on credit risk (default risk).

Basel II

Basel II was introduced in 2004 focusing on more risks and remedies.

Basel III

It is a global, voluntary regulatory framework on bank capital adequacy, stress testing, etc. It was agreed upon in 2010–11, and was introduced in 2013 to be adopted till 31 March 2019. It was developed in response to the deficiencies in financial regulation revealed by the financial crisis of 2007–08. The major thrust area of Basel III is improvement of quantity and quality of capital of banks, with stronger supervision, risk management and disclosure standards.

Under Basel III norms, banks need to have a total capital adequacy ratio of 11.5% against 9% earlier.

Basel III has three pillars:

1. Pillar 1 is made up of risks
2. Pillar 2 Enlarges the role of banking supervisors
3. Pillar 3 Defines the standards and requirements for higher disclosure by banks on capital adequacy, asset quality and other risk management processes.

Basel III norms cover three risks- credit risk, market risk and operational risk.

Credit risk: A bank faces the risk that some of its borrowers may not repay loan, interest or both. This risk is called credit risk, which varies from borrower to borrower depending on their credit quality. Basel III requires banks to accurately measure credit risk to hold sufficient capital to cover it.

Market risk: As part of the statutory requirement, in the form of SLR (statutory liquidity ratio), banks are required to invest in liquid assets such as cash, gold, government and other approved securities. Some money of the banks is also invested in other assets like shares, real estate etc. Such investments except the government securities (which carry zero risk) are risky as prices fluctuate. It is known as the market risk as the value of the investments depends on market forces.

Operational risk: Operational risks include fraud, security, physical (e.g. infrastructure shutdown) or cyber attacks and digital threats.

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Capital Adequacy Norms

To absorb the risks mentioned above, banks need to have adequate capital. It is set at a certain level as Capital Adequacy Ratio (CAR) which is the same as Capital to Risk (Weighted) Assets Ratio (CRAR). It is expressed as a percentage of a bank's risk weighted credit exposures. Historically, all businesses and consumers who borrow - agriculture, students, exporters, infrastructure etc are calculated to have certain quantified level of risk. Each sector carries its own level of risk depending on past performance. Government securities and cash carry zero risk. Its purpose is to protect depositors and promote stability and efficiency of financial systems around the world. RBI mandated the CAR at 9% which is higher than the international norm of at least 8%.

Under Basel III norms, a countercyclical capital buffer is prescribed: keep aside capital that can be used when the cycle turns down due to slowdown or recession and the loans may turn bad.

India and CAR

As per the Reserve Bank of India direction, the Basel III capital regulation is being implemented from April 1, 2013 in India in phases, and it will be fully adopted as on March 31, 2019. As noted above, RBI laid down 9% CAR. In addition, a capital conservation buffer, of 2.5 percent of the risk weighted assets is also necessary. Thus, totally it is 11.5%.

It is a challenge for Indian banks as they face lakhs of crores of NPAs; stock markets and debt markets are not in a position to lend them money for the capital requirements; their profits are dwindling due to the NPAs; GOI is unable to infuse capital except to a very limited extent under Indradhanush initiative (Recapitalization).

BIS

The Bank for International Settlements (BIS) is an international financial institution owned by central banks which "fosters international monetary and financial cooperation and serves as a bank for central banks". It also provides banking services, but only to central banks and other international organizations. It is based in Basel, Switzerland. Sixty member central banks or monetary authorities are there in BIS including India.

Write off, Write down and Haircut

Hair cut in bank parlance is when an asset value is brought down as it can not be realized in full. For example, a loan that is given may not be recovered fully or at all. The first case is one of write down and the latter is write off. Both are examples of hair cut.

Insolvency and Bankruptcy Code 2016

A globalised economy like ours needs laws incorporating best practices. Unless bankruptcy laws are codified for expeditious resolution, investment suffers. Capital that is lent gets locked up. Capital that is invested lies idle. It has impact on jobs and growth. Laws were debtor centric and creditors were helpless. Till IBC came into effect, India did not have effective legal and institutional machinery for dealing with debt defaults. There were multiple laws and institutions. The recovery proceedings by creditors, either through the Contract Act or through special laws such as the Recovery of Debts due to Banks and Financial Institutions Act, 1993 and SARFAESI Act did not have desired outcomes. Nor did Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and the winding up provisions of the Companies Act, 1956.

Laws dealing with individual insolvency- Presidency Towns Insolvency Act, 1909; Provincial Insolvency Act, 1920 were outdated.

IBC aims to consolidate the laws relating to insolvency into a single legislation and provide for their resolution in a time bound manner. This law thus aims to promote entrepreneurship, availability of credit and balance the interest of all stakeholders- debtors, creditors, suppliers, employees etc.

Highlights of the Code

Insolvency is a situation when an individual/firm is unable to meet the financial obligations due to its creditors. In such a situation, he/it can file for bankruptcy. Bankruptcy is a legally-declared status that an individual/firm cannot repay debts.

The 2016 Code seeks to speed up the process of resolution and do justice to stakeholders. The Code creates various institutions to facilitate resolution of insolvency. These are as follows:

- **Insolvency Professionals:** A specialised cadre of licensed professionals is created to administer the resolution process, manage the assets of the debtor, and provide information for creditors to assist them in decision making.
- **Insolvency Professional Agencies:** The insolvency professionals are registered with insolvency professional agencies. The agencies conduct examinations to certify the insolvency professionals and enforce a code of conduct for their performance.
- **Information Utilities:** Creditors report financial information of the debt owed to them by the debtor. Such system by creating a database tracks serial defaulters. It also helps creditors understand the financial profile of the debtors. Such information includes records of debt, liabilities and defaults.
- **Adjudicating authorities:** There are two adjudicating authorities: National Companies Law Tribunal (NCLT), for companies; and the Debt Recovery Tribunal (DRT) for individuals and small firms. The duties of the authorities include approval to initiate the resolution process, appoint the insolvency professional, and approve the final decision of creditors. The NCLT appoints an insolvency professional or 'Resolution Professional' to administer the insolvency resolution process. The Resolution Professional's primary function is to take over the management of the corporate borrower and operate its business as a going concern under the broad directions of a committee of creditors. Therefore, the thrust of the Code is to allow a shift of control from the defaulting debtor's management to its creditors, where the creditors drive the business of the debtor with the Resolution Professional acting as their agent.
- **Insolvency and Bankruptcy Board:** The Board regulates insolvency professionals, insolvency professional agencies and information utilities set up under the Code. The Board consists of representatives of Reserve Bank of India, and the Ministries of Finance, Corporate Affairs and Law.

NCLT is a quasi-judicial authority created under the Companies Act, 2013. Decisions of NCLT can be challenged in NCLAT, Appellate Tribunal. Debt Recovery Tribunals were established to facilitate the debt recovery involving banks and other financial institutions after the passing of Recovery of Debts Due to Banks and Financial Institutions Act (RDDBFI), 1993. Appeals against orders passed by DRTs lie before Debts Recovery Appellate Tribunal (DRAT).

The procedure and the process

In case of individual defaulters and unlimited partnerships, the minimum amount required for attracting the insolvency code is Rs.1000. Minimum default required to initiate insolvency procedure for corporate debtors under the Code is Rs.1,00,000.

Initiation: The Code makes a significant departure from the existing resolution regimen by shifting the responsibility on the creditor to initiate the insolvency resolution process against the corporate debtor. Any corporate debtor who commits a default, a financial creditor (banks and bond-holders), an operational creditor (suppliers) or the corporate debtor or employees or shareholders may initiate corporate insolvency resolution process.

- The insolvency professional administers the process. The professional provides financial information of the debtor from the information utilities to the creditor and manage the debtor's assets. This process lasts for 180 days and any legal action against the debtor is prohibited during this period.

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- Decision to resolve insolvency: A committee consisting of the financial creditors who lent money to the debtor will be formed by the insolvency professional. The creditors committee will take a decision regarding the future of the outstanding debt owed to them. They may choose to revive the debt owed to them by changing the repayment schedule, or sell (liquidate) the assets of the debtor to repay the debts owed to them. A decision is to be taken in 180 days or a one time extension of another 90 days is given. 75% of financial creditors have to consent to revival plans. Or liquidation- sell the assets of the company, is the other option. For firms with smaller operations, the code stipulates a fast-track insolvency resolution process which will be completed within 90 days.
- Liquidation and waterfall: If the debtor goes into liquidation, an insolvency professional administers the liquidation process. Proceeds from the sale of the debtor's assets are distributed in the following order of precedence (waterfall): i) insolvency resolution costs, including the remuneration to the insolvency professional, ii) secured creditors, whose loans are backed by collateral, dues to workers, other employees, iii) unsecured creditors, iv) dues to government, v) priority shareholders and vi) equity shareholders.

Workers' salaries for up to 24 months will get first priority in case of liquidation of assets of a company, ahead of secured creditors.

Significance of The Code-

- More power to creditors
- Easier exit
- Speedier insolvency resolution
- Enhance ease of doing business
- Reduce bad loans
- India is a capital scarce country and therefore, it is essential that capital is used productively. Quick resolution of bankruptcy can ensure this.

Even though DRTs and SARFAESI had time frames for settlement, they were caught up in litigation. It may not happen with the IBC because there is an elaborate infrastructure of IPs and IUs.

IBC stands out for the following reasons-

1. Single code
 2. Time bound process
 3. Elaborate institutional infrastructure
 4. Deals not only with manufacturers as SICA did but all businesses
- IBC dropped SICA completely and amended various other laws.

Banking Regulation (Amendment) Act 2017

It amended the Banking Regulation Act, 1949 to allow the Reserve Bank of India (RBI) to issue directions to banks for initiating recovery proceedings against loan defaulters under the recently enacted Insolvency and Bankruptcy Code, 2016 (IBC). RBI acted on these powers and directed banks to initiate recovery proceedings against many defaulters.

TBS Challenge

India's Twin Balance Sheet (TBS) problem - companies over borrowed and became distressed as their investments did not yield and so could not repay to the banks who thus became mired in NPAs. Thus, the balance sheets of both the borrowing companies and the lending banks are under pressure. The issue is important because it is holding up private investment in the country and therefore, growth in all sectors. Many measures are introduced by the government like IBC, recapitalisation etc. but the problem still persists as it is a gigantic challenge. The suggestion of the Economic Survey 2016-17 is that a Public Sector Asset Reconstruction Company (PARA) be formed to buy the biggest, most complex NPAs and then dispose of them.

PARA

Economic Survey 2016-17 proposed that Public Sector Asset Rehabilitation Agency (PARA) be set up to solve the NPA problem of PSBs. PARA is expected to be the special purpose vehicle (SPV) that will raise money by issuing government bonds with which it will buy the big bad loans of the PSBs. The proposal has advantages of relieving the banks of NPAs; settling the issue faster than when each bank has to settle independently; get better bargain as there is only one buyer etc. It is the 'bad bank' that the country has been debating for some years- an SPV that holds the bad loans of the PSBs.

P. J. Nayak Committee

It was set up by the RBI for suggestions on governance issues of banks. It suggested that-

1. government should reduce its holding in PSBs to below 50%.
2. process of board appointments in PSBs needs to be professionalised
3. fixed term of 5 years for the chairman/managing director of a bank and a term of 3 years for a whole-time director.

Bank Consolidation

The idea of bank mergers- consolidation- has been around since at least 1991, when former Reserve Bank of India governor M. Narasimham recommended that the government merge banks into a three-tiered structure, with three large banks with an international presence at the top. In 2014, the P. J. Nayak panel suggested that the government either merge or privatize state-owned banks.

Consolidation is aimed at building scale, strengthening their risk-taking ability, operational efficiency, deal better with their credit portfolio, including stressed assets, prevent duplication of bank branches in the same area and strengthen banks to deal with shocks.

The government wants that this, along with measures such as capital infusions in weak banks, will cause a revival. The government is looking to reduce the number of state-run banks to 10-15 through mergers and acquisitions. In case of consolidation, GOI factors in balance sheet, integration of technology and people.

SBI has merged operations of five of its associate banks and Bharatiya Mahila Bank with itself, marking the first consolidation move in the sector following the bad loan crisis. The merger has reduced the number of state-controlled banks to 21 from 26. Critics disagree about benefits. The objections are that it is a tactical decision to address the NPA issues and so will be damaging in the long run. Employee rationalization is also worrying some.

Indradhanush

To revive the NPA-burdened public sector banks, government introduced in 2015 a seven-point plan called 'Indradhanush'.

The Indradhanush strategy consists of-

- Appointments in a professional manner- Open PSBs to private sector professionals
- Banks Board Bureau
- Capitalization
- De-Stressing Public Sector Banks by consolidation
- Empowerment is by government's non-interference
- Framework of accountability: The government also announced a new framework of key performance indicators for state-run lenders to boost efficiency in functioning while assuring them of independence in decision making on purely commercial considerations.
- Governance Reforms: "Gyan Sangam" - a conclave of PSBs and FIs organized at the beginning since 2015 as a Retreat for Banks and Financial Institutions" to take forward the Government's commitment to reforms in the banking and financial Sector.

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Banks Board Bureau

The Banks Board Bureau (BBB) is an autonomous body, responsible for: (i) making recommendations on appointments of heads of public sector banks and financial institutions (ii) helping banks with developing strategies and raising capital; (iii) recommendations on PSB consolidation

A committee set up by the RBI to review the governance of bank boards, headed by P.J. Nayak, in 2014 had suggested the formation of the bureau. BBB aims to "professionalize and depoliticize" the appointment process. The objective of BBB is to help prepare the banks in the public sector to take on the competition, have the ability to manage risk across business cycles. The Bureau engages with the Public Sector Banks to help build capacity to attract, retain and nurture both talent and technology.

Differentiated Banking

It means there are different types of banks with different aims, clients, and modes of working. Banking sector catering to different segments- general public, firms and companies, farmers, rural, microfinance, MSMEs etc. offering specialised services and unique products is crucial for economic growth and financial inclusion.

There has been movement towards differentiated banking in the country. We had cooperative banks, RRBs, development banks like IDBI for a long time. The current wave of differentiated banking started since Nachiket Mor Committee in 2013.

Differentiated banks are distinct from universal banks (offer all financial products) as they function in a specific segment. The differentiation may be based on capital requirement, scope of activities or area of operations. They offer a limited range of services / products or function under a different regulatory framework.

Reserve Bank of India (RBI) in recent years pursued it to widen sources of funding in the economy. For example, RBI since 2014, gave in-principle approval to small finance banks (SFBs) and payments banks. Wholesale and Long-Term Finance (WLTF) banks are under discussion. WLTF banks will focus primarily on lending to infrastructure sector and small, medium and corporate businesses. They may have negligible retail sector exposure on asset side.

Small Finance Banks (SFBs)

Small finance banks are scheduled commercial banks that are a part of differentiated banking in India focused on lending for financial inclusion to small business units, small and marginal farmers, micro and small industries and unorganised sector entities, but not exclusively so.

They can be promoted either by individuals, corporates, trusts or societies. They are established as public limited companies in the private sector under the Companies Act, 1956; licensed under the Banking Regulation Act, 1949 and are governed by the provisions of Reserve Bank of India Act, 1934, Banking Regulation Act, 1949 and other relevant statutes.

SFB is a private financial institution that can operate without any restriction in the area unlike Regional Rural Banks (RRBs) or Local Area Banks. The minimum capital for SFBs is prescribed at Rs. 100 crore. Foreign Investment is permitted as in the case of other private sector commercial banks. SFBs are subject to all prudential norms and regulations of RBI as applicable to existing commercial banks like maintenance of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). SFBs are required to extend 75 per cent of credit to the sectors eligible for classification as priority sector lending (PSL) by the Reserve Bank. At least 50 per cent of its loan portfolio should constitute loans and advances of upto Rs. 25 lakh. It is mandatory that at least 25 percent of its branches shall be in unbanked rural centers.

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SFBs can undertake other non-risk sharing financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension products, etc. SFBs can set up dealership in foreign exchange business. SFBs cannot set up subsidiaries to undertake non-banking financial services activities.

There will not be any restriction in the area of operations of small finance banks; however, preference will be given to those applicants who in the initial phase set up the bank in a cluster of under-banked States / districts.

Resident individuals/professionals with 10 years of experience in banking and finance; and Companies and Societies owned and controlled by residents will be eligible as promoters to set up small finance banks. Existing Non-Banking Finance Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs) that are owned and controlled by residents can also opt for conversion into small finance banks.

The concept of small finance banks was one of the recommendations in the 2009 Report - "A Hundred Small Steps" of the Committee on Financial Sector Reforms headed by Dr. Raghu Ram Rajan.

Many SFBs started operations.

Payments Bank

In 2013, Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, headed by Nachiket Mor recommended that payments banks be allowed. They are a new type of bank that can accept a limited amount as deposit, which is currently limited to ₹ 1 lakh per customer.

The payments bank will be set up as a differentiated bank and shall confine its activities to further the objectives for which it is set up. Therefore, the payments bank would be permitted to set up its own outlets such as branches, Automated Teller Machines (ATMs), Business Correspondents (BCs), etc. to undertake only certain restricted activities permitted to banks under the Banking Regulation Act, 1949.

- Acceptance of demand deposits, i.e., current deposits, and savings bank deposits is permitted.
- No NRI deposits should be accepted.
- The eligible deposits mobilised by the payments bank would be covered under the deposit insurance scheme of the Deposit Insurance and Credit Guarantee Corporation of India (DICGC). Given that their primary role is to provide payments and remittance services and demand deposit products to small businesses and low-income households, payments bank will initially be restricted to holding a maximum balance of Rs. 1,00,000 per individual customer. However, payments bank can accept a large pool of money to be remitted to a number of accounts provided at the end of the day the balance does not exceed Rs. 1,00,000. Money deposited in the bank gets interest.
- **Can not accept fixed deposits (FDs), term deposits and recurring deposits (RDs)**
- Cannot undertake lending activities.
- Allowed Issuance of ATM / Debit Cards. Payments banks, however, cannot issue credit cards.
- Apart from amounts maintained as Cash Reserve Ratio (CRR) with RBI, it will be required to invest minimum 75 percent of its deposits in Government securities/Treasury Bills with maturity up to one year that are recognized by RBI as eligible securities for maintenance of Statutory Liquidity Ratio (SLR) and hold maximum 25 per cent in current and time / fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

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- Since payments banks are exposed to operational risks (not credit or market risk), they have to conform to capital adequacy ratio (CAR) norms which are different from banks
- Permitted to handle cross border remittance transactions
- They can provide mutual funds and other financial products, net-banking and mobile-banking.

The bank should be fully networked from the beginning. The bank can accept utility bills. It cannot form subsidiaries to undertake non-banking activities. 25% of its branches must be in the unbanked rural area. The banks are licensed as payments banks under Banking Regulation Act, 1949, and will be registered as public limited company under the Companies Act, 2013. The minimum capital requirement is ₹ 100 crore.

Objectives of payments banks

There is a need for transactions and savings accounts for the underserved in the population. Also remittances have both macro-economic benefits for the region receiving them as well as micro-economic benefits to the recipients. Higher transaction costs of making remittances diminish these benefits. Therefore, the primary objective of setting up of payments banks will be to further financial inclusion by providing-

- small savings accounts
- payments / remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users, by enabling high volume-low value transactions in deposits and payments / remittance services in a secured technology-driven environment.

India Post Payments Bank (IPPB)

In 2014, a task force was formed by GOI to study ways in which the existing postal network could be used more, headed by T. S. R. Subramanian. It said that more services should be provided in the field of banking, insurance and e-commerce.

India Post Payments Bank (IPPB) is a public limited company under the Department of Posts, Ministry of Communications, with 100 per cent government equity.

It aims to utilize all of India's 1,55,000 post offices and 3,00,000 postal service workers to provide house to house banking services. The first phase of the bank with 650 branches and 3250 post offices as access points was inaugurated in 2018.

90% of post offices are in rural areas. There is one post office for every 7200 people in India. Crores of people already receive their National Rural Employment Guarantee Act (NREGA) payments by post offices. After State Bank of India, India Post has the largest deposits.

The four key features of IPPB are:

1. Financial literacy: IPPB aims to make India prosperous by ensuring that everyone has equal access to financial information and services.
2. Streamlining payments: Beneficiaries can access income from government's DBT programs like MNREGA wages, Social Security Pensions and scholarships, directly from their IPPB bank account. They can also pay their utility bills, fees for educational institutions and many more from the same IPPB account.
3. Financial inclusion: Hundreds of millions of Indians who don't have access to banking facilities cannot avail of government benefits, loans and insurance, and even interest on savings. IPPB will reach the unbanked and the under-banked across all cross sections of society and geographies.
4. Easy access: With over 1.54 lac post offices across the country, postal delivery system will make IPPB an accessible banking network. IPPB also offers services through internet and mobile banking, and prepaid instruments like mobile wallets, debit cards, ATMs, PoS and MPoS terminals etc.

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MUDRA Bank

Pradhan Mantri Mudra Yojana (PMMY) is a scheme to extend collateral free loans by Banks, Non-Banking Financial Companies (NBFCs) and Micro Finance Institutions (MFIs) to Small/Micro business enterprises and individuals in the non-agricultural sector to enable them to setup or expand their business activities and to generate self employment. While launching PMMY, Mudra bank also was launched.

MUDRA Bank was registered as a Company in 2015 under the Companies Act 2013 and as a Non Banking Finance Company with the RBI later. MUDRA has been initially formed as a wholly owned subsidiary of Small Industries Development bank of India (SIDBI) with 100% capital being contributed by it. Presently, the authorized capital of MUDRA is 1000 crores and paid up capital is 750 crore, fully subscribed by SIDBI.

This Agency would be responsible for developing and refinancing all Micro- enterprises sector by supporting the finance institutions which are in the business of lending to micro / small business entities engaged in manufacturing, trading and service activities. MUDRA would partner with Banks, MFIs and other lending institutions at state level / regional level to provide micro finance support to the micro enterprise sector in the country.

GOI decided that MUDRA will provide refinance support, monitor the PMMY data by managing the web portal and facilitate offering guarantees for loans granted under PMMY.

It aims to provide the funding to the non-corporate small business sector. MUDRA is conceived not only as a refinance institution and but also as a regulator for the micro finance institutions (MFIs).

The MUDRA Bank is primarily be responsible for-

- Laying down policy guidelines for micro/small enterprise financing business
- Registration and Regulation of MFI entities
- Accreditation /rating of MFI entities
- Promoting right technology solutions for the last mile
- Formulating and running a Credit Guarantee scheme for providing guarantees to the loans which are being extended to micro enterprises
- Creating a good architecture of Last Mile Credit Delivery to micro businesses under the scheme of Pradhan Mantri Mudra Yojana.

Union Budget 2015-16 proposed to create MUDRA with a corpus of Rs. 20,000 crore made available from the shortfalls of priority sector lending. There is a credit guarantee corpus of Rs.3,000 crore for guaranteeing loans being provided to the micro enterprises. MUDRA Bank will refinance Micro-Finance Institutions through a Pradhan Mantri Mudra Yojana.

MUDRA Bank operates through financing institutions who in turn connect with last mile lenders such as Micro Finance Institutions (MFIs), Primary Credit Cooperative Societies, Self Help Groups (SHGs), NBFC (other than MFI) and such other lending institutions.

The micro finance institutions (MFIs) can become Member Lending Institutions (MLIs) with MUDRA (SIDBI) Bank for refinance and with National Credit Guarantee Trustee Company (NCGTC) for credit guarantee.

In lending, MUDRA gives priority to enterprises set up by the under-privileged sections of the society particularly those from the scheduled caste / tribe (SC/ST) groups, first generation entrepreneurs and existing small businesses. There are estimated to be some 5.77 crore small business units in India, mostly individual proprietorship, which run small manufacturing, trading or service businesses. 62% of these are owned by SC/ST/OBC.

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Micro Finance is an economic development tool whose objective is to provide income generating opportunities to the people at the bottom of the pyramid. It covers a range of services which include, in addition to the provision of credit, many other credit plus services, financial literacy and other social support services.

Recapitalisation

It has been in news since many years as PSBs are in need of capital both to meet the Basel 3 norms by 2019 and also to withstand the impact of NPAs. As NPAs increase, a certain capital needs to be kept aside to secure banking operations. Indradhanush in 2015 commits the government to recapitalization. Banks like other corporate entities have equity and debt making up their capital in a certain ratio. Changing the ratio is called recapitalization. It can happen by infusion of fresh capital or conversion of debt into shares or vice versa.

In 2017, GOI floated recap bonds to which PSB banks subscribed. The money that GOI thus received was used to infuse capital into troubled PSBs for them to be secure and to conform to the Basel 3 norms.

Bonds fetch banks interest. Interest will be paid from budget. Banks' health will improve as they can start lending with the higher amount of capital. (Unless bank has a certain amount of capital, it can not lend the deposit money to businesses.) Share prices of the banks will rise. GOI will sell the shares at a higher price to redeem the bonds. Thus, it is a win-win solution.

GOI did it in the early 1990s when the PSBs saw a severe erosion in their profitability and capital base due to reckless lending in the preceding decade.

The advantages of the bonds are that-

- the same money need not be raised by taxing the citizen
- by borrowing directly from the banking system instead of the markets, the Centre can avoid crowding out private borrowings
- banks find the investment in these bonds safe and they just need to divert the SLR excess investment.
- But there are downsides too-
- it should not act as a moral hazard and banks should not lend without due diligence as they know the GOI will come to their rescue
- fiscal deficit calculation also matters.

It needs to be stressed that unless the temporary relief is used to improve PSB governance based on some recommendations from PJ Nayak Committee and BBB, this policy may not make much of a long term difference.

FDI In Banks

FDI in Indian banks is allowed. In PSBs, 20% of FDI is allowed and in private banks it is 74%-upto 49% is automatic and beyond that is on approval basis. However, voting rights are capped in national interest at 10%.

Foreign Banks: Subsidiary Vs Branch

Indian Government allows foreign banks to operate by registering as a branch office or by incorporating a subsidiary. A branch office is considered an extension of the parent company and is not considered an independent legal entity. The assets and liabilities of branch office are considered as merged with the parent office. Subsidiary has a separate legal status; there is Indian investment; assets and liabilities are separate. It has to have a separate management in India. Any losses incurred by parent can not be offset by subsidiary's assets. This arrangement protects Indian capital and operations from external economic shocks as such outfits follow local guidelines. It can raise capital from Indian share market as a separate entity. RBI is encouraging foreign banks to become subsidiaries. At present, most foreign banks operate as branches or representative offices of the parent.

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Development Banks

Development Banks are financial institutions which provide long term capital for industries and agriculture: Industrial Finance Corporation of India (IFCI); Industrial Development Bank of India (IDBI) which became a universal bank- IDBI Bank; Industrial Credit and Investment Corporation of India (ICICI) that was merged with the ICICI Bank in 2000; Industrial Investment Bank of India (IIBI); Small Industries Development Bank of India (SIDBI); National Bank for Agriculture and Rural Development (NABARD); Export Import Bank of India; National Housing Bank(NHB).

The commercial banking network addressed the needs of general banking mainly and for meeting the short-term working capital requirements of industry and agriculture. Specialised development financial institutions (DFIs) such as the IDBI, NABARD, NHB and SIDBI, etc., were set up to meet the long-term financing requirements of industry and agriculture. To facilitate the growth of these institutions, a mechanism to provide concessional finance to these institutions was also put in place by the Reserve Bank.

The first development bank in India- IFCI- was incorporated immediately after Independence in 1948 under the Industrial Finance Corporation Act as a statutory corporation to pioneer institutional credit to medium and large-scale. New and different development financial institutions were set up by GOI.

S. H. Khan committee appointed by RBI (1997) recommended to transform the DFI (development finance institution) into universal banks that can provide a menu of financial services and leverage on their assets and talent. The result was IDBI Bank and ICICI Bank.

Co-operative Banks

Co-operative Banks are organised and managed on the principle of co-operation, self-help, and mutual help. They function with the rule of "one member, one vote" and on "no-profit, no-loss" basis. Co-operative banks, as a principle, do not pursue the goal of profit maximisation. Co-operative bank performs all the main banking functions of deposit mobilisation, supply of credit and provision of remittance facilities.

Co-operative Banks provide limited banking products and are functionally specialists in agriculture related products. However, co-operative banks now provide housing loans also.

Urban Co-operative Banks (UCBs) are located in urban and semi-urban areas. These banks, originally were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. Earlier, they essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. Co-operative banks get financial and other help from the Reserve Bank of India, NABARD, central government and state governments. RBI provides financial resources in the form of contribution to the initial capital (through state governments), working capital, refinance. Co-operative Banks belong to the money market as well as to the capital market- they offer short term and long term loans. Land Development Banks (LDBs) provide long-term loans.

The sources of their funds (resources) are

- ownership funds
- deposits or debenture issues.
- central and state government
- Reserve Bank of India
- NABARD
- other co-operative institutions

Some co-operative banks are scheduled banks, while others are non-scheduled banks. For instance, SCBs and some UCBs are scheduled banks (included in the Second Schedule of the Reserve Bank of India Act).

Co-operative Banks are subject to CRR and SLR requirements as other banks. However, their requirements are less than commercial banks.

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Shadow Banks

There are many financial institutions that perform functions like banks- raise deposits and equity, float bonds and so on and lend them to investors and consumers – but are not covered by the stringent regulations like banks. Some of them are floated by the banks themselves like mutual funds, investment banks, housing finance bodies etc. They are referred to as shadow banking system. Because of their lax conduct, some say the sub-prime crisis of 2008 resulted. They can cause serious damage to the otherwise well-regulated banking system.

Universal Banking in India

A universal bank is one that follows a “cafeteria” approach to financial services by offering all of them itself- retail, wholesale and investment banking services under one roof. It is both a commercial bank and an investment bank. It also provides other financial services such as insurance. Thus, it is a “full-service” bank providing wealth and asset management, housing and auto finance, trading, underwriting, consultancy, financial advisory etc. All commercial banks in India are universal banks. Reserve Bank of India appointed committee — Khan Working group — in 1998 recommended universal banking as was done earlier by the Narasimham Committee in 1988. It has advantages like better use of given human, financial and institutional resources. Disadvantage is that the regulatory norms not being strict for the non-banking activities, they can derail the entire bank as it happened in the sub-prime crisis in 2008 in the USA.

Bank Run

There are times when people are not confident about their bank's capacity to honour its financial commitments. They fear its insolvency for any number of reasons. When a large number of such customers of a bank want to withdraw their deposits at the same time due to such concerns, the bank's resources get even more depleted, the likelihood of default increases, thereby prompting more people to withdraw their deposits. It is known as a Bank Run.

New Delhi

MONEY MARKET AND CAPITAL MARKET IN INDIA: INSTRUMENTS AND DYNAMICS

There is need and demand for funds for both short and long periods of time- less than one year is short and a year or more is long. The market for the former is money market and the latter is capital market. Thus, the differentiation between money and capital markets is not based on the amount but the period. The need for finance in the money market is for working capital requirements, repayment of loans, consumption etc.

Money market for short-term funds has maturities ranging from overnight to one year. Money market transactions could be both secured (with collateral) and unsecured (clean, without collateral).

Banks and financial institutions (LIC etc.) individuals, mutual funds, foreign institutional investors (FII), companies and government (RBI) are the main lenders and borrowers. The informal market operates through small-scale money-lenders as well as others outside the RBI control.

Money market instruments broadly are: call money; bill market (both commercial bills and treasury bills) Certificates of Deposit (CD); Commercial paper (CP).

Call Money

Call/Notice money is money borrowed or lent for a very short period. If the period is more than one day and up to 14 days it is called 'Notice money' otherwise the amount is known as Call money. No collateral security is required to cover these transactions and goodwill and reputation are the basis apart from the documents like promissory notes. The call market enables the banks and institutions to even out their day-to-day deficits and surpluses of money.

Commercial banks, both Indian and foreign, co-operative banks, Discount and Finance House of India Ltd.(DFHI), Securities trading corporation of India (STCI) participate as both lenders and borrowers and Life Insurance Corporation of India (LIC), Unit Trust of India(UTI), National Bank for Agriculture and Rural Development (NABARD) can participate only as lenders.

Interest rates in the call and notice money market are market determined.

Primary dealers are RBI-recognised traders who buy and sell government securities and provide underwriting support to the government whenever it seeks to raise funds through bond issues. Thus acting as a market maker of government securities.

Government Securities

The Government securities comprise dated securities issued by the Government of India and state governments as also, treasury bills issued by the Government of India. Reserve Bank of India manages and services these securities through its public debt offices located in various places as an agent of the Government. T-Bills are a money market instrument.

Treasury Bills

Treasury bills (T-bills) are short-term investment opportunities, generally up to one year. They are thus useful in managing short-term liquidity. At present, the Government of India issues three types of treasury bills through auctions, namely, 91-day, 182-day and 364-day. There are no treasury bills issued by State Governments. Treasury bills are available for a minimum amount of Rs.25,000 and in multiples of Rs. 25,000. Treasury bills are issued at a discount and are redeemed at par. Treasury bills are also issued under the Market Stabilization Scheme (MSS). They are available in primary and secondary market.

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Treasury bills are zero coupon securities and pay no interest. The return to the investors is the difference between the maturity value or the face value (that is Rs.100) and the issue price. The usual investors in these instruments are banks, insurance companies, FIs etc. T-bills auctions are held on the Negotiated Dealing System (NDS) and the members electronically submit their bids on the system.

Cash Management Bills (CMBs)

The CMBs have the generic character of T-bills but are issued for maturities less than 91 days. Like T-bills, they are also issued at a discount and redeemed at face value(par) at maturity.

Inter Bank Term Money

Inter bank market for deposits of maturity beyond 14 days and upto three months is referred to as the term money market.

Certificates Of Deposit

Certificate of deposit (CD) is issued by scheduled commercial banks and Financial institutions (FI). Regional Rural Banks and Local Area Banks can not issue CDs.

CD is a negotiable promissory note and is secure. A CD is issued at a discount to the face value, the discount rate being negotiated between the issuer and the investor. The maturity period of CDs issued by banks should be not less than 15 days and not more than one year. The FIs can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue. The minimum deposit that could be accepted from a single subscriber should not be less than Rs.1 lakh, and in multiples of Rs. 1 lakh thereafter. CDs can be issued to individuals, corporations, companies (including banks and PDs), trusts, funds, associations, etc.

Inter Corporate Deposits Market

Apart from CPs, corporates also have access to another market called the inter corporate deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as an avenue for low rated corporates, this market allows fund- surplus corporate to lend to other corporates.

Commercial Paper

It is a short term unsecured promissory note issued by top rated corporates, primary dealers (PDs), satellite dealers (SDs) (those who are the sub-dealers for the PDs) and the all-India financial institutions (FIs). CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. However, the maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid. CP can be issued in denominations of Rs.5 lakh or multiples thereof.

The main features of these papers are:

- corporates having tangible net worth of not less than Rs.4 crore can issue them
- All CPs require credit rating from a credit rating agency
- Minimum amount invested by single investor is Rs. Five lakh or multiple thereof.
- CPs are issued at a discount to face value.

Ready Forward Contracts (Repos)

Repo is an abbreviation for Repurchase agreement, which involves a simultaneous "sale and purchase" agreement. When banks have any shortage of funds, they can borrow it from Reserve Bank of India or from other banks. The rate at which the RBI lends money to commercial banks on the basis of government securities is called repo rate.

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Commercial Bills

Bills of exchange are negotiable instruments drawn by the seller (drawer) of the goods or services on the buyer (drawee) of the goods for the value of the goods delivered. These bills are called trade bills. These trade bills are called commercial bills when they are accepted by commercial banks for discounting. If the bill is payable at a future date and the seller needs money immediately, he may approach his bank for discounting the bill. The bank or any other discounting body takes a commission for it.

Discount and Finance House of India (DFHI)

It was set up in 1988 by RBI to strengthen the bill market and to deal in money market instruments in order to provide liquidity. Thus the task assigned to DFHI is to develop a secondary market in the existing money market instruments. The main objective of DFHI is to facilitate the smoothening of the short term liquidity imbalances by developing an active money market and integrating the various segments of the money market. At present DFHI's activities are:

- Dealing in Treasury Bills
- Re-discounting short term commercial bills.
- Participating in the inert bank call money, notice money and term deposits and
- Dealing in Commercial Paper and Certificate of deposits.
- Government dated Securities

Libor

The London Interbank Offered Rate is the average interest rate estimated by leading banks in London that they would be charged for what they borrow from other banks. It is usually abbreviated to BBA Libor (for British Bankers' Association Libor). It is the primary benchmark, along with the Euribor, for short term interest rates around the world. Many financial institutions, mortgage lenders and credit card agencies set their own rates relative to it.

Mibor - Mumbai Inter-Bank Offer Rate

NSE developed and launched the NSE Mumbai Inter-bank Bid Rate (MIBID) and NSE Mumbai Inter-bank Offer Rate (MIBOR) for the overnight money market in 1998. The MIBID/MIBOR rate is used as a benchmark rate for majority of deals.

Money Market Reforms

On the recommendations of the Sukhoy Chakravarty Committee on the Review of the Working of the monetary system (1985) and the Narasimham Committee Report on the Working of the Financial System in India, 1991, Reserve Bank of India initiated a series of money market reforms basically directed towards the efficient discharge of its objectives.

Reforms made in the Indian Money Market are

- Deregulation of the Interest Rate
- Money Market Mutual Fund (MMMFs) are allowed to sell units to corporates and individuals
- Discount and Finance House of India (DFHI) was set up in 1988 to impart liquidity in the money market. It was set up jointly by the RBI, Public sector Banks and Financial Institutions.
- Liquidity Adjustment Facility (LAF) LAF adjusts liquidity in the market through absorption and or injection of financial resources by the RBI.
- In order to impart transparency and efficiency in the money market transaction the electronic dealing system has been started. It is useful for the RBI to watchdog the money market.

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- Establishment of the CCIL: The Clearing Corporation of India limited (CCIL) in 2001.
- Development of New Market Instruments like CMBs
- MSS since 2004 that was useful in 2016 post-demonetisation
- SDF

Capital Market

It refers to market for funds with a maturity of 1 year and above called as term funds that include medium and long term funds. The demand for these funds comes from both the government for its investment purposes and also the private sector. Banks, public financial institutions like LIC and GIC; development financial institutions, mutual funds are the main participants in the market. The components of the capital market in India are the following:

1. Government securities
2. industrial securities that include the shares and debentures of Indian companies- both the primary and secondary market
3. DFIs
4. merchant banks
5. mutual funds
6. venture capital companies and others.

G - Secs (Gilt Edged Securities)

A Government security is a tradable instrument issued by the Central Government or the State Governments through RBI. If a government security is for a short term (called treasury bills or Cash Management Bills with original maturities of less than one year) or long term (Government bonds or dated securities with original maturity of one year or more). In India, the Central Government issues both treasury bills and bonds (dated securities) while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). Government securities carry zero risk of default and, hence, are called risk-free gilt-edged instruments. Gilt edged because the original ones issued by the British government had golden border. Government of India also issues savings instruments (Savings Bonds, National Saving Certificates (NSCs), etc.) or special securities (oil bonds, Food Corporation of India bonds, fertiliser bonds, power bonds, recapitalization bonds etc.). They may not be tradable and are not eligible to be SLR securities. They are not issued through the RBI.

Dated Government securities are long term securities and carry a fixed or floating coupon (interest rate) which is paid on the face value, payable at fixed time periods (usually half-yearly). The tenor of dated securities can be up to 30 years.

GOI Dated Security can be held by any person, firm, company, corporate body or institution, State Governments, Provident Funds and Trusts. Non-Resident Indians (NRIs, viz., Indian citizens and Individuals of Indian origin), Overseas corporate bodies predominantly owned by NRIs and Foreign Institutional Investors registered with SEBI and approved by Reserve Bank of India are also eligible to invest in the government stock. G-Sec are issued both in demat and physical form. The minimum investment in G-Secs is Rs 10,000. G-Secs could be of the following types:

Dated Securities: They have fixed maturity and fixed coupon rates payable half yearly and are identified by their year of maturity.

Floating Rate Bonds: They are bonds with variable interest rates with a fixed percentage over a benchmark rate. There may also be a cap and a floor rate attached, thereby fixing a maximum and minimum interest rate payable on it.

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Capital Indexed Bonds: They are bonds where the interest rate is a fixed percentage over the inflation rate: WPI or CPI depending on the terms.

Reserve Bank of India sets limits to FPI investment in GOI securities, state development loans (SDLs) and corporate bonds.

State Development Loan (SDL)

State Governments also raise loans from the market through the RBI. SDLs are dated securities issued through an auction similar to the auctions conducted for dated securities issued by the Central Government. Interest is serviced at half-yearly intervals and the principal is repaid on the maturity date. Like dated securities issued by the Central Government, SDLs issued by the State Governments qualify for SLR. They are also eligible as collaterals for borrowing through market repo as well as borrowing by eligible entities from the RBI under the Liquidity Adjustment Facility (LAF).

DFIs or Development Banks

Financial institutions assume a critical role in the provision of long term credit. A development finance institution (DFI) can be broadly categorised as All-India or State / regional level institutions depending on their geographical coverage of operation. Functionally, All-India institutions can be classified as

- term-lending institutions (IFCI Ltd, IDFC Ltd., IIBI Ltd.) extending long-term finance to different industrial sectors
- refinancing institutions (NABARD, SIDBI, NHB) extending refinance to banking as well as non-banking intermediaries for finance to agriculture, SSIs and housing sector, respectively
- sector-specific / specialised institutions (EXIM Bank, TFCL Ltd., REC Ltd., HUDCO Ltd., IREDA Ltd., PFC Ltd., IRFC Ltd.)
- investment institutions (LIC, UTI, GIC, IFCI Venture Capital Funds Ltd., ICICI Venture Funds Management Co Ltd.). State / regional level institutions are various SFCs, SIDCs etc.

Historically, low-cost funds were made available to DFIs to ensure that the spread on their lending operations did not come under pressure. DFIs had access to soft window of Long Term Operation (LTO) funds from RBI at concessional rates. But with the onset of economic reforms in India when capital markets opened up for equity both within and outside the country, DFIs like ICICI, IDBI etc were largely bypassed and so on the basis of Khan Committee report in 1998, many of them became universal banks.

Merchant Banks / Investment Banks

They deal with companies and not with the retail public essentially. MBs manage and underwrite (underwriting an issue means to guarantee to purchase any shares in a new issue (IPO) or rights issue not fully subscribed by the public.) new public issues floated by companies to raise funds from public. They advise corporate clients on fund raising. They are also called investment banks (I banks).

Lehman Brothers (bankrupt since 2008), behind Goldman Sachs, Morgan Stanley are some global examples doing business in investment banking, equity, trading (especially U.S. Treasury securities), research, investment management, private equity and private banking.

They exist in India too. Some NBFCs are examples.

CIS

A Collective Investment Scheme (CIS) is an investment scheme in which several individuals come together to pool their money for investing in assets and share the returns from that investment. They exclude mutual funds and are regulated by the SEBI

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Alternative Investment Funds

AIFs is a newly created class of pooled-in investment vehicles for real estate, private equity and hedge funds. Angels are the new category of AIFs by SEBI. AIFs are basically funds established or incorporated in India for the purpose of pooling in capital from Indian and foreign investors for investing.

REITs

Securities and Exchange Board of India (SEBI) regulates Real Estate Investment Trusts (REITs). Like mutual funds, REITs pool in money from investors and issue units in exchange.

Money so collected is invested in commercial properties which are completed and generate income. The REIT has to first get registered and raise funds through an initial public offer or IPO. The minimum requirement for asset sizes permitted to be listed in India is Rs 500 crore. The minimum issue size of the initial public offer shouldn't be less than Rs 250 crore. Therefore, like stocks, investors will be able to buy units of REITs from both primary and secondary markets which are based on commercial real estate without actually having to buy those assets.

Mutual Funds

Mutual funds raise money from public and invest them in stock market securities; bonds etc. SEBI regulates mutual funds.

Hedge Fund

A hedge fund is like a mutual fund (MFs): both are investment vehicles which pool investors' money and invested as per the fund's mandate and returns are distributed among unit holders for a commission. However, hedge funds use strategies far more complex than a MFs. Hedge funds are less transparent. SEBI (Securities and Exchange Board of India) regulates them under alternative investment fund (AIF).

Venture Capital

Venture capital is money provided by financial institutions who invest in startups generally that have the potential to develop into significant economic contributors. The name comes from the fact that the enterprise has certain risk built into it.

Angel Investors

An angel investor or angel is an wealthy individual or firm that provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. They invest their own money unlike a venture capitalist who invests public money. They became popular after the web-based enterprises came up in the 1990's. With an aim to encourage entrepreneurship in the country by financing small start-ups, SEBI in 2013 notified norms for angel investors who are allowed to be registered as Alternative Investment Funds (AIFs) - a newly created class of pooled-in investment vehicles for real estate, private equity and hedge funds.

In order to ensure investment by angel funds is genuine, the Securities and Exchange Board of India (Sebi) restricted investment by such funds between Rs. 50 lakh and Rs 5 crore. Among other norms included, angel funds can make investments only in those companies which are incorporated in India. These funds need to be invested in a firm for at least three years, can invest in companies not older than 3 years. Angel funds are required to have a corpus of at least Rs 10 crore and minimum investment by an investor should be Rs 25 lakh. The regulator also stipulated that the fund must not have any family connection with the investee company.

The new norms would help in encouraging entrepreneurship in the country by financing small start-ups at a stage where such start-up finds it difficult to obtain funds from traditional sources of funding such as banks, financial institutions among others.

In 2016, GOI introduced a start-up policy which can get a stimulus from the angels.

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Private Equity

It is a firm that is issued equity privately. The quantum of equity thus issued is substantial. The PE firm stays invested for only some period of time- few years or so. PE firm also takes part in the management of the company. The aim is to boost the company for which the PE firm has the skills and experience.. The company may be listed or not. The placement of equity is private and not through an IPO. It generally has a lock in period during which they are not publicly traded on a stock exchange.

Hundi

A Hundi is a written order made by a person directing another to pay a certain sum of money to a person named in the order- bearer of the communication. Hundis were legal financial instruments and evolved in India. When banking did not develop so extensively, they were used in trade and credit transactions; as remittance instruments for the purpose of transfer of funds from one place to another. Hundis then served as travellers' cheques. They were also used as credit instruments for borrowing and as bills of exchange for trade transactions. Being a part of an informal system, hundis now have no legal status and were not covered under the Negotiable Instruments Act, 1881.

Chit Funds

A group of people save together and the fund that develops is used for investments to generate returns. From the fund, members who want to borrow can borrow. It is a kind of savings scheme. There are chit fund schemes organized by registered financial firms and also informally among friends and relatives. conducted by organised financial institutions, or may be unorganised schemes conducted between friends or relatives. Chit funds played an important role in the financial development of people of south Indian state of Kerala, by providing easier access to credit. In Kerala, chitty (chit fund) is a common phenomenon practiced by all sections of the society. A company named Kerala State Financial Enterprise exists under the Kerala State Government, whose main business activity is the chitty. These schemes are very popular in tier II and III towns in India and even in rural India, because under-penetration of banking services, as they are a way of raising quick money or catering for sudden liquidity needs or even a planned expenditure. They thrive as bank loans are very cumbersome and many are not eligible. Chit funds are governed by state or central laws. There is a central Chit Funds Act of 1982, apart from a number of state chit fund Acts. There is an office of "Registrar of Chit Funds" in every state that monitors operations which are quite stringent. Securities Laws (Amendment) Act, 2014 provides Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, (ponzi schemes) and gives guidelines for the formation of special fast trial courts.

QIPs

QIPs are eligible under "Qualified Institutional Placement" (which includes public financial institutions, mutual funds, foreign institutional investors, venture capital funds and foreign venture capital funds registered with the SEBI) to be sold shares/ fully convertible debentures/ partly convertible debentures or any securities which are convertible into or exchangeable with equity shares at a later date.

NBFC

NBFC means Non-banking financial company. A non-banking financial company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, housing finance, acquisition of shares/stock/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but does not include any institution whose principal business is that of agriculture activity, industrial activity. NBFCs are similar to banks; however they do not accept demand deposits.

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Some microfinance companies are registered as NBFCs and are regulated by the RBI while other MFIs are either registered as money lenders or Societies. An RBI-appointed panel headed by Y H Malegam had recommended setting up of a special category of NBFCs operating in the micro finance sector in 2011. These are called Non Banking Financial Company-Micro Finance Institution (NBFC-MFI).

The Reserve Bank of India (RBI) introduced a new category called Non-Banking Financial Company-Factors. Factoring is the business of selling invoices (receivables) to a factoring company (Factor) at a discount. Consequently, the selling corporate can get cash quickly and avoid risk of collecting debt. Factoring can be of two types: domestic and export oriented, the latter being called forfaiting. Forfaiting is the purchasing of an exporter's receivables (the amount importers owe the exporter) at a discount by paying cash. The forfaiter, the purchaser of the receivables, becomes the entity to whom the importer is obliged to pay its debt.

ECBs

ECB (External Commercial Borrowings) is an instrument used to facilitate the access to foreign currency by Indian corporations and PSUs (Public Sector Undertakings). ECBs include commercial bank loans, buyers' credit, credit from official export credit agencies and commercial borrowings from the private sector window of Multilateral Financial Institutions such as International Finance Corporation (Washington), ADB and Investment by Foreign Institutional Investors (FIIs) in dedicated debt funds. ECBs cannot be used for investment in stock market or speculation in real estate. The DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates ECB guidelines and policies. External Commercial Borrowings provide an additional source of funds to Indian corporates and PSUs for financing expansion of existing capacity and as well as for fresh investment to augment the resources available domestically. ECBs can be used for any purpose (rupee-related expenditure as well as imports) except for investment in stock market and speculation in real estate. Applicants are free to raise ECB from any internationally recognised source like banks, export credit agencies, suppliers of equipment, international capital markets etc. ECBs help diversify risk for the companies. Also, the interest rates are softer abroad. They help Indian companies with foreign funds. Country benefits as it has access to forex.

ECBs can be raised through two routes: Automatic Route and the Approval Route. The former does not require permit from the Regulator whereas the latter requires. RBI policy allows corporates registered under the Companies Act, 1956, except financial intermediaries such as banks, financial institutions (FIs), housing finance companies and Non-Banking Finance Companies (NBFCs) to access ECBs. NGOs engaged in micro-finance activities have been permitted to raise ECB up to certain limits. Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank are considered on a case-by-case basis.

The priority end use of ECBs includes investment (such as import of capital goods, new projects, modernization/expansion of existing production units) in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector, power exploration, telecom, railways, roads & bridges, ports and exports. ECB Policy helps source loans cheap; domestic liquidity constraints are eased; country gets forex; rupee slide could be contained; infrastructure benefits.

Euro Issues

Indian companies are permitted to raise foreign currency resources through issue of Foreign Currency Convertible Bonds (FCCBs), ordinary equity shares through Global Depository

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Receipts (GDRs) to foreign investors i.e. institutional investors or individuals (including NRIs) residing abroad. That is, Euro-issues include Euro-convertible bonds and GDRs.

Credit Default Swap

It is a form of insurance against debt default. When an investor buys corporate (or government) bonds he/she faces the risks of default on the part of the issuing agent. The investor can insure its investment in such bonds against default through a third party. The investor pays a premium to the party providing insurance. In the event of default by the bond issuer, the insurer would step in and pay the investor. A CDS is just like insurance, which is bought by those who fear default.

Infrastructure Debt Funds (IDFs)

IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, specially insurance and pension funds can invest through units and bonds issued by the IDFs. They can be set up either as a Trust or as a Company. A trust based IDF would normally be a Mutual Fund (MF), regulated by SEBI, while a company based IDF would normally be a NBFC regulated by the Reserve Bank. IDF-MFs can be sponsored by banks and NBFCs. Only banks and Infrastructure Finance companies can sponsor IDF-NBFCs.

FII's Investment in Debt

FIIs can invest in government and corporate debt- primary and secondary market. These limits and the rules are relaxed from time to time depending on the needs of the economy. FII debt is rupee debt.

Take-out Financing (TOF)

Banks collect deposits whose maturity essentially is 3-5 years but the infrastructure funding for roads, ports etc is for much longer periods. There is thus a mismatch. Thus came ToF. It came into effect in 2010. It is a method of providing finance for longer duration projects (for example, 15 years) by banks by sanctioning medium term loans (like 5-7 years). It is the understanding that the loan will be taken out of books of the financing bank within pre-fixed period, by another institution thus preventing any possible asset-liability mismatch.

Under this process, the institutions engaged in long term financing such as IDFC, agree to take out the loan from books of the banks financing such projects after the fixed time period when the project reaches certain previously defined milestones. On the basis of such understanding, the bank concerned agrees to provide a medium term loan- 5-7 years. At the end of the period, the bank could sell the loans to the institution and get it off its books. This ensures that the project gets long-term funding through various participants. Banks otherwise cannot lend for infrastructure as their deposits are for a short period and the loans are for a long period- asset liability mismatch.

External Sources of Finance For India

- Stock market like ADRs and GDRs
- ECB
- IBRD and IFC(separate Chapter)
- Private equity
- Bilateral loans by Governments abroad
- Masala bonds

STOCK MARKET

Companies need finance for their investment and other minor needs. They can either source it from their own reserves(profits) or borrow or raise share capital. Share capital is raised by issue of shares. The entire worth of the company is made up of the value of all the shares put together. The person who starts the company is called the promoter. He retains majority of shares generally and sells the rest to public.

The company may be a private limited company or public limited company. The number of shareholders in a private limited company is limited to a maximum of two hundred (Indian Companies Act 2013). Minimum is 2 persons. Public limited company is one where the company issues shares to the public at large- individuals and institutions through an IPO-initial public offering. The word 'limited' means that the liability of the company in case of winding up is limited to the assets of the company and not that of any other company of the group or the personal wealth of the promoters and other share holders.

In the case of the public limited company, the stock exchange becomes useful where the company is listed and its shares are traded.

A stock exchange is an organization which provides a platform for trading shares. In a stock exchange, investors through stock brokers buy and sell shares and other financial products in a wide range of listed companies. Thus, not only shares but also mutual funds, debentures, government securities and other financial products are traded on the stock exchanges.

Stock is the capital raised by a corporation, through the sale of shares. In common language, stocks and shares are used interchangeably. A shareholder is any person or organization which owns one or more shares issued by a company. Owning a share of a company is owning to that extent the company itself. Stock broker buys and sells for an investor as officially no one but the only the broker can do it.

The origin of the stock market dates back to the year 1494, when the Amsterdam Stock Exchange was first set up.

Importance of Stock Exchanges

- an efficient medium for raising long term resources for business
- help raise savings from the general public by the way of issue of equity / debt capital
- attract foreign investment
- exercise discipline on companies and make them strive to be profitable
- investment in backward regions for job generation
- another vehicle for investors' savings

Primary Market

The primary market is that part of the capital markets that deals with the issuance of new securities directly by the company to the investors by an initial public offering (IPO). If the company already issued shares and is going to the market again with a new issue, it is called Follow on Public Offer (FPO). At times, listed companies want to raise money by the issue of shares and opt for a rights issue where the existing shareholders are first offered additional shares at a price. They may accept or not.

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Secondary Market

The secondary market is the financial market for trading of securities that have already been issued in an initial public offering. Once a newly issued stock is listed on a stock exchange, investors and speculators can trade on the exchange as there are buyers and sellers.

Stock Exchanges in India

The first company that issued shares was the VOC or Dutch East India Company in the early 17th century (1602). India has millions of shareholders; thousands of companies listed on the stock exchanges and thousands of stock brokers. The Indian capital market is globally significant in terms of the degree of development and volume of trading and its tremendous growth potential.

There are 5 stock exchanges in the country: **Bombay Stock Exchange (BSE)**, **National Stock Exchange (NSE)**, **United Stock Exchange (USE)**, **MCX Stock Exchange Ltd (MCX-SX)** and **India International Exchange (INX)**.

Bombay Stock Exchange (BSE)

BSE is Asia's first stock exchange and the world's 11th largest stock exchange with an overall market capitalization of \$2.3 trillion (2018). More than 5000 companies are listed on the BSE.

BSE's popular equity index - the **S&P BSE SENSEX** (Formerly **SENSEX**) - is India's most widely tracked stock market benchmark index. It is traded internationally on the **EUREX** as well as leading exchanges of the **BRICS** nations (Brazil, Russia, China and South Africa).

BSE's automatic online trading system is known as **BOLT**. It went for an IPO in 2017 and got listed on NSE.

National Stock Exchange (NSE)

It is stock exchange located in Mumbai, India. **National Stock Exchange (NSE)** was established in 1992 and started trading in 1994. It was recognised as a stock exchange in 1993. NSE played a critical role in reforming the Indian securities market and in bringing transparency, efficiency and market integrity. NSE has a market capitalization almost equal to BSE though the number of companies listed is less than half of BSE. About 1600 companies are listed on it.

NSE was set up by a group of leading Indian financial institutions at the behest of the government of India to bring transparency to the Indian capital market. There are many domestic and global institutions and companies that hold stake in the exchange. Some of the domestic investors include **LIC**, **GIC**, **State Bank of India** and **IDFC Ltd.** Foreign investors include **Citigroup**.

The **Standard & Poor's CRISIL NSE Index 50** or **S&P CNX Nifty -Nifty 50** or simply **Nifty** is the leading index for large companies on the National Stock Exchange of India. The Nifty is a well diversified 50 stock index accounting for leading sectors of the economy.

The **CNX Nifty Junior** is an index for companies on the National Stock Exchange of India. It consists of 50 companies on the National Stock Exchange of India. It has the second tier of stocks in terms of market capitalisation (value of all the shares of a company added up at the latest price of the share).

NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India and between them are responsible for the vast majority of share transactions.

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Metropolitan Stock Exchange of India (MSE)

It was earlier known as MCX-SX. It commenced operations in 2008. But became a full-fledged exchange with equity trading in 2013. It went for an IPO in 2012.

United Stock Exchange of India (USE)

The United Stock Exchange of India (USE) is an Indian stock exchange. It is the 4th pan India exchange launched for trading financial instruments in India. USE's shareholders include 21 Indian public sector banks, private banks, international banks (Standard Chartered) and corporate houses. USE launched its operations in 2010 and deals in currency futures.

INX 2017

India International Exchange (INX) is India's first international stock exchange, opened in 2017. It is located at the International Financial Services Centre (IFSC), GIFT City in Gujarat. It is a wholly owned subsidiary of the Bombay Stock Exchange (BSE).

India INX is one of the world's most advanced technology platforms with a turn-around-time of 4 micro seconds which operates for 22 hours a day, allowing international investors and NRIs to trade from anywhere across the globe. India INX offers equity, currency, commodity and interest rate derivatives and proposes to offer depository receipts and bonds once the infrastructure is in place.

Sensex

Sensex or Sensitive Index is a weighted index composed of 30 companies with the base 1978-1979 = 100. It consists of the 30 largest and most actively traded blue chip stocks (profit making), representative of various sectors, on the Bombay Stock Exchange. Inclusion of the company is basically on the basis of market capitalization. The 30 companies in the index are revised periodically—some are replaced by others and new sectors may find representation as the economy evolves. The Sensex is generally regarded a mirror or barometer of the Indian stock markets and economy.

Demutualization

Mutualization refers to ownership and management of the exchange being combined in the same hands—brokers elected by the broker community from among themselves. Brokers are the owners of the BSE. Demutualization is when management and ownership are separated. Ownership is divested from the brokers and the company becomes a public company. All stock exchanges are to be demutualised according to the Government law made in 2004. Demutualization, thus means that ownership, management and trading rights are separated in a stock exchange.

BSE SME and NSE Emerge

BSE and NSE in 2012 launched their Small and medium-sized enterprises (SMEs) exchange platforms to enable small and medium enterprises to raise funds and get listed as public entities. While BSE started its SME platform under the brand name of BSE SME Exchange NSE platform is called 'Emerge'. The exchange provides an opportunity to small entrepreneurs to raise equity capital for growth and expansion. It also provides opportunity for investors to identify and invest in good SMEs at early stage.

SMEs have huge listing potential but had only debt-financing options, without any access to equity options. There is a general lack of awareness among SMEs about equity capital, stock markets and funding options, other than banks.

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Classification of companies listed in BSE

Group	Classification
A	Companies with large capital base, large shareholder base, and good growth record with regular dividends & greater volumes in secondary market.
B1	Relatively liquid scrips with good management & satisfactory growth prospects & volumes
F	Segment for Non-convertible debentures
G	Central and State Government Securities
Z	It comprises of companies not complying with clauses of the listing agreement and are not redressing the grievances of the investor.

Securities and Exchange Board of India (SEBI)

The capital markets in India are regulated by the Securities and Exchange Board of India. (SEBI) It was established in 1988 and given a statutory basis in 1992 through the Parliamentary Act-SEBI Act 1992. SEBI regulates the working of stock exchanges and intermediaries such as stock brokers and merchant bankers, accords approval for mutual funds, and registers foreign institutional investors (FII) who wish to trade in Indian stocks. Section 11(1) of the Sebi Act says that it shall be the duty of the Board to protect the interests of investors in securities.

SEBI promotes investor's education and training of intermediaries of securities markets like brokers, credit rating agencies, underwriters like the investment banks etc. It prohibits fraudulent and unfair trade practices relating to securities markets, and insider trading in securities, with the imposition of monetary penalties, on erring market intermediaries. It also regulates substantial acquisition of shares (like Life Insurance Corporation of India buying large number of shares in the IDBI Bank in 2018) and takeover of companies and calling for information from, carrying out inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self regulatory organizations in the securities market. SEBI has its head office in Mumbai and its three regional offices in New Delhi, Calcutta and Chennai.

SEBI's powers were enhanced in 2002 and 2014 - strengthen the SEBI's board, more full-time directors; given enhanced powers to conduct search and seizure etc. Rebi also regulates credit rating agencies.

SEBI and the Reforms

The Stock Exchange Scam of 1992 (Harshad Mehta) and the scam in 2000 (Ketan Parekh) led to various measures by the Government to protect the interests of the small investors. SEBI introduced reforms like improved transparency, computerisation, enactment against insider trading, restrictions on forward trading, introduction of T + 2 system of settlement etc. Steps taken by SEBI to strengthen markets are:

- SEBI introduced capital adequacy norms for brokers and rules for making client/broker relationship more transparent
- SEBI enforces corporate disclosures
- Enforces ban on insider trading
- Protects retail investors

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- SEBI is empowered to register and regulate mutual funds.
- introducing a code of conduct for all credit rating agencies operating in India.
- Clause 49 of the listing agreement that SEBI introduced mandates that all listed companies should have half the Directors on the Board as Independent Directors
- Making it mandatory to have anchor investors(one who is allotted substantial number of shares in an IPO and can not sell them on listing as his responsibility is to ensure that the listing is smooth and price is not manipulated)

Securities Laws (Amendment) Act 2014

Securities Laws (Amendment) Act 2014 is a legislation in India which provided the securities market regulator Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, especially ponzi schemes. It also provides guidelines for the formation of special fast trial courts.

SEBI's Role as Protector of Investors

Investors are the pillar of the financial and securities market putting the money in funds, stocks. If they are protected, the stock market's credibility grows; investment is more; millions more add to the investing public strength and so on. It thus very important to protect the interests of the investors. Investor protection involves prevention of malpractices. Securities and Exchange Board of India (SEBI) is responsible to safeguard the interests of the investors. SEBI published various directives, conducted many investor awareness programmes, set up Investor Protection Fund (IPF) to compensate the investors. Other measures are as follows:

- Registering and regulating the intermediaries of the business like brokers, portfolio managers, merchant bankers, etc.
- Recording and monitoring the work of credit rating agencies, etc.
- Registering investment schemes like Mutual fund & venture capital funds, and regulating their functioning.
- Keeping a check on frauds and unfair trading methods related to the securities market.
- Observing and regulating major transactions and take-over of the companies.
- Carry out investor awareness and education programme.
- Inspecting and auditing the exchanges (SEs)
- Assessment of fees and other charges.
- Banning insider trading
- Strengthening of corporate governance in the listed companies

Investor protection measures by SEBI follows the slogan 'An informed investor is a safe investor'. SEBI launched the Securities Market Awareness Campaign which covers major subjects like portfolio management, Mutual Funds, tax provisions, Investor Protection Fund, Investors' Grievance Redressal.

Capital Market Reforms

Since 1991 when the Government launched economic reforms, the following measures were taken

- SEBI given statutory status- that is Act of Parliament
- Electronic trade
- Rolling settlement to reduce speculation
- FIIs are permitted since 1992
- setting up of clearing houses

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- settlement guarantee funds at all stock exchanges
- compulsory dematerialization of share certificates so as to remove problems associated with paper trading; and speed up the transfer
- clause 49 of the listing agreement for corporate governance
- restrictions on PNs
- platform for msme
- law in 2014 strengthens SEBI
- merger of FMC with SEBI

Essentially, the government is involved in providing the regulator, SEBI, with more teeth to prevent and take action against market frauds, take steps to boost retail participation into equities and provide for a viable fund-raising option for SMEs – as also provide gains by tweaking tax structures in favour of the long term gains which is for investment and not speculation.

Types of Shares

There are essentially two types of shares: common stock and preferred stock.

Preferred stock is generally issued to investors like banks and others by the companies though retail investors are also eligible for them. They are preferred for the following reasons:

- In terms of dividend payment, generally, they are given dividends even if the common stock holders are not
- When the company is to be closed, preference stock holders are given money first from the proceeds of the sale of the assets of the companies and come immediately after the creditors
- They may have enhanced voting rights such as the ability to veto mergers or acquisitions or the right of first refusal when new shares are issued (i.e. the holder of the preferred stock can buy as much as they want before the stock is offered to others)

Derivatives

Derivative is a financial instrument. It derives from an underlying asset- securities, shares, debt instruments, commodities etc. The price of the derivative is directly dependent upon the value of the underlying asset in the present and the projected future trends. Futures and options are the two classes of derivatives.

Futures

Futures are financial instruments based on a physical underlying (commodity, equities etc.). A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future for a certain price.

Futures are different from forwards as the former are traded on exchange while the later may be merely a signed contract between two parties (OTC, over the counter)

Options are a class of futures where the buyer or seller has the option whether to buy or not – put option is the right but not the obligation to sell. Call option is right but not the obligation to buy.

Buyback of Shares

Buyback of shares is the process of a company's repurchase of stock it has issued at a price that is usually higher than the market price. In the case of stocks, this reduces the number of shares outstanding, giving each remaining shareholder a larger percentage of ownership of the company. This is usually considered a sign that the company's management is optimistic about the future and believes that the current share price is undervalued.

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Reasons for buybacks include

- Boosting the share price
- Giving share holders an exit at a relatively attractive price in a dull market
- putting unused cash to use

Shares bought back need to be cancelled (extinguished) and thus the total equity shrinks and the shareholders benefit. Buyback price is more than the market prices. Companies can buy back with the reserves but can not borrow to buyback. It is allowed in India since 1998. The government has encouraged cash—surplus PSUs to go for share buybacks to meet its disinvestment target. GOI benefited from the buyback operations of Coal India Ltd (CIL) and Engineers India Ltd in 2017.

Anchor Investor

Anchor investors or cornerstone investors (as they are called globally) are institutional investors like sovereign wealth funds, mutual funds and pension funds that are invited to subscribe for shares ahead of the IPO to boost the popularity of the issue and provide confidence to potential IPO investors. The benefit for institutional investors applying in anchor quota is that they get guaranteed allotment. Anchor investors, however, cannot sell their shares for a period of 30 days from the date of allotment as against IPO investors who are allowed to sell on listing day.

Global Depository Receipts (GDR)

Indian companies are allowed to raise equity capital in the international market through the issue of Global Depository Receipt (GDRs). GDRs are designated in foreign currency. The proceeds of the GDRs can be used for financing capital goods imports, capital expenditure including domestic purchase/installation of plant, equipment and building and investment in software development, prepayment or scheduled repayment of earlier external borrowings, equity investment in JVs in India etc. GDRs are listed on London SE or Luxembourg or elsewhere. They are also called euroissues in a general sense.

American depository receipts (ADRs)

American depository receipts are like GDRs but the investors are from America and listing is on an American stock exchange like Nasdaq or New York stock exchange. They are issued to US retail and institutional investors. They are entitled like the shares to bonus, stock split and dividend. Like GDRs, they help raise equity capital in forex for various benefits like expansion, acquisition etc. ADR route is taken as non-USA companies are not allowed to list on the US stock exchanges by issuing shares. For almost all purposes, ADRs are like shares.

Similarly with Indian Depository Receipts (IDRs) - non-Indian companies issue them.

Difference between FDI and FII

FDI is involved in setting up firms to produce goods and services. That is why it is called "direct" institution. FII on the other hand buys financial assets for profits. In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), it was decided to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI.

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Foreign Portfolio Investor (FPI)

In 2012, SEBI had constituted K. M. Chandrasekhar committee to rationalize/harmonize various foreign portfolio investment routes and to establish a unified, simple regulatory framework. Based on the committee report, in 2014, new FPI Regime came into effect from.

Highlights are:

- Portfolio Investment by any single investor or investor group cannot exceed 10% of the equity of an Indian company, beyond which it will now be treated as FDI.
- FIIs, Sub-Accounts and QFIs are brought together to form the new investor class, Foreign Portfolio Investors
- FPIs are permitted to invest in Government Securities with a minimum residual maturity of one year. It means, FPIs have been prohibited from investing in T-Bills.

FIIs

Foreign Institutional Investor (FII) means an institution established or incorporated outside India which proposes to make investment in securities in India. They are registered as FIIs with the SEBI (FII).

FIIs include banks, insurance companies, retirement or pension funds, and mutual funds. FIIs are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS). The ceiling for overall investment for FIIs varies from company to company.

Reasons for FIIs having India as a favourite destination

- growing economy
- corporate profits are high
- government policies are encouraging
- well developed stock market
- sound regulation by SEBI

FII investment is referred to as hot money for the reason that it can leave the country at the same speed at which it comes in.

QFIs

A QFI is an individual, group or association resident in a foreign country that is a member of Financial Action Task Force (FATF) or a country that is a member of a group which is a member of FATF and a country that is a signatory to International Organization of Securities Commission's (IOSCO). Till 2012, they were investing in India through the FIIs registered with the SEBI. From 2012, they are allowed to invest in India directly for which Sebi and RBI have made the necessary rules. They are a part of FPI from 2014. They can invest in corporate debt, equities and mutual funds. Its aim is to widen the class of investors, attract more foreign funds and reduce market volatility and deepen the Indian capital market. QFIs need not register with Sebi.

FATF

The Financial Action Task Force (on Money Laundering) (FATF) is an intergovernmental organization founded in 1989. The purpose of the FATF is to develop policies to combat money laundering and terrorism financing. The FATF Secretariat is housed at the headquarters of the OECD in Paris. FATF is responsible for setting global standards on anti-money laundering (AML) and combating financing of terrorism (CFT).

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Following its inclusion in 2010, India and its tax enforcement authorities — the Financial Intelligence Unit, the Enforcement Directorate, the Central Economic Intelligence Bureau and the Directorate of Revenue Intelligence — would be able to exchange vital information from member-countries on money laundering and terrorist financing activities.

Sub account

"Sub-account" includes foreign corporates or foreign individuals and those institutions, established or incorporated outside India and those funds, or portfolios, established outside India on whose behalf investments are proposed to be made in India by a Foreign Institutional Investor (FII).

IOSCO

The International Organization of Securities Commissions (IOSCO) is an association of organisations that regulate the world's securities and futures markets.

Members are the Securities Commission like Sebi or the main financial regulator from each country. IOSCO has members from over 100 different countries, who regulate more than 90 percent of the world's securities markets. The organisations role is to assist its members to promote high standards of regulation and act as a forum for national regulators to cooperate with each other and other international organisations. India is a member. IOSCO is has a permanent secretariat based in Madrid.

Sustainable Stock Exchanges (SSE)

The Sustainable Stock Exchanges (SSE) initiative is a project of the United Nations (UN) co-organized by the United Nations Conference on Trade and Development (UNCTAD), the United Nations Global Compact, the United Nations Environment Programme Finance Initiative (UNEP-FI) and the UN-supported Principles for Responsible Investment (PRI). Other key stakeholders include the World Federation of Exchanges (WFE), and the International Organization of Securities Commissions (IOSCO).

The SSE provides a multi-stakeholder learning platform for stock exchanges, investors, regulators, and companies to adopt best practices in promoting corporate sustainability. In collaboration with investors, regulators, and companies, they strive to encourage sustainable investment.

Participatory Notes (PN)

In India, FIIs are allowed to invest in the capital market. Some foreign funds and individuals use these PN instruments for participation in Indian stock markets.

Those who buy participatory notes are not required to register with SEBI (Securities and Exchange Board of India). FIIs sell these notes to them based on the money they contribute. They are tradeable. PNs are offshore derivative instruments. Participatory notes are popular because they provide a high degree of anonymity, which enables large hedge funds to carry out their operations without disclosing their identity and the source of funds. KYC (know your customer) norms are not applied here.

Since the source of funds is not revealed, the PNs are potentially unsafe. Therefore, SEBI in imposed certain conditions like limits on the PNs that a single FII can issue etc. SEBI wants the PN holders to register with the SEBI and invest directly as India is a long term growth story. Sebi policy paid off with the number of FIIs registering with the regulator going over time to about 2000. The SEBI action aims at ensuring that the quality of flows into stock markets and Indian forex market is clean.

Clearing House

An organisation which registers, monitors, matches and guarantees the trades of its members and carries out the final settlement of all transactions on the stock exchanges. When a buy order in an exchange matches with a sell order, a trade is generated. The central counterparty steps in between the buyer and the seller and acts as a buyer to every seller and a seller to every buyer guaranteeing settlement of trades. This process is called novation. Clearing corporations maintain funds for guaranteeing trades, settlement and in case a buyer or a seller defaults.

National Securities Clearing Corporation Ltd (NSCCL), Indian Clearing Corporation Ltd (ICCL) and MCX-SX Clearing Corporation Ltd (MCX-SXCCL) are examples. The three corporations clear and settle trades in securities or other instruments/ products traded on the stock exchanges.

Clearing Corporations are designated as Market Infrastructure Institutions for oversight considering its systemic importance in securities markets regulated by the SEBI.

They are also subject to rules and regulations that are based on International Organisation of Securities Commissions' (IOSCO) Principles.

Demutualisation

BSE was begun in 1875 and was owned and managed by the brokers. Thus the three functions were in the same hands involving conflict of interest. Scams took place as a result. It meant that investors would not trust the platform and that was a barrier to the development of stock market. Therefore, GOI made a law that all stock exchanges should be demutualised-corporatised. Board of Directors who are professionals should manage it. Brokers could only own some part of equity.

Securities and Contract (Regulations) Act was amended. Representation of brokers in the governing body of a corporatised exchange should not exceed 25%, while their holding should not exceed 49% of the capital.

BSE did so and in fact as mentioned elsewhere in the chapter, BSE went public in 2017 and thus became a public limited company. NSE from inception has been a corporate entity.

Commodity Exchanges

Commodity exchanges are institutions which provide a platform for trading in 'commodity futures' like stock exchanges provide space for trading in equities. They play a critical role in price discovery where several buyers and sellers interact and determine the most efficient price for the product. Indian commodity exchanges offer trading in 'commodity futures' in a number of commodities. Presently, the regulator, SEBI allows futures trading in over 120 commodities.

Currently 6 national exchanges, viz. Multi Commodity Exchange, Mumbai (MCX), National Commodity and Derivatives Exchange, Mumbai (NCDEX), National Multi Commodity Exchange, Ahmedabad (NMCE), Indian Commodity Exchange Ltd., Mumbai (ICEX), ACE Derivatives and Commodity Exchange, Mumbai (ACE) and Universal Commodity Exchange Ltd., Navi Mumbai (UCX), operate forward trading in commodities. Besides, there are 11 Commodity specific exchanges recognized for trading in various commodities approved by the Commission under the Forward Contracts (Regulation) Act, 1952.

The commodities traded at these Exchanges comprise the following:

- Edible oilseeds complexes like Mustard seed, Cottonseed, Soybean oil etc.
- Food grains – Wheat, Gram, Bajra, Maize etc.
- Metals – Gold, Silver, Copper, Zinc etc.

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- Spices – Turmeric, Pepper, Jeera etc.
- Fibres – Cotton, Jute etc.
- Others – Sugar, Gur, Rubber, Natural Gas, Crude Oil etc.

Gold, Crude oil, Silver, Copper, Natural Gas, Lead, Soy Oil, Zinc, Soybean and Castor seed are the prominently traded commodities.

FMC

Forward Markets Commission (FMC) that was headquartered at Mumbai was a regulatory authority, which was overseen by the Ministry of Consumer Affairs and Public Distribution, Govt. of India. It was merged with the Securities and Exchange Board of India in 2015. The Forward Contracts Regulation Act (FCRA) stands repealed, and the regulation of the commodity derivatives market shifts to Sebi under the Securities Contracts Regulation Act (SCRA), 1956. SCRA is a stronger law, and gives more powers to Sebi than FCRA offered to FMC. It means that commodity markets will now be better regulated, with more stringent processes — and will thus evoke greater confidence. The FMC only regulated the exchanges and had no direct control over brokers. SEBI has a far superior surveillance, risk-monitoring and enforcement mechanism that will give more confidence to investors, and may help businesses grow.

Depository

A depository holds securities (like shares, debentures, bonds, Government Securities, units etc.) of investors in electronic form. Besides holding securities, a depository also provides services related to transactions in securities. Benefits of a depository are reduction in paperwork involved in transfer of securities, reduction in transaction cost.

National Securities Depository Limited (NSDL)

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. NSDL is the first depository in India. NSDL offers facilities like dematerialisation i.e., converting physical share certificates to electronic form; rematerialisation i.e., conversion of securities in demat form into physical certificates etc.

Important Indices in the World

— Market index is a number to indicate the average movement of prices of a securities market. It usually tracks select stocks.

- Nasdaq
- American Dow Jones Industrial Average
- American S&P 500 Index
- British FTSE 100 (Fotsie): It is a share index of the 100 most highly capitalised companies listed on the London Stock Exchange. The index is maintained by the FTSE Group, an independent company which originated as a joint venture between the Financial Times and the London Stock Exchange.
- French CAC 40
- German DAX
- Ibex for Spain
- Japanese Nikkei
- Australian All Ordinaries
- Hong Kong Hang Seng Index
- South Korea's Kospi
- Straits Times Index (STI) of Singapore

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- Bovespa Index
- RTS Index (RTSI) is an index of 50 Russian stocks that trade on the RTS Stock Exchange in Moscow
- SSE (Shenzhen Stock Exchange) Composite Index- China
- SSE (Shanghai Stock Exchange) Composite index-China

Nasdaq

Nasdaq stands for the National Association of Securities Dealers Automated Quotation System. It is an electronic stock market- first in the world- run by the National Association of Securities Dealers. Many of the stocks traded through Nasdaq are in the technology sector.

Dow Jones Index

The New York Stock Exchange (NYSE) index. Currently there are three Dow Jones Indices: The Dow Jones Industrial Average (DJIA). The Dow Jones Transport Average (DJTA) and finally DJUA (Dow Jones Utility Average).

In recent years, broader indices such as the Standard & Poor's 500 (for large companies), the Russell 2000 (for smaller companies) and the Wilshire 5000 (for an especially broad measure) have gained currency, in part due to the rising popularity of index investing

Decoupling

It means that a nation's economy may have an autonomous logic and need not be entirely dependent on the global economy. For example, if the world goes into a recession, all countries need not have their stock markets collapse beyond a point. India, for example grew at 6.7% (2008-09) while the USA and the west were contracting. Reflecting the economic realities, equity markets also perform autonomously after a point. It is called decoupling- that is, isolation from the rest. China is more integrated with the world as its economy is driven by exports. However, even China is decoupled as it has a lot of domestic consumption driving its growth.

Clause 49

Clause 49 of the Listing Agreement to the Indian stock exchange came into effect in 2005. It has been formulated for the improvement of corporate governance in all listed companies as it mandates that there should be certain independent directors on the Board of a Company.

Shariah Index

Bombay Stock Exchange (BSE) launched its Shariah index in 2010. The index has 50 stocks selected from the BSE-500 bracket. Infrastructure, capital goods, IT, telecom and pharmaceuticals shares will form a large chunk of the 'BSE Tasis Shariah-50 Index', as the new index is known. The new index attracts investments from Arab and European countries, where Shariah funds are already popular. Shariah, the religious law of the followers of Islam, has strictures regarding finance and commercial activities permitted for believers. Arab investors only invest in a portfolio of 'clean' stocks. They do not invest in stocks of companies dealing in alcohol, conventional financial services (banking and insurance), entertainment (cinemas and hotels), tobacco, pork meat, defence and weapons.

BRICS Cooperation Among Exchanges

In 2011 seven major stock exchanges in Brazil, Russia, India, China and South Africa announced plans to cross-list derivatives on their benchmark indexes. The five founding members of the BRICS Exchanges Alliance began cross-listing benchmark equity index derivatives on each others trading platforms from 2012. The five exchanges, BOVESPA from Brazil, MICEX from Russia, BSE from India, Hong Kong Exchanges and Clearing Limited (HKEx) from China, and

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JSE Limited from South Africa, announced the formation of the alliance. In this initial stage of implementation, the exchanges aim to expand their product offerings beyond their home markets and give investors of each exchange exposure to the dynamic, emerging, and increasingly important BRICS economies.

Power Exchanges

A power exchange is an institution that is responsible for conducting auctions to sell power at competitive market prices. Central Electricity Regulatory Commission (CERC) permitted trading of Electricity through Power Exchange in 2008. Currently, two exchanges viz. Indian Energy Exchange (IEX) and Power Exchange of India Limited (PXIL) are in operation in India which facilitate an automated on-line platform for physical day-ahead contracts. It is the core of an electricity market which is a system for effecting purchases, through bids to buy and sell. It would bring about efficiency as well as liquidity as power companies bought and sold electricity.

Stock markets and macro-economy

It can be argued that stock markets reflect the larger economy. Following points can be presented in favour

When the economy does well, companies make profits, give bonuses and dividends and thus share holders will benefit. Based on this logic, there is demand for shares and thus markets will go up and vice versa.

It can be seen that when the recession took place in 2008, all over the world, stock markets crashed.

It is said that all companies are not listed. But it does not diminish the mirror effect as the companies that are listed are a fair cross-section of the whole economy.

It is further said that agriculture is not represented. But the fact is some agro companies are listed and the performance of the macro-economy is based on agriculture as well. Thus, the dynamics of agriculture are factored in.

Liquidity – the money that is chasing stocks- exaggerates the valuations.

Political factors also have an impact by way of stability and the priorities.

However, stock markets are influenced by psychological factors like greed and fear and that partly distorts the valuations but the trend is not violated.

Indian Stock Market performance

The reasons are Indian stocks to do well are both global and domestic

- Economic growth and potential is sound
- Large market
- Under-tapped in the sense that a large section of society is yet to enter the market
- World class infrastructure for trading
- Credible regulation by Sebi
- Market-friendly policies
- Allowing QFIs, sub accounts and PNs
- Global liquidity flows due to loose money policies like QE

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Mutual Fund

Mutual fund – a financial intermediary that collects money from a large number of investors, to invest in capital market so as to generate returns for the investors. Mutual fund does it for a fees. There are two types of MFs.

- Open-ended Funds
- Closed-ended Fund

Open-ended or open mutual funds issue shares (units) to the investors directly at any time. The price of share is based on the fund's net asset value. Open funds have no time duration, and can be purchased or redeemed at any time on demand, but from the Fund office itself and not on the stock market.

Closed-ended means only a fixed number of shares (units) are issued in an initial public offering which may be called New Fund Offering (NFO). They trade on an exchange. Share prices are determined not by the total net asset value (NAV), but by investor demand. Once the offering closes, new shares are rarely issued. They can be traded only on the secondary market (stock exchanges).

Share

Share is a certificate representing ownership of the company that issued it. Shares can yield dividends and entitle the holder to vote at general meetings. The company may be listed on a stock exchange. Shares are also known as stock or equity. It can be split if the price is too high to make everyone afford it. If the company does well, there may be bonus shares issued to the existing holders.

Bond

A secured debt instrument issued for a specific period at a fixed or floating rate of interest for raising capital by borrowing.

Debenture

Debt not secured by a specific asset of the corporation, but issued against the issuer's general credit (good will, reputation) - that is, it is unsecured debt. Investment earns an interest for the debenture holder. The following are various types of debentures

- convertible debentures can be converted into equity at a future date
- Non-convertible debentures will not be converted
- Partly convertible debentures will have some part converted into shares.

Bear

Bear is an investor who believes that market will go down.

Bull

Bull is an investor who believes that the market will go up- optimistic

Bear Market

A prolonged period of falling stock prices usually preceding or accompanied by a period of poor economic performance known as recession or slowdown.

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Bull Market

A stock market that is characterized by rising prices over a long period of time. It represents a period of investor optimism, lower interest rates and economic growth. The opposite of a bear market.

Blue Chip

Blue chip shares are the shares of the companies that are the most valuable. Companies that are profit making; usually dividend –paying and are liquid in the market- that is there is almost always in demand on the market.

Largecap, Midcap or Small cap Company

Generally, companies with a market capitalization that is very high are called large caps and the next rung below is mid cap and the bottom one is small cap companies. Limits are not statutorily laid down and vary from institution to institution.

Retail Investor

A retail investor is one who applies for shares worth less than Rs.2 lakh in any IPO, according to Sebi. Sebi allows price discount for retail investors. This discount is offered to attract retail investors into the market and broad base ownership.

Negotiated Dealing System

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments.

Short Selling

The sale of a security made by an investor who does not own the security. The short sale is made in expectation of a decline in the price of a security, which would allow the investor to then purchase the shares at a lower price in order to deliver the securities earlier sold short.

Market Capitalization

Price per share in the market, latest price, multiplied by the total number of shares of the company.

MPS Norms —

SEBI mandated that there should be 25% minimum public shareholding (MPS) by all listed companies.

Sweat equity

It is the large amount of shares that the Directors of a company are issued for their contribution to the intellectual property of a company that is locked in for some time and may be sold later.

Insider Trading

Insider trading occurs when any one with information related to strategic and price-influencing information purchases or sells stocks so as to make speculative profits. SEBI punishes those who are involved in insider trading.

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BALANCE OF PAYMENTS

Balance of payments (BOP) is the overall statement of a country's economic and financial transactions with the rest of the world over a specific period- usually one year. It includes all outflows and inflows (payments and receipts). If financial outflows are more, it is a BOP deficit and if inflows are more it is a surplus. Balance of payments can be broken down into balance of trade (export & import of goods); balance of current account (includes the balance of trade, the balance of services and remittances; and balance on capital account (investment and borrowing). Trade account is a part of the current account. Capital account deals with investment and borrowings and the rest of the BOP is the current account.

India's Balance of Payments (BOP) Crisis in 1991

The beginning of 1990s saw major BOP crisis due to many factors like Gulf war and the cumulative problems of the Indian economy. It led to an IMF-sponsored bail out.

India has been dependent on crude imports. International crude prices are very crucial for our BOP condition. When there was geopolitical disturbance due to Iraq crisis, crude prices shot up as our import bill. Tourism dropped. It depleted our foreign exchange reserves. International rating agencies downgraded India. This fuelled the crisis further as India's credit worthiness plunged and there were no ready international lenders. A substantial outflow of deposits held by Non-resident Indian during 1990-91 added to the crisis. Reserves declined to a low of \$0.9 billion in January 1991. India had to pledge gold in May 1991 and again in July 1991 to avoid a default on its short term obligations. Further, in 1991, India attracted forex through India Development Bonds and Foreign Exchange Immunity Scheme.

Confidence building measures were taken up after the new Rao government was formed in June 1991. The rupee was devalued and brought closer to the market value as earlier it was artificially overvalued. International investors saw in this reform progress towards market orientation. Indian exporters felt encouraged as their earnings in foreign currency would fetch them more rupees.

Devaluation is a precursor to the beginning of rupee convertibility.

Some steps were taken to stabilize the economy with immediate access to foreign currency like India Development Bonds and Foreign Exchange Immunity Scheme. IMF loan was also one of them. Some more were taken to restructure the economy- structural adjustment so that the economy is put on a competitive path by opening up.

Devaluation And Depreciation

Exchange rate of a currency is defined as the price of one currency in terms of another currency. It may be fixed by the central bank or left to the market forces of demand and supply. Indian rupee had a fixed rate. When the value is changed by the central bank, it is called devaluation if it is made cheaper and revaluation if it is made stronger. Cheaper means more of rupees for a dollar, for example. Stronger means less of rupees for a dollar. Thus, loss of value due to central bank decision to lower it is called devaluation. If market forces bring down the value due to demand falling behind supply of the currency, depreciation is the result. Depreciation and evaluation have the same effect but the method is different- the former is driven by market forces and the latter by administered rate of the central bank (RBI).

When RBI fixes the rate, it is called fixed-rate.

When market forces operate, it is called floating exchange rate.

When the central bank increases the value of the currency, it is called revaluation. Same increase in value taking place as a result of market forces of demand and supply makes it appreciation.

Convertibility of Rupee

Convertibility of a currency means giving freedom to the holders of the currency to convert them freely into other currencies at the prevailing market rate. For example, one who has Indian rupees can convert them into foreign currencies if rupee is convertible.

Balance of payments lists covers a vast number of transactions from trade, remittances by foreign workers to loans and investment. All these transactions of a country with the rest of the world are classified broadly into current and capital accounts as indicated above. Current account includes foreign trade in physical goods (merchandise) and invisibles which are foreign trade in services like software, knowledge process outsourcing based earnings, consulting services, shipping services, tourism, and royalty on patents; and also movements of money without exchange for goods or services called 'remittances' and may include money sent from one country to another by an individual, business, government or non-governmental organisations (NGO) – like charities. India has been the topmost country for remittances sent by its diaspora. It includes what is sent as a part of what is earned as wage, interest, profit or rent.

In the BOP when one overlooks the current account part that is detailed above, the rest is loan and investment and that is called the capital account. The same information helps us to differentiate between balance of trade and the balance of payments. 'Balance of trade' is the foreign trade part of the overall balance. Trade is a part of current account. But current account also includes remittances. Thus, BOP covers current account and capital account.

Convertibility can be permitted on both current and capital accounts in a limited manner or more liberally. Limitation is by way of depth and spread. If 100% FDI is allowed in a sector, it refers to depth on capital account. If more sectors are opened for FDI it refers to spread. In other words, former is vertical and the latter horizontal.

Convertibility has many advantages as we will see when discussing Tarapore committee.

No country grants full convertibility – opens up for some sectors; restricts it for certain purposes and excluding certain other purposes. For example, the trade account convertibility is confined to exports and imports and certain associated aspects like remittances (what Indians living abroad send to their friends and relatives in India), tourism, etc. Even here, restrictions are imposed after a point. The larger the scope of convertibility that is permitted by a country, the stronger and the more resilient its economy is said to be, according to its advocates.

Rupee Convertibility

The rupee's external value was regulated by the Reserve Bank of India till 1992. Unlike in the developed countries where, where by and large, the market forces dictate the exchange rate of the currency, the rupee was artificially valued by the RBI because the country did not have a policy that is pro-exports or pro-FDI.

Devaluation of the rupee was done by the RBI in 1991 to set the stage for convertibility. The rupee was made partially convertible in 1992, under which 40 per cent of the foreign exchange earnings were to be traded at the official exchange rate and the remaining 60 per cent could be converted at market determined exchange rates. It was the dual exchange rate system of 40:60 and was known as partial convertibility of rupee (PCR) and was a part of Liberalised Exchange Rate Management System (LERMS) that was introduced in 1992. Rupee was made fully convertible on the trade account in 1993 and it was further extended to current account in 1994. Thus, India assumed obligations under Article VIII of the International Monetary Fund, as a result of which, India is committed to adopt current account convertibility. The measures helped in international investors reposing faith in Indian economy.

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India's response to the crisis was essentially aimed to build confidence of the international investing community in India. Foreign institutional investments (investments into financial assets like shares, bonds etc) were permitted and Indian companies were permitted to raise resources in the international capital markets in the form of GDRs. Norms for foreign direct investments were liberalised and multinational companies were wooed by Central/state governments to invest in white goods (consumer durables), infrastructure and other projects. The dramatic change in the environment led to a surge in capital flows. Foreign investments into India improved perceptibly.

Convertibility has the following dimensions:

- Freedom to convert
- Convert at market rate
- liberalization of flows. It means convertibility for more purposes (like FDI in retail); higher or no caps on existing convertibility regime (49% FDI in insurance etc); more of automatic than approval route
- Liberalization of outflows from India. Indians being allowed greater freedom to take their money abroad.

The fuller the convertibility, the more the above four items are relaxed.

Current account convertibility is relatively risk free as it can be regulated. It refers to freedom to convert domestic currency into foreign currency and vice versa for the following purposes:

1. exports and imports in goods
2. export and import of services
3. remittances

Capital Account convertibility is a major structural reform. It means FDI/FPI being allowed into more areas and more in percentage terms too. For example, foreign investment in India; how much Indian companies can borrow. Similarly, Indians to open bank accounts in foreign countries; invest abroad; hold assets abroad etc. It is a challenge and needs to be sequenced well depending on the ability of the economy to absorb it. For example, Walmart.

Full Convertibility

Full convertibility means freedom to convert rupee into foreign currency and vice versa for both current and capital account purposes with least restrictions. That means, in the capital account, there should be close to 100% FDI and FPI allowed across as many sectors as possible (except security related areas). Similarly, there should be very liberal regime for outflows- that is, Indians can invest abroad and borrow from abroad. There should be no controls on current account transactions either.

Full convertibility is not practiced anywhere in the world but many advanced countries aim for it. India has a large measure of capital account convertibility for foreigners and NRIs for investing in India and taking out profits relating to FDI, portfolio investment and NRI bank deposits in India. For Indian residents and corporates, some limits still exist on how much they can invest abroad. Indian companies also need RBI permission to borrow funds from abroad for some designated purposes. The controls are being relaxed.

Benefits of fuller convertibility

First, India needs huge resources, especially to upgrade its infrastructure. Domestic savings alone are not enough. More foreign funds would come in only if they are sure of free entry and exit.

Second, Indian businesses (especially, the established companies) would be able to access cheaper foreign funds that would improve their international cost competitiveness.

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Third, Indian banks would be able to borrow foreign funds at lower rates which would, in turn, enable them to lend at a lesser rate to Indian small and medium enterprises which may not otherwise be able to borrow directly from the international capital market.

Fourth, access to foreign funds would facilitate Indian companies taking over firms abroad and developing more Indian MNCs in the process. For example, Tatas acquiring Jaguar.

Fifthly, it exerts macro-economic discipline.

Sixthly, ordinary Indian investors would be able to further diversify their asset portfolios as we allow them to invest abroad. Outflows are necessary to balance the inflows or the problem of appreciation will plague the economy. Otherwise Dutch disease may result. Netherlands experienced Dutch disease as a result of its discovery of oil and related fuels in 1960s. The foreign exchange inflows led to the Guilder appreciating so much that the imports shot up and the competitiveness of Dutch industry was affected adversely. Exports suffered and imports increased due to appreciation. Deindustrialization is the result. The Dutch disease is something similar to what the emerging market economies have experienced due to capital inflows, particularly of the portfolio variety.

Further, all advantages of FDI will be available-technology, investment and trade accrue.

There will be macro economic discipline.

Fears are

- As the east Asian financial crisis(1997) and the global financial crisis(2008) show, adoption of fuller convertibility should be calibrated or it can be quite destabilizing
- Domestic interests are hurt as it can create unemployment. For example, FDI in retail.
- Rupee still not being a hard currency, can be subject to volatility with serious effects as we have seen in October 2018

- FDI hike in defence has national security effects

In order to minimize the ill effects of full convertibility the following prerequisites need to be ensured

- Fiscal deficit should be minimal
- Forex reserves should be adequate
- NPAs of banks should be minimal
- Inflation and interest rates should be moderate

Unless these conditions are met, great steps towards fuller convertibility should be kept on hold.

Tarapore Committee on CAC

Tarapore Committee on CAC that was set up in 1997 and gave a road map for introduction of capital account convertibility. The objective of the committee was to study economies that had implemented capital account convertibility and understand the prerequisites for it. They had to make recommendations on the measures to be taken and the time frame to achieve full capital account convertibility.

The report noted that India had adopted current account convertibility in 1994. It also noted that capital account convertibility already existed for foreign investors, both direct and portfolio, non-resident depositors and Indian corporates which take external commercial borrowings (ECB). The report said that implementing capital account convertibility would increase capital inflows and bring in all the other advantages cited above. The report said that the time was appropriate

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for India to take some steps towards it but it should be done only when the prerequisites are met otherwise the CAC is a double edged sword. The report said that the move should be phased. The transition from one phase to the next should be made, only if certain preconditions are met. The preconditions were reduction of fiscal deficit, keeping the inflation in a 3-5% range and reforming the financial sector, including reduction of non-performing assets.

But it could not be implemented as East Asian currency crisis struck in 1997.

Capital Account Convertibility Relaxations So Far

Capital account transactions continue to be regulated under the FEMA which is a highly liberalized version of the earlier FERA.

Foreign direct investment, barring a few strategic industries is put on automatic route, with most of the sectors permitted to have ever increasing foreign equity participation.

- The foreign portfolio investment by FIIs is allowed liberally.
- The external commercial borrowings (ECB) no longer require the RBI or Ministry approval up to a value.
- Inflows are liberalized far more than outflows for reasons of deterring capital flight and ensuring BOP security.
- Overseas investment limit for Indian companies enhanced.
- ceiling on overseas investment by mutual funds enhanced.
- Prepayment limit of external commercial borrowings (ECBs) without prior Reserve Bank approval increased.
- an Indian citizen can invest up to \$2,50,000 per year in foreign markets

Tarapore II on Fuller Rupee Convertibility 2006

The committee was set up to explore the need and feasibility and the cautions to be observed about opening up the convertibility door further. Tarapore Committee on Fuller Convertibility that presented its report in 2006 recommended that India should make the rupee more freely convertible over the next five years to realize the country's "maximum" economic potential. Tarapore committee said that in view of the huge investment needs of the country and that domestic savings alone will not be adequate to meet this aim, inflows of foreign capital become imperative. The shift toward fuller convertibility should be phased. But, before making the rupee more freely tradeable, India must "improve regulatory and supervisory standards across the banking system".

The report sought a ban on participatory notes as a mode of investment in Indian equities and easing the direct investment routes for foreigners. It suggested that foreign individuals investors should be brought at par with non-resident Indian investors. The committee recommended the restrictions on overseas borrowings by Indian firms and banks be eased. It said that the limit on outbound remittances by Indian citizens should be increased. It also recommended that the fiscal deficit be brought under control otherwise a large deficit will make India's economy vulnerable to shocks. It proposed the formation of a monetary policy committee (MPC) which has since been set up and operating.

Internationalization of Rupee

Internationalisation of rupee means the following

- when Indians import they should be able to pay for the imports in rupees
- when they export they should accept payments in rupees
- when they issue bonds globally, they should be able to repay in rupee regardless of the fact that they borrowed in foreign currency
- all over the world individuals, companies and central banks should accumulate Indian rupee as a reserve currency because of its global demand.

US dollar, Euro, Japanese Yen, British Pound, Swiss Franc and Chinese Yuan make the grade and are international currencies.

India is slowly acquiring the status with the recent masala bonds floated since 2014. It may be said that the currency swap that India has with Japan (USD 75 billion) is another small step in that direction.

An international currency is traded actively in global markets. It is accepted for international trade transactions.

To be an international currency is dependent on three prerequisites.

First, the issuing country must have sufficient scale: there must be so much currency available for non-residents to hold it in terms of volume of international transactions. It is linked to macroeconomic fundamentals like strength of the economy, its exports, its resilience etc.

Second, the value of the currency must be stable over time. Stability has multiple aspects: macroeconomic, financial and political.

Third, the currency must be liquid. A currency is liquid if significant quantities of assets can be bought and sold in the currency, without noticeably affecting its price. This requires depth in financial markets, a large stock of domestic currency-denominated bonds.

Scale, stability and liquidity can be achieved through strong economic fundamentals and once these are achieved, the rupee will come to be accepted as an international currency.

Benefits of Internationalization of Rupee

- greater degree of integration of Indian economy with rest of the world in terms of foreign trade and international capital flows.
- savings on foreign exchange transactions for Indian residents- we can pay in rupee for external transactions and need not route them through dollars etc.
- reduction in dependence on foreign exchange reserves for balance of payment stability.

One of the important drivers for internationalization of a currency is the country's share in global trade. India's percentage share in the global trade is still on the lower. Internationalization of Indian currency would also require full capital account convertibility, though China is an exception. The capital account is being progressively liberalized in accordance with the evolving macro-economic conditions and requirements of the Indian industries, individuals and financial sectors.

Balance of Payments and Invisibles

Invisibles in international trade are essentially "services." Visible, in international trade stands for "physical goods."

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Invisibles are in three parts

- Services
- Transfers and
- Income.

Services include transportation, financial services, travel, telecommunications, computer services and professional services.

Transfers include remittances from Indians working abroad.

Income receipts are the income earned (as profits, interest and dividends) from the ownership of overseas assets by Indian companies, government and individuals

Remittances

India has been the largest remittances receiving country at about \$70 billion for some years followed by China. Kerala, Gujarat, Maharashtra, and Punjab are the maximum inward-remittance generating states, according to the RBI. The largest remittances came from the UAE and USA.

Indian Diaspora which is one of the most prosperous in the world is sending money home. Controls are lifted and so there are greater inflows. The government has progressively reduced the red tape. Interest rates are high. RBI increased the amount that can be remitted home. In recent months, the rupee has weakened considerably vis-à-vis the dollar, and a surge in remittances is expected as non-resident Indians take advantage of it.

Exchange Rate

Exchange rate is the price of one currency in terms of another currency. For example, approximately 66 India rupees are exchanged for 1 US dollar in 2017. That is the exchange rate. 25 years back it was 20 rupees. But that was artificially fixed by the RBI for the reasons stated above. Since the rupee exchange rate was deregulated, left to the market forces largely, rupee lost its value and came down to almost close to 70 rupees in late 2013 and since then recovered. The exchange rate depends upon many factors:

- Growth rate of the economy
- Future potential
- Foreign trade profile which includes import dependency
- Inflation
- Forex reserves with RBI
- Interest rates in the country and global majors like US
- Monetary policy of countries like USA
- International commodity prices
- External debt levels, particularly the short term commercial debt level
- The extent of convertibility of the currency
- Twin deficits – fiscal and external current account
- Political stability

Rupee is fully floated. RBI buys and sells foreign currency only to facilitate normal operations for foreign trade, debt servicing etc. That is, rupee exchange rate is not "managed" by the RBI. It is not even semi-managed (dirty float). RBI's significant marked forex market intervention is only when there is manipulation of forex market that can create instability internally and externally. The reason for \$400 b is built up as the foreign currency reserve war chest is primarily for this reason.

Currency Mechanisms

There are many ways a currency's exchange rate is arrived at. Some are:

1. In floating rate, the forces of demand and supply determine the valuation and the role of monetary authority is nil or negligible except in indirect terms like buying and selling currency in the market, changes it makes in the interest rates, cash reserves ratio etc.
2. In dirty float the exchange rate is largely market determined but the central bank manages the rate in a specific band that suits certain national goals like export promotion etc. Management of the currency valuation is within a band called the target zone and it is declared by the central bank. The objective here is to make exchange rate conducive for certain macro economic goals like export promotion and balancing it with import liberalization; remittances etc. It is also called managed float.
3. In the fixed exchange rate, the Central Bank artificially and arbitrarily fixes the exchange rate which may not have any relation to market forces. India had the system till 1992 before trade account convertibility was introduced. India had the system as it did not need any FDI or exports.
4. In the pegged system the currency is pegged to the international hard currency like dollar so as to signal the commitment of the central bank to stability. Its movements may or may not be determined by the hard currency because the valuations that suit the local currency are independent of the hard currency. It is essentially meant for imparting stability and credibility to the domestic currency in its exchange rate so as to invite investors. The stability, however, depends on the ability of the country to manage the rate that is necessary for its exports and gain other benefits. For that, the Central bank should have sufficient forex reserves to intervene whenever necessary. Otherwise, there will be speculative attacks and currency meltdowns. China is an example of currency peg. Crawling peg means, the Government accepts that the currency will crawl up or down gradually by a certain annual rate.

Current Account Deficit

The current account of the balance of payments is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid). Both government and private payments are included in the calculation. The balance of trade is typically the most important part of the current account. This means that changes in the patterns of trade are key drivers of the current account.

CAD is said to be good upto a limit as the country uses foreign savings which are imports for its development. However, two points must be made to qualify the same. One, it should be financed from dependable inflows like FDI. Two, it should be within limits. Foreign investment inflows were encouraged into the country to finance the current account deficit (CAD). The steps include liberalizing long-term external commercial borrowings (ECBs), asking state-run companies to raise funds from overseas markets etc. The government also talked to sovereign wealth funds and pension funds to get them to invest in India. Promoting exports and measures to reduce imports, especially non-essential ones were taken up.

Deficit on the current account means a net outflow of foreign currency and depletion of forex reserves. In India's case, this means a dollar outgo. Therefore, a country with a current account deficit has to attract capital flows, which could be in the form of FDI/NRI deposits/FII etc to meet the shortfall. But when capital flows are insufficient to meet the deficit, the country's currency starts to depreciate as its capacity to defend its currency weakens. It has no forex to meet its debt servicing obligations. It runs into a sovereign debt crisis thus. This is why a current account deficit in excess of 2.5% of GDP is seen as worrisome in case of India. To act against CAD, India needs to promote exports and slow down consumption imports such as fuel and gold. Reduction of subsidies will also reduce the demand for imported fuel and thus balance trade.

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2013 And The Exchange Rate Of Rupee: Why Did The Rupee Slide To Historic Lows Of Nearly 69 In 2013

Rupee fell its lowest ever against the dollar culminating in 2013 - at little less than Rs.69 for which the external and internal reason are responsible

- Eurozone crisis
- Fed taper and rate hike
- Flight to safety
- Dollar is relatively strong as the US economy came out of recession and growth resurfaced
- Risk aversion for the foreign investor
- GAAR/retro taxation laws
- CAD widening
- **Weakening capital inflows:** The capital account (the net flow of funds through investments and borrowings) surplus has been used to finance the current account deficit for many years. Capital inflows have reduced due to the improving economic situation in the US and other developed countries. Investors are exiting developing markets in expectation of the US Federal Reserve increasing the interest rates, impacting the currencies of emerging markets, like India, Brazil, Russia, Indonesia, Turkey and South Africa.
- **Inflation:** part of the depreciation is attributable to the adjustment of the rupee exchange rate to the inflation differential, i.e. India's relatively high rate of inflation versus other economies.

Steps taken by the RBI and the government of India to stabilise the currency markets:

Issue	Details
Capital Outflow	The RBI reduced the limit for outbound investment and remittances from India.
Encouraging Capital Inflows	RBI has removed administrative restrictions on investment schemes offered by banks to non-resident Indians, and removed ceiling on interest rates on deposit accounts held by NRIs. The government liberalised the FDI limits for 12 sectors, including oil and gas.
Limiting Imports and encouraging exports	The Finance Ministry increased the customs duty on importing precious metals including gold and platinum. 20% of every lot of import of gold must be exclusively made available for the purpose of export of gold-related items
Oil Import Needs	RBI decided to provide dollar liquidity to three public sector oil marketing companies (IOC, HPCL and BPCL) to help them meet their entire daily dollar requirements. Government also considered increasing its import of crude oil from Iran, and pay for it directly in Indian rupees.
Trade Deficit	Ministry of Commerce explored the possibility of using local currency for trade with major trading partners. RBI allowed exporters and importers more flexibility in management of their forward currency contracts.

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Curbing Speculative in currency	RBI increased the short-term emergency borrowing rates for banks. The daily holding requirements under the Cash Reserve Ratio for banks have been modified. MSF was increased to curb borrowing for speculation
International Cooperation	Government increased its currency swap limit with Japan from USD15 billion to USD50 billion. The BRICS nations also agreed on a USD100 billion foreign currency reserve pool as part of their plan to create a BRICS -CRA

As is evident, some were related to capital account; some others were long term and confidence boosting measures; few are related to immediate relief. From the above sub topic where the reasons and remedies were given, it is clear as to how the currency moves and what policy levers are available to ensure order. The reason for giving in such detail the case of rupee in 2013 is it is a good case study.

Since then rupee recovered and fell again in 2016 November to close to Rs.69 levels.

What is the Real Value of the Rupee?

Since 1991 when dollar fetched 16 rupees, rupee has depreciated to Rs. 65 per dollar by 2017 October. Erosion is caused by the fact that unlike the arbitrary value fixed till 1991, the rupee is finding its market value according to demand and supply in the market. The factors that influence the value are:

- Demand and supply
- Net Capital flows
- Performance of economy and its prospects
- Forex reserves with the RBI
- Interest rates
- Short term debt and the Current Account Deficit(CAD) or CAS
- International prices of the commodities on whom the nation depends. For example, the crude prices in the international markets influence exchange rate of rupee as India depends for more than 80% of its requirements on imports
- speculators
- Political stability – current government has overwhelming majority in the Lok Sabha and gives an edge

The prevailing official exchange rate is called the nominal effective exchange rate (NEER). Adjustment –upward or downward –according to inflation shows real effective exchange rate (REER). REER is an inflation adjusted exchange rate – the differential between the inflation in India and India's trading partners is factored to arrive at the REER. NEER always tends towards REER even though there may be a time lag to suit the macro-requirements of the economy.

Forex Reserves

RBI holds foreign exchange reserves which are made up of

- foreign currency held in US Dollars, Euro, British Pound , Japanese Yen etc
- foreign bank deposits
- foreign government securities
- gold reserves
- Special Drawing Rights of IMF and International Monetary Fund reserve positions

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Reasons For Accumulation of Forex

Today (2017) RBI has \$400b of reserves. It is acquired by the RBI for the following reasons

- To gain external account security
- To defend the rupee when needed
- To import essentials for economic and social security
- To enable the country to globalise further
- To deter speculators
- To enjoy favourable rating by sovereign credit rating agencies which in turn will confer advantages like borrowing cheap from offshore currency market etc.

The foreign currency assets (FCAs), a major component of the overall reserves, were at \$375 billion in September when RBI had \$400 billion forex reserves for the first time.

Expressed in US dollar terms, FCAs include the effect of appreciation or depreciation of non-US dollar currencies, such as the euro, the pound and the yen held in the reserves.

Gold reserves were \$21 billion.

The special drawing rights with the International Monetary Fund (IMF) were \$1.5 billion.

The country's reserve position with the IMF was \$2.3 billion.

These are reserves and not resources and can not be used for infrastructure etc as the investors want to see the country hold enough of these reserves to give them confidence to come and leave without uncertainties.

Adequacy or Otherwise of The Forex Reserves

Whether it is adequate or not is determined by the composition of our flows and external debt. NRI deposits and FII investment (hot money) are vulnerable. Global crude prices are also a factor in estimating the quantum of forex that is necessary. Drought and resulting food position is one more. Short term debt is another input. With all these factors, including the import cover required, we have to decide the extent of forex necessary.

RBI is diversifying the reserves into SDR and gold since 2008 and the US-centered global recession.

Problems of Plenty With Large Forex Reserves

But there are problems with huge forex reserves as to

- Cost of acquisition is high
- Sterilization costs are high, that is, when rupees are printed to buy dollars, the rupees that put into market have to be absorbed by floating government securities carrying significant interest cost through MSBs (discussed in the Monetary Policy Chapter)
- Market risks associated with their deployment in US securities are evident since 2008
- Returns on such deployment is also miniscule

RBI is diversifying the reserves into SDR and gold since 2008 and the US-centered global recession.

China, Japan, Switzerland, Saudi Arabia, Taiwan, Russia, Hong Kong and India are the top eight countries in terms of forex reserves- in the descending order.

Strong Rupee 2017: Causes And Effects

Indian rupee has turned out to be one of the best-performing currencies in the world with a gain of well over 6% against the U.S. dollar by August 2017. The rupee has been appreciating because of strong capital inflows. These include portfolio inflows into equities and, more importantly, debt markets. They also include higher levels of foreign direct investment and instruments such as masala bonds. These are driven partly by global liquidity and partly by the improving fundamentals of the Indian economy. The Reserve Bank of India's (RBI) relatively hawkish stance on the policy rate has attracted funds searching for yield. According to the Reserve Bank of India, foreign portfolio investors invested \$15.2 billion in India's equity and debt markets this year until the end of July. In addition, foreign direct investment in April-May doubled compared to last year. Oil prices remaining stable at around the \$50 mark too has helped as it helps reduce forex outgo on oil imports. This is reflected in the improved current account deficit, which stood at 0.7% of GDP in 2016-17 compared to almost 4.8% in 2012-13.

Foreign exchange reserves are at a record level of \$393 billion.

However, strong rupee can cause concerns if our object is to stimulate investment, create employment and foster growth, it is a cause for serious concern.

The exchange rate is a determinant of the price competitiveness of exports in world markets and the price competitiveness of imports in the domestic market. Similarly, it exercises an important influence on the profitability of domestic firms that produce goods which are exported, or produce goods which compete with imports. The relative profitability of domestic firms is particularly important in a large economy such as India, because most exports are goods that can be sold either in the world market or in the domestic market, while most imports are goods that can be bought either from abroad or at home.

It is possible that any currency is overvalued or undervalued. Overvaluation of the rupee means that its price in terms of foreign currencies is too high, compared to what it would be with a more appropriate exchange rate. This makes our exports expensive in foreign markets and our imports cheap in the home market. Undervaluation of the rupee means the opposite. Its price in terms of foreign currencies is too low, so that it discriminates against imports and in favour of exports.

In 2017, almost every currency appreciated against the dollar, but the rupee rose the most (along with the Korean won).

India's export performance in the past three years has seen setbacks. India's share in world exports, around 1.65%, was maintained but not increased. The slow growth in world trade does impose a demand constraint on total exports from developing countries taken together. But China, Korea and even Bangladesh, managed to increase their shares in world exports. Thus, it would be misleading to blame the world economy for India's dismal export performance. Some part of the explanation lies in domestic economic factors such as infrastructure or quality but these have been problems for a long time. The exchange rate of the rupee has been the main reason in recent years. Software exports, which have continued to grow—from \$98 billion in 2014-15 to \$108 billion in 2015-16 and \$117 billion in 2016-17—appear to be an exception to the rule, but these would have done far better if the overvalued and appreciating rupee had not dented the profitability of domestic firms.

The essential underlying factor was the exchange rate of the rupee, which also made imports distinctly cheaper than home-produced goods, whether fruits, mobile phones, consumer electronics or household goods. Every consumer in India is familiar with the overwhelming presence of Chinese manufactured goods. The consequent switch in domestic expenditure from home-produced goods to imports did lead to a contraction in demand and jobs which in turn had a dampening impact on jobs and economic growth.

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High interest rates to sustain portfolio investment led to strong rupee as seen the first paragraph above. These capital inflows drive prices up in stock markets and add to foreign exchange reserves. But this solution can cause considerable collateral damage to the economy.

First, portfolio investment flows have a significant impact on the exchange rate. The appreciating overvalued rupee erodes the price competitiveness of exports and enhances the price competitiveness of imports, which hurts the profitability of domestic firms and is bound to enlarge the trade deficit. At a macro level, this also leads to a contraction in domestic demand so that economic growth is slower than it would have been in the absence of an appreciating rupee.

Interest rates have been kept at high levels, said to combat inflation—at its lowest in years—but substantively to ensure profitability of short-term foreign capital inflows and maintain confidence in international financial markets. As inflation rates have come down sharply while nominal interest rates have not, real interest rates have risen sharply in the past three years. This has tended to crowd out domestic investment in the real sector of the economy, whether agriculture, manufacturing or services. Such dampening of domestic investment also means that economic growth is slower than it would have been in the absence of high interest rates.

It is essential to recognize that the exchange rate is a price which matters for the economy in many spheres. It is far more important than portfolio investment inflows that can be volatile. The overvaluation of the rupee, which makes exports difficult and imports attractive, must be corrected. The time has come to let the rupee depreciate not just in nominal but in real terms. A more appropriate exchange rate would stimulate exports and dampen imports, just as it would help domestic manufacturing firms to be more competitive, both abroad and at home, to “Make in India” and combat the onset of deindustrialization.

The way forward, now, is to drop interest rates, which would also help the exchange rate depreciate. Together, these would stimulate investment and revive exports, which in turn will drive economic growth and employment creation from the demand side. The time is also most opportune as the consumer price annual inflation rate has dropped to 1.5% in June 2017.

Sovereign Wealth Fund

It is a fund of foreign currency that is meant to be invested in global assets. It is set up and managed by the central bank or a special body (special purpose vehicle) of the government. It is commonly seen in countries that have substantial foreign currency assets earned by them from exports or by foreign investors like MNCs. The fund is invested in shares, bonds, property or other areas of potential growth—like energy assets like oil and gas fields, uranium and agricultural fields. It may also be used to acquire foreign companies. The main reason for it is to earn more than making investments in government bonds of foreign central banks. It helps in energy and food security. Some of the countries that use sovereign wealth funds (SWFs) have economies that are rely on one source of income—oil revenues in Norway and the Middle East.

SWFs diversify their incomes and help them with external account security. India has not set up an SWF because our reserves are not adequate for our needs and contingencies. Besides, the forex held by the RBI is not earned through exports or FDI but is essentially borrowed resources. Our external debt is about \$475 billion and our forex reserves are \$ 400 billion.

Rupee Devaluation/Depreciation and Export Performance and Promotion

It is argued that when a currency depreciates due to market forces of supply and demand or is devalued by the Central bank, exports go up as in price terms as the country's goods and services will be cheaper especially in relation to similar goods and services from competitive countries. In fact, in the case of India, since the beginning of reforms in 1991 one of the reasons for the growth in exports in dollar terms was the depreciation of rupees. With depreciated rupee, FII will also flow in. Remittances will increase. Inessential imports will reduce. More money in rupee terms is realized for the loans in foreign currency that Indian firms take.

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However, when rupee loses its value externally, debt servicing becomes costlier. Inflation will rise as imports will become costlier. Government's subsidy bill and fiscal deficit may rise as it will have to make imported goods like petroleum products and food affordable to the general public. At the same time, a cheaper rupee making the imports costly may drive the domestic import –dependent firms to become either import-substituting or cut corners and raise productivity. The result can be innovation and indigenous production.

To boost exports, pricing the external value of the rupee low is not the strategy beyond a point. Sclae, quality, reliability, packaging and so on matter. Price-elasticity of our exports is also to be considered before depreciation is advocated. That is, price may not boost consumption beyond a point. Further, competitive devaluation will harm the economy as elaborated above. Also, import elasticity of Indian exports- about 50% exports like engineering goods, gems and jewellery etc is high and thus depreciation hurts them.

J curve effect is a theory stating that a country's trade deficit will initially worsen after the depreciation of its currency. This is because higher prices on foreign imports will be greater than the reduced volume of imports and the growth in exports initially. When exports become price-competitive and imports are reduced due to high cost, the BOP turns positive.

Rupee Appreciation: Why And What It Does

Normally, currencies appreciate when the economies are doing well. An appreciating currency is the result of a booming economy. Performance of economy brings in FIIs; huge FII inflows into financial asset markets and an increasing reliance on low cost foreign loans (ECB) add to the foreign currency glut, and help power the rupee higher. NRI deposits also explain the appreciation.

The resentment is among exporters while importers, borrowers from abroad and the consumers are gainers. Borrowers gain as they can prepay at reduced cost. Importers are delighted with the rupee's appreciation to the dollar as most imports and external borrowings are denominated in dollars. Borrowings through Masala-bond does not make the debtors relieved as the borrowing and repayment both are in rupees and so is the interest.

The Indian consumer is a beneficiary too, as costs of a host of imported goods — from petro products to electronic, electrical and consumer items — would be cheaper.

The effect on exporters too is not all negative. With increasing global integration an ever-increasing proportion of exports consist of imported raw-materials and components. This is particularly true of the diamond, high-end textile and engineering industries that use a high proportion of imported goods in their exports.

The rupee's rise has helped these exporters to rein in their costs and increased their competitiveness in the global market place. However, exporters, in general, have seen their profit margins erode as a result of the rupee's unexpected appreciation.

Appreciation is suggested for the following reasons

- Helps manage inflation
- Puts pressure on export sector to scale up the value chain and export niche products
- Forces the industry to cut costs and be competitive on quality terms.

Currency Manipulation

A country depends on the price of its currency in overseas markets- the exchange rate, for a variety of its macroeconomic objectives. Some want it weak so as to export more etc and some want it balanced if they also have a need to import substantially. China is in the former category

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and India in the latter. China keeps its exchange rate weak by having the yuan (renminbi) fixed (pegged) to a basket of currencies since 2015 and till then to the US dollar. By artificially keeping it devalued, it has posed a threat to other countries that also want to export but can not weaken the currency for the purpose. For example, India. When a country damages its competitors through a weak currency, it is called a "beggar thy neighbor policy." The decline of India's exports and the huge trade deficit that India runs with China (about \$50 billion in 2017) may be cited as an example of such policies. It is the result of currency manipulation. The United States accused China of keeping the yuan, artificially low by massively accumulating foreign reserves, in order to give Chinese exports an advantage over competitors.

US wants to have Chinese yuan to move freely in foreign exchange markets and find its value.

A weak currency cheapens the price of a country's exports, making them more attractive to international buyers by undercutting competitors.

China's economy is primarily export-driven and international competition could be killed only by currency manipulation. Other countries can not join this currency war as they do not have such large scale manufacturing capacity nor the population to supply cheap labour skills nor the authoritarian government that can take decisions against popular will, for examples environmentally incompatible projects. Other countries lose by way of growth, jobs, fiscal receipts, competitiveness, welfare and so on as they lose their global and domestic markets.

Certain professional economists and policy makers are apprehensive that the devaluation driven growth could overheat the economy and hardland the country into a rapid slowdown hindering the world recovery.

Other countries also reacted in a similar manner. US started quantitative easing one of whose objectives was to oversupply dollar to weaken it to check imports and boost exports. President's Trump's "America First" is also a response to it. Protectionism is spreading across the world as a result.

Currency War

New Delhi

In 2010 by Brazil's Finance Minister Guido Mantega coined the term while describing the competition between the United States and China to cheapen their currency- US having joined the war started by China by introducing the QE. As detailed in the note on currency manipulation, some nations deliberately weaken their currencies to gain in terms of exports etc. When the other nations join the race of devaluation, it is called a currency war. Currency cheapening is made possible by the central bank following an expansionary monetary policy to lower the value of its money. The central bank buys foreign currency and keeps a war chest of it like China with which it ensures that its domestic currency has a low valuation vis a vis other currencies to aid exports. That helps businesses and boosts economic growth.

Other countries may not be able to join as their currencies are not fixed but are floated; imports will be costlier; inflation will shoot up; growth will suffer; jobs will be lost and financial sector may be destabilized as banks may accumulate non-performing assets(NPA).

A central bank has many tools to lower the exchange rate: increase the money supply by expanding credit. It can lower interest rates. It can also add credit to a money supply through open market operations an extreme form of which is Quantitative Easing.

Governments can also aid in currency losing its value through expansionary fiscal policy: by spending more or cutting taxes. But its effects can be severely destabilizing and anti-growth unless the entire ecosystem is in place to take relative advantage of the weak currency from the global market.

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Dollarization

When a country uses the currency of another country along with its own currency or by official substitution, it is called Dollarization. Currency substitution can be in complete replacement of domestic currency or along with it. Nepal and Bhutan people hold Indian rupee along with their own official currencies Nepalese rupee and Bhutanese Ngultrum respectively for financial security and for trade across the border. Similarly, residents of Zimbabwe hold British Pound or South African Rand along with Zimbabwe dollar.

Currency Board

In recent times, currency board came into international headlines in 2001-02 when Argentina adopted it to flush out its extra currency that was losing its value due to fiscal profligacy. When foreign investors were leaving the country and the exchange rate of peso was plunging, the decision was taken to adopt the currency board mechanism. It set a fixed exchange rate to US dollar. It ruled that the country should print so many pesos as it had dollars- the ratio between the two being fixed at a certain level. Thus the country retrieved its financial stability and FDI and FII resumed. Thus, like a central bank, a currency board is a country's monetary authority that issues notes and coins. That is its only function and is performed in line with the fixed currency exchange rate. In other words, CB, unlike a central bank, is not the lender of last resort, nor banker to government nor is it the bank's bank.

Global Reserve Currency

There are some national currencies that are held by central banks around the world as a part of their foreign exchange reserves as they are accepted in the international markets for all types of transactions like payment for imports, debt servicing etc. For example, US dollar, Japanese yen, Euro etc. It is held not only by the central banks but also firms and individuals as it is considered a hard currency or safe-haven currency. U.S. dollar is the most preferred and makes up 64 percent of all known central bank foreign exchange reserve. More than 85 percent of forex trading involves the U.S. dollar. 39 percent of the world's debt is issued in dollars. The reason for the dollar gaining the predominant position was that in 1944 the Bretton Woods Agreement assigned a unique status to the US dollar – it took the world off the gold standard and made the US dollar the basis for other countries printing their currencies. That is, US dollar was made the global reserve currency. They could hold US dollars instead of gold. When they wanted to convert the dollars into gold, US would exchange. US dollar was printed on the basis of gold holding. It meant that all countries held dollar; dollar dominated the world; all others used the dollar to buy US goods; dollar was in huge demand; others were grossly undervalued. But they felt inflationary pressures. It worked well when the US held sway over the world- till the end of sixties.

When Japan and Germany and others were coming up, they defied it and wanted their own currencies also to emerge as global reserve currencies. When they wanted gold for dollars, Richard Nixon changed the system and discontinued with the gold standard for the USA. That is, even the US dollar was not tied to the gold reserves. In other words, since 1971, the amount of currency that US printed is not linked to gold. Each country followed its own standard (gold standard is followed when a country promises the holders of its currency to redeem their currencies for their value in gold upon demand). The next most popular reserve currency is the euro. About 20% (2017) of known central bank foreign currency reserves were in euros. Most of the other currencies are only used inside their own countries. Whether a currency becomes a reserve currency or not does not depend on the size of the currency. Swiss economy is worth only \$660 billion (2017) but has been one for many years. China was more than \$5 trillion 10 years back and was not.

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(Bretton Woods Agreement 1944 was decided upon at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire, in 1944. The creation of the International Monetary Fund (IMF) and World Bank Group and valuation of gold and foreign exchange rates was the contribution of 44 countries that met to create a new international monetary system. The main goals of the meeting of the 730 delegates were to ensure a foreign exchange rate system, prevent competitive devaluations and promote economic growth.)

The reasons for any national currency to emerge as a global currency are that it should have strength in the form of a large economy; it should have performed well for decades; it should be stable which the central bank should be able to ensure; there should be adequate amount of the currency in global markets to convert it into other currencies and vice versa. If a currency satisfies these features, it can be accepted across the world.

If a currency is held by others, it has a great advantage: other countries will hold it. They do not hold it as currency as it does not fetch returns. They buy government bonds with it. For example, US dollar is held, it is held as US government security which fetches some returns. It means, world will give USA the dollars that it holds and US will exchange it for US government securities. These securities are thus sold for an interest rate that is negligible-1% or so. It means, the rate at which US raises loans is very cheap. That reflects on the global trust in these bonds. US spends the money for its own growth and consumption.

Hard And Soft Currency

In line with the explanation of global reserve currency above, hard currency is any globally traded currency that is liquid (adequate supply) and stable (does not fluctuate much). Such currency is in global demand as a store of value. Long-term stability, fiscal and economic policies of the country, strength of the economy etc are the relevant factors behind the emergence as a hard currency. It becomes a safe haven currency. Soft currency exhibits opposite features.

Flight of Capital

When financial assets or money rapidly leave a country due to the understanding that the economy is not doing well; or is imposing controls that will mean losses; or is likely to make policies that are inimical for investments, government facing sovereign debt crisis defaulting on its debt etc. Any of these events will cause loss of confidence in the economy. When flight of capital takes place, exchange rate drops thus causing even greater flight and harm to the economy. The country's currency will lose value and the purchasing power. High inflation will result. The problem is worse if the country is import dependent. In such a situation- either before or after the capital flight, the country will resort to capital controls.

Capital Controls

In 2017, China imposed regulations targeting "irrational" overseas investments in the property, entertainment and sports sectors. In 2015, Greece imposed capital controls on foreign currency outflows. In India, in August 2013, the Reserve Bank of India (RBI) imposed partial capital restrictions on companies and individuals to stabilise the rapidly weakening rupee. Overseas direct investment by Indian companies was cut by three-fourths, making it more difficult for local corporate entities to buy overseas assets. RBI also lowered overseas remittances by locals to \$75,000 a year from \$200,000, and prohibited investments in overseas property. These measures were rolled back after the rupee stabilized.

These measures constitute 'capital controls': Any measure taken by a government, central bank or other regulatory body to limit the flow of foreign capital in and out of the domestic economy. These controls include taxes (Tobin tax), quantitative restrictions etc.

They are not confined to capital account as the above mentioned RBI policies include remittances too which are in the current account. These controls can be economy-wide or specific to either a sector or industry as can be inferred from above.

Capital controls are temporary and are aimed at stabilization. In the long run they limit economic progress and efficiency.

Exchange Rate

Exchange rate is the price of one currency in terms of another currency. For example, approximately 70 rupees are exchanged for 1 US dollar in late 2018. That is the exchange rate of rupee. In 1991, it was less than 20 rupees. The difference is largely due to the fact that at that time the exchange rate was set by the RBI arbitrarily and today it is left to market forces. The exchange rate depends upon many factors:

- Growth rate of the economy
- Future potential
- Foreign trade profile which includes import dependency
- Inflation
- Forex reserves with RBI
- Interest rates in the country
- Monetary policy of countries like USA
- International commodity prices
- External debt levels, particularly the short term commercial debt level

• Twin deficits – fiscal and external current account

• Political stability

Rupee is fully floated. RBI buys and sells foreign currency only to facilitate normal operations for foreign trade, debt servicing etc. That is, rupee exchange rate is not "managed" by the RBI. It is not even semi-managed (dirty float). RBI's forex market intervention is only when there is manipulation of forex market that can create instability internally and externally. The reason for \$400 b is built up as the foreign currency reserve war chest is primarily for this reason.

Currency Mechanisms

There are many ways a currency's exchange rate is arrived at. Some are:

1. In the fixed exchange rate, the Central Bank artificially and arbitrarily fixes the exchange rate which may not have any relation to market forces. India had the system till 1992 before trade account convertibility was introduced. India had the system as it did not need any FDI or exports.
2. In floating rate, the forces of demand and supply determine the valuation and the role of monetary authority is indirect like buying and selling currency in the market, changes it makes in the interest rates, cash reserves ratio etc.
3. In dirty float the exchange rate is largely market determined but the central bank manages the rate in a specific band that suits certain national goals like export promotion etc. Management of the currency valuation is within a band called the target zone and it is declared by the central bank. The objective here is to make exchange rate conducive for certain macro economic goals like export promotion and balancing it with import liberalization; remittances etc. It is also called managed float.
4. In the pegged system the currency is pegged to the international hard currency like dollar so as to signal the commitment of the central bank to stability. Its movements may or may not be determined by the hard currency because the valuations that suit the local currency are independent of the hard currency. It is essentially meant for imparting stability and credibility

to the domestic currency in its exchange rate so as to invite investors. The stability, however, depends on the ability of the country to manage the rate that is necessary for its exports and gain other benefits. For that, the Central bank should have sufficient forex reserves to intervene whenever necessary. Otherwise, there will be speculative attacks and currency meltdowns. China is an example of currency peg. Crawling peg means, the Government accepts that the currency will crawl up or down gradually by a certain annual rate.

Current Account Deficit

The current account of the balance of payments is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as royalty, interest and dividends) and net transfer payments (such as remittances). Both government and private payments are included in the calculation. The balance of trade is however the most important part of the current account. This means that changes in the patterns of trade are key drivers of the current account.

Deficit on the current account means a net outflow of foreign currency and depletion of forex reserves. In India's case, this means a dollar outgo. India's trade deficit is large and is covered up largely by remittances and the surpluses on service export surplus over service imports. But still there is a CAD. Therefore, India relies on attracting capital inflows, which could be in the form of FDI/NRI deposits/FPI etc. to meet the shortfall. But when capital flows are insufficient to meet the deficit, the country's currency starts to depreciate as its outflows are more. Its capacity to defend its currency weakens. It has no forex to meet its debt servicing obligations. It runs into a sovereign debt crisis thus. This is why a current account deficit in excess of 2.5% of GDP is seen as worrisome in case of India. To act against CAD, India needs to promote exports and slow down consumption imports such as fuel and gold. Reduction of fuel subsidies will also reduce the demand for imported fuel and thus balance trade.

CAD is said to be good up to a limit as the country uses foreign savings which are imports for its development. However, two points must be made to qualify the same. One, it should be financed from dependable inflows like FDI. Two, it should be within limits. Foreign portfolio investments to cover the CAD is advisable only to some extent because they are volatile.

Some steps to cover the CAD that government took over decades are

- liberalise FDI/FPI
- liberalizing long-term external commercial borrowings (ECBs),
- asking state-run companies to raise funds from overseas markets etc.
- government also talked to sovereign wealth funds and pension funds to get them to invest in India
- Promoting exports
- measures to reduce imports, especially non-essential ones
- floating dollar bonds

Rupee depreciation in 2018

The historic low of more than Rs.74 vis a vis dollar in 2008 October had reasons- global and domestic

1. US interest rates were raised and so global money headed to the US
2. QE was tapering and so inflows were relatively less

3. Turkish Lira fell due to its own domestic reasons but its impact was felt by many emerging economies as investors doubted the stability and resilience of them and so pulled out
4. US-China trade tensions gave global economy uncertainty and thus investors wanted a safe haven which was US dollar and US economy
5. Global crude prices rose and thus the pressure on India GDP also grew
6. India's CAD was relatively high due to inessential imports like gold and also items like electronic goods
7. Investors sold off rupee as they felt that in future it would be costlier to do so due to further depreciation
8. country

Government took some steps to correct the fall: Liberalised

1. ECBs
2. FPI
3. Masala bonds and
4. Imposed import restrictions on some electronic items.

Real Value of the Rupee

Since 1991 when dollar fetched 16 rupees, rupee depreciated to more than Rs. 74 per dollar by 2018 October. Erosion is caused by market forces according to demand and supply in the market. The factors that influence the value are listed earlier in the chapter.

There are three ways of seeing the value of a currency

1. The prevailing official exchange rate is called the nominal effective exchange rate (NEER).
2. Adjustment –upward or downward –according to inflation shows real effective exchange rate (REER). REER is an inflation adjusted exchange rate – the differential between the inflation in India and India's trading partners is factored to arrive at the REER. NEER always tends towards REER even though there may be a time lag to suit the macro-requirements of the economy. Reserve Bank of India uses its 36-country REER as an indicator to understand whether the rupee is overvalued or undervalued.
3. Purchasing power parity (PPP) method (first chapter)

Any currency is overvalued or undervalued. Overvaluation of the rupee means that its price in terms of foreign currencies is too high. This makes our exports expensive in foreign markets and our imports cheap in the home market. Undervaluation of the rupee means the opposite. Its price in terms of foreign currencies is too low, so that it discriminates against imports and favours exports. Currency wars are waged to cheapen the currencies to boost exports.

Devaluation/depreciation and its effects

It is argued that when a currency depreciates due to market forces of supply and demand or is devalued by the Central bank, exports go up as in price terms as the country's goods and services will be cheaper especially in relation to similar goods and services from competitive countries. In fact, in the case of India, since the beginning of reforms in 1991 one of the reasons for the growth in exports in dollar terms was the depreciation of rupees. With depreciated rupee, FPIs also flow in. Remittances will increase. Inessential imports will reduce. More money in rupee terms is realized for the loans in foreign currency that Indian firms take.

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However, when rupee loses its value externally, debt servicing becomes costlier. Inflation will rise as imports will become costlier. Government's subsidy bill and fiscal deficit may rise as it will have to make imported goods like petroleum products and food affordable to the general public. At the same time, a cheaper rupee making the imports costly may drive the domestic import – dependent firms to become either import-substituting or cut corners and raise productivity. The result can be innovation and indigenous production.

To boost exports, pricing the external value of the rupee low is not the strategy beyond a point. Scale, quality, reliability, packaging and so on matter. Price-elasticity of our exports is also to be considered before depreciation is advocated. That is, if imports make up a significant part of exports, the export competitiveness due to depreciation is eroded as import costs also rise. Import elasticity of Indian exports- about 50% exports like engineering goods, gems and jewellery etc. is high and thus depreciation hurts them.

J curve effect is a theory stating that a country's trade deficit will initially worsen after the depreciation of its currency. This is because higher prices on foreign imports will be greater than the reduced volume of imports and the growth in exports initially. When exports become price-competitive and imports are reduced due to high cost, the BOP turns positive.

Appreciation and its effects

Normally, currencies appreciate when the economies are doing well. An appreciating currency is the result of a booming economy. Performance of economy brings in huge FPI inflows into financial asset markets and an increasing reliance on low cost foreign loans (ECB) add to the foreign currency glut, and help the rupee quote higher. NRI deposits also accumulate further fueling the appreciation.

The resentment is among exporters while importers, borrowers from abroad and the consumers are gainers. Those who already borrowed gain as their repayment costs are lower. Borrowings through Masala bond does not make any difference as the borrowers pay exactly what they borrowed in rupee terms with interest.

The Indian consumer is a beneficiary too, as costs of a host of imported goods — from petro products to electronic, electrical and consumer items — would be cheaper.

Appreciation is suggested for the following reasons

- Helps manage inflation
- Puts pressure on export sector to scale up the value chain and export niche products
- Forces the industry to cut costs and be competitive on quality terms.

Dutch disease is given elsewhere in this chapter.

Forex Reserves

RBI holds foreign exchange reserves which are made up of

- foreign currency held in US Dollars, Euro, British Pound, Japanese Yen etc
- gold reserves
- Special Drawing Rights of IMF and
- International Monetary Fund reserve positions

India's forex reserves comprise foreign currency assets (FCAs), gold reserves, special drawing rights (SDRs) and India's position with the International Monetary Fund (IMF). FCAs are the largest component of the forex reserves. Rest of the assets as they stood at the end of 2018 were as follows: gold reserves \$20.96 billion; SDR were \$1.45 billion, while the country's reserve position with the IMF was \$2.62 billion.

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RBI is diversifying the reserves into SDR and gold since 2008 and the US-centered global recession.

FCAs are kept in the form of deposits with central banks of other countries and also as government securities of US, Japan etc. The returns are low but it is safe.

RBI accumulated the forex reserves for the following reasons

- To gain external account security
- To import essentials for economic and social security- energy and food security
- To defend the rupee when needed
- To deter speculators
- To enjoy favourable rating by sovereign credit rating agencies which in turn will confer advantages like borrowing cheap from offshore currency market etc.
- To enable the country to globalise further

Expressed in US dollar terms, FCAs include the effect of appreciation or depreciation of non-US dollar currencies, such as the euro, the pound and the yen held in the reserves. When assets are valued at current levels, the gains that may be made are known as revaluation gains. For example, USD may have been bought with Rs.40 years back but current value is more than Rs.70 and thus yields revaluation gains.

These are reserves and not resources and can not be used for infrastructure etc as suggested by some as the investors want to see the country hold enough of these reserves to give them confidence to come and leave without uncertainties.

Adequacy or otherwise of forex reserves is measured with reference to the

- composition of the reserves- whether they are made up of export and FDI earnings or FPIs and loans
- global interface of the economy which is revealed by import dependency, export levels, CAD, external debt (particularly short term debt), sovereign credit rating etc.

There is a notion called **import cover** of reserves which is the traditional trade-based indicator of foreign exchange reserve adequacy. It tells us how long imports can be sustained in the event of a shock. According to the IMF, traditionally, the import coverage measure has been based on months of prospective imports, with three months' coverage used as a benchmark. It is not an indicator of adequacy of forex reserves which is based on a comprehensive list of criteria mentioned above.

But there are problems with huge forex reserves as to

- Cost of acquisition is high
- Sterilization costs are high, that is, when rupees are printed to buy dollars, the rupees that put into market have to be absorbed by floating government securities carrying significant interest cost through MSBs (discussed in the Monetary Policy Chapter)
- Market risks associated with their deployment in US securities are evident since 2008
- Returns on such deployment is also miniscule

RBI is diversifying the reserves into SDR and gold since 2008 and the US-centered global recession.

China, Japan, Switzerland, Saudi Arabia, Taiwan, Russia, Hong Kong and India are the top eight countries in terms of forex reserves- in the descending order.

The exchange rate is one of the determinants of the price competitiveness of exports in world markets. It exercises an important influence on the profitability of domestic firms that produce goods which are exported, or produce goods which compete with imports.

Currency War

In 2010 by Brazil's Finance Minister Guido Mantega coined the term while describing the competition between the United States and China to cheapen their currency. While countries cheapened their currencies to gain undue export advantage for many decades, China in contemporary times is known for it. Its export-led economy depended on weak exchange rate that is set by its central bank- People's Bank of China. When other nations join the race of devaluation to withstand the competition and win it it becomes competitive devaluation for which another name is currency war. Currency cheapening is made possible by the central bank following an expansionary monetary policy to lower the value of its money. It may also be done by the central bank by fixing the exchange rate low in countries like China where there is no capital account convertibility as the central bank administers the exchange rate. In market economies, central bank buys foreign currency and keeps a war chest of it with which it ensures that its domestic currency has a low valuation vis a vis other currencies to aid exports. That helps businesses and boosts economic growth.

Other countries may not be able to join as their currencies are not fixed but are floated. Also, not all countries can afford such devaluation as they may be import dependent like India and imports will be costlier; inflation will shoot up; growth will suffer; jobs will be lost and financial sector may be destabilized as banks may accumulate non-performing assets(NPA).

A central bank has many tools to lower the exchange rate: increase the money supply by expanding credit. It can lower interest rates. It can also add credit to a money supply through open-market operations.

USA undertook Quantitative Easing for many reasons, one important reason being joining currency war to boost exports.

Governments can also aid in currency losing its value through expansionary fiscal policy: by spending more or cutting taxes. But its effects can be severely destabilizing and anti-growth unless the entire ecosystem is in place to take relative advantage of the weak currency from the global market- for example, large scale export capacity.

Currency Manipulation

Currency manipulation is to weaken the currency to gain unfair global advantages. It is the crux of currency wars. A country depends on the price of its currency in overseas markets- the exchange rate; for a variety of its macroeconomic objectives. Some want it weak so as to export more etc and some want it balanced if they also have a need to import substantially. China is in the former category and India in the latter. China keeps its exchange rate weak by having the yuan (renminbi) fixed (pegged) to a basket of currencies since 2015. By artificially keeping it devalued, it has posed a threat to other countries that also want to export but can not weaken the currency so much. For example, India. When a country damages its competitors through a weak currency, it is called a "beggar thy neighbor policy." The decline of India's exports and the huge trade deficit that India runs with China may be cited as an example of such policies. It is the result of currency manipulation. The United States accused China of keeping the yuan, artificially low by massively accumulating foreign reserves, in order to give Chinese exports an advantage over competitors.

US wants to have Chinese yuan to move freely in foreign exchange markets and find its value. President's Trump's "America First" is also a response to it. Protectionism is spreading across the world as a result. Trade wars of imposing higher tariffs and quantitative restrictions on one another are becoming currency wars.

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Global Reserve Currency

There are some national currencies that are held by central banks around the world as a part of their foreign exchange reserves as they are accepted in the international markets for all types of transactions like payment for imports, debt servicing etc. For example, US dollar, Japanese yen, Euro etc. It is held not only by the central banks but also firms and individuals as it is considered a hard currency or safe-haven currency. U.S. dollar is the most preferred and makes up 2/3rds of all known central bank foreign exchange reserves. More than 85 percent of forex trading involves the U.S. dollar. 40 percent of the world's debt is issued in dollars.

The next most popular reserve currency is the euro. About 20% of central bank foreign currency reserves were in euros. Japanese yen, British Pound, Swiss Franc and Chinese Yuan are also in global reserve currencies.

Most of the other currencies are only used inside their own countries. Whether a currency becomes a reserve currency or not does not depend on the size of the currency. Swiss economy is worth only \$660 billion in 2018 but has been a global reserve currency for many years. China was more than \$5 trillion in 2010 and was not.

The reasons for any national currency to emerge as a global currency are that

- it should have strength in the form of a large economy;
- it should have performed well for decades;
- it should be liquid, that is, should have buyers and sellers in any amount at any time;
- it should be stable which the central bank should be able to ensure;

If a currency satisfies these features, it can be accepted across the world.

If a currency is held by others, it has a great advantage when other countries hold it, they do not hold it as currency as it does not fetch returns and so they buy government bonds with it which most often happens to be the bonds of the country whose currency is held as reserve. For example, US dollar is held, it is held as US government security which fetches some returns. It means, world will give USA the dollars that it holds and US will exchange it for US government securities. These securities are thus sold for an interest rate that is negligible-1% or so. It means, the rate at which US raises loans is very cheap. That reflects on the global trust in these bonds. US spends the money for its own growth and consumption.

Hard and Soft Currency

In line with the explanation of global reserve currency above, hard currency is any globally traded currency that is liquid (adequate supply) and stable (does not fluctuate much). Such currency is in global demand as a store of value. Long-term stability, fiscal and economic policies of the country, strength of the economy etc. are the relevant factors behind the emergence as a hard currency. It becomes a safe haven currency. Soft currency exhibits opposite features.

Flight of Capital

When domestic currency is converted into foreign currency in large amounts and rapidly leaves the country, it is called capital flight. It may be due to

- perception that the economy is not doing well; or
- is imposing controls that will mean losses; or
- is likely to make policies that are inimical for investments
- government facing sovereign debt crisis defaulting on its external debt

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Any of these events will cause loss of confidence in the economy. When flight of capital takes place, exchange rate drops thus causing even greater flight and harm to the economy. The country's currency will lose value and the purchasing power. High inflation will result. The problem is worse if the country is import dependent. In such a situation- the country will resort to capital controls.

Capital Controls

'Capital controls' are any measure taken by a government, central bank or other regulatory body to limit the flow of foreign capital in and out of the domestic economy. These controls include taxes (Tobin tax), quantitative restrictions etc. These controls can be economy-wide or specific to either a sector or industry as can be inferred from above. Capital controls are temporary and are aimed at stabilization. In the long run they limit economic progress and efficiency.

Currency Board

In recent times, currency board came into international headlines when Argentina adopted it to flush out its extra currency that was losing its value due to fiscal profligacy. When foreign investors were leaving the country and the exchange rate of peso was plunging, the decision was taken to adopt the currency board mechanism. It set a fixed exchange rate to US dollar. It ruled that the country should print so many pesos as it had dollars- the ratio between the two being fixed at a certain level. Thus the country retrieved its financial stability and FDI and FII resumed. Thus, like a central bank, a currency board is a country's monetary authority that issues notes and coins and controls money supply. That is its only function and is performed in line with the fixed currency exchange rate.

Dollarization

When a country uses the currency of another country along with its own currency or by official substitution, it is called Dollarization. Currency substitution can be in complete replacement of domestic currency or along with it. Nepal and Bhutan people hold Indian rupee along with their own official currencies Nepalese rupee and Bhutanese Ngultrum respectively for financial security and for trade across the border. Similarly, residents of Zimbabwe hold British Pound or South African Rand along with Zimbabwe dollar.

Sovereign Wealth Fund

It is a fund of foreign currency that is meant to be invested in global assets. It is set up and managed by the central bank or a special body (special purpose vehicle) of the government. It is commonly seen in countries that have substantial foreign currency assets earned by them from exports or by foreign investors like MNCs. The fund is invested in shares, bonds, property or other areas of potential growth- like energy assets like oil and gas fields, uranium and agricultural fields. It may also be used to acquire foreign companies. The main reason for it is to earn more than making investments in government bonds of foreign central banks.

India has not set up an SWF because our reserves are not adequate for our needs and contingencies. Besides, the forex held by the RBI is not earned through exports or FDI but is essentially borrowed resources. Our external debt is about \$500 billion and our forex reserves are less than \$ 400 billion.

World Trade Organisation (WTO)

The General Agreement on Tariffs and Trade (GATT) was adopted in 1947 by 23 countries to establish a free and fair international trading regime among member countries based on dismantling of trade barriers -tariffs or non-tariff restrictions like quotas. It came into existence in 1948. India was a founding member. GATT progressed- expanded its scope in terms of areas covered and depth of coverage - by a series of "trade rounds"- negotiations centered around a specific set of issues over a period of a few years leading to agreement among members are called a round. GATT was headquartered in Geneva, Switzerland.

Eight rounds of such negotiations were held under GATT:

1. Havana Round (1947) with 23 countries brought into being the GATT
2. Annecy (France) Round (1949) (France)
3. Torquay Round(England) (1950) (England)
4. Geneva Fourth Round (1956)
5. Dillon Round (1960-1961) was held in Geneva
6. Kennedy Round (1962-1967) was held in Geneva but was named after the US President John F Kennedy
7. Tokyo Round (1973-1979)
8. Uruguay Round (1986-94)

As can be seen from the above, the Uruguay round lasted the longest under the GATT as it took place at a time when the world was undergoing basic changes in terms of the way economies were managed. Industrial democracies were becoming more acceptable to the developing countries; Union of Soviet Socialist Republics (USSR) was disintegrating leaving the developing countries so much weaker in world diplomacy. China was adopting LPG policies in a historic manner; communist model of economy was losing value; Francis Fukuyama, an American political scientist wrote the book *The End of History and the Last Man* (1992) where he argued that liberal democracies with market model of economic growth were the highest point of human history.

On the back of historic confidence and led by the largest global economy, the USA, GATT conducted negotiations to open up economies of members. New areas were brought into the agenda- intellectual property rights; agriculture; services; foreign direct investment and so on. Initially, the developing countries were reluctant and resisted the expansion of the agenda. But partly due to western force; lack of unity among the developing countries; and partly due to seeing benefits for themselves, they agreed. There was no agreement after protracted negotiations. The Director General of the GATT was asked to draft an agreement for the consideration of the members. It was called Dunkel Draft, named after the Director General Arthur Dunkel. After attaining consensus, it was made into the Marrakesh Treaty and was signed in Marrakesh (Morocco) in 1994 and paved the way for the establishment of World Trade Organization (WTO) at the beginning of 1995.

WTO since 1995: The Ministerial Conferences

- January 1, 1995 - The WTO came into existence.
- 1996 - The first ministerial conference in Singapore.
- 1998 – Second ministerial conference in Geneva, Switzerland.
- 1999 – Third ministerial conference in Seattle, Washington, USA

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- 2001 - Fourth ministerial conference in Doha, capital of Qatar. A new Round of trade talks begin called Doha Development Round.
- 2001 - The People's Republic of China joined the WTO after 15 years of negotiations
- 2003 - Fifth ministerial conference in Cancún, Mexico. Formation of G20. Rejection of the 'overloading' of the Doha agenda with Singapore issues though trade facilitation which is one of the Singapore issues was accepted by all
- 2005 - Sixth Ministerial at Hong Kong once again failed to deliver results
- Seventh Ministerial 2009 in Geneva
- 8th in 2011 in Geneva
- 9th Ministerial in Bali 2013
- 10th Ministerial in 2015 in Nairobi
- 11th Ministerial Conference in Buenos Aires, Argentina in 2017

GATT and WTO

GATT is different from WTO in many ways

1. GATT is a treaty while WTO is an organization
2. GATT had no dispute settlement process while WTO has
3. GATT was essentially concerned with traditional trade issues such as tariffs and quotas in international trade. WTO encompasses many more areas
4. GATT had only a relatively small secretariat with no institutional foundation to implement these rules.

The World Trade Organization that came into existence at the beginning of 1995 replaced the General Agreement on Tariffs and Trade (GATT). It is headquartered in Geneva, Switzerland. It has 164 members. Afghanistan became the 164th WTO member. Liberia was the 163rd member. Kazakhstan was the 162nd member.

In addition to states, the European Union is a member. WTO members do not have to be full sovereign nation-members. Instead, they must be a customs territory with full autonomy in the conduct of their external commercial relations. Thus Hong Kong and Taiwan became WTO members. Iran is not a member.

It is headed by a Director-General whose term is 4 years.

The WTO states that its aims are to increase international trade by slashing trade barriers and providing a platform for the negotiation of trade and related issues. Basically, it sets up a rule based multilateral trading system to liberalise and boost world trade.

Unlike other organizations like World bank and the International Monetary Fund(IMF) where there is weighted voting- a country has as much voting power as it contributes financially-, WTO has a 'one country one vote' system making it relatively democratic. Decisions are taken by consensus.

WTO is not part of the United Nations and acts autonomously at the members decide. A global arrangement exists between the two like the relationship that had existed between the UN and General Agreement on Tariffs and Trade (GATT). This includes provision and exchange of information, representation at each other's meetings and cooperation between the secretariats.

Trade Negotiations

While International Monetary Fund (IMF), and the World Bank operate on weighted voting basis, WTO decisions, such as adopting agreements (and revisions to them) are officially determined by consensus of all members. The advantage of consensus decision-making is that it encourages efforts to find the most widely acceptable decision. Small countries and low income countries also weigh for as much as rich countries.

In reality, WTO negotiations proceed not by consensus of all members, but by a process of informal negotiations between small groups of countries. Such negotiations are often called "Green Room" negotiations (after the colour of the WTO Director-General's Office in Geneva), or "Mini-Ministerials", when they occur in other countries.

India conducted a two-day mini-ministerial in 2018 to further the spirit of multilateralism and give and take as the WTO faced new challenges.

Decision making in the WTO

Highest level decision-making body of the WTO is the Ministerial Conference, which usually meets once every two years with each member country represented by the commerce minister. There have been eleven ministerial conferences from 1996 to 2017. Twelfth Ministerial Conference (MC12) is to be held in 2020 in Astana, Kazakhstan.

Next in authority is the General Council which carries out the decisions of the Ministerial Conferences. It is seated in Geneva. It has representatives (usually ambassadors or equivalent) from all member governments and has the authority to act on behalf of the ministerial conference.

There are two other bodies apart from the General Council. They are the Dispute Settlement Body composed of all members, usually represented by ambassadors or equivalent; and Trade Policy Review Body (TPRB) - the WTO General Council meets as the Trade Policy Review Body to undertake trade policy reviews of Members.

Below the above three bodies, at the third level, there are Councils for Trade. The Councils for Trade work under the General Council. There are three councils - Council for Trade in Goods, Council for Trade-Related Aspects of Intellectual Property Rights, and Council for Trade in Services.

Apart from these three councils, six other bodies report to the General Council on issues such as trade and development, the environment, regional trading arrangements and administrative issues.

Dispute Settlement

Disputes can arise from trade policies of members that are violative of the WTO rules.

The request for consultations formally initiates a dispute in the WTO.

Bilateral consultations between the parties are the first stage of formal dispute settlement. They give the parties an opportunity to discuss the matter and to find a satisfactory solution without resorting to litigation. Only after such mandatory consultations have failed to produce a satisfactory solution within 60 days may the complainant request adjudication by a panel.

There is no separate DSB but the General Council which is the second highest body in the organization works as the DSB while giving verdict on the trade dispute. DSB conclusion can be challenged in an appellate body. After the ruling, the erring nation is directed to make changes in its laws to make them WTO-compliant within a reasonable time. If the 'erring country' does not correct its laws, the complainant country is allowed to take cross retaliatory measures.

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On the face of it, it gives all member countries a level playing field as the process is multilateral. But the fact is that there is no punishment for the erring country and; poor countries can not retaliate against rich countries.

There has been a crisis in the dispute settlement process of the WTO since Donald Trump became the US President. The Appellate Body has seven seats, but four were empty, because the Trump administration refused to allow the appointment of judges to fill them. Only three judges are there by the end of 2018. That's the minimum number with which the AB can operate, because three judges serve on every case.

Thus, the multilateral body is becoming weak in the face of US opposition.

Three foundational principles

WTO laid down three principles for its operation

1. National treatment
2. Most favoured nation(MFN)
3. Special and differential treatment

National Treatment

National treatment is a basic principle of GATT/WTO that prohibits discrimination between imported and domestically produced goods with respect to internal taxation or other government regulation. Any one in the country can purchase goods either from the domestic producer or from a foreign source and the two are treated alike.

MFN

In international trade, MFN treatment means normal trading relations between two countries. All WTO members are statutorily obliged to grant one another the MFN status. MFN means treating one's trading partners equally on the principle of non-discrimination.

MFN is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Some exceptions are allowed. For example, countries can set up a free trade agreement that applies only to trade within the group — discriminating against goods from outside. Or they can give developing countries special access to their markets. In general, MFN means that every time a country lowers a trade barrier or opens up its domestic market, it has to do so for the same goods or services from all its trading partners.

MFN has benefits in line with the WTO aims.

- It increases trade as there are more countries trading normally without any trade barriers. It is the basis for global trade liberalization. Since all countries are treated alike under the MFN, global trade is based on cost and quality which are legitimate.
- MFN helps small countries as otherwise they come under bilateral pressure.
- They also become eligible for normal trade with all WTO members which is an enormous entitlement that is otherwise difficult to attain. China had to negotiate and compromise for 15 years to gain entry into the WTO finally in 2001 Doha Ministerial. Having one set of tariffs for all countries simplifies the rules and makes them more transparent.
- MFN prevents domestic special interests from obtaining protectionist measures.

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Exceptions to MFN

- Regional trade blocs such as the European Union and the North American Free Trade Agreement (NAFTA or the United States-Mexico-Canada Agreement, or USMCA), which have lowered or eliminated tariffs among the members while maintaining tariff walls between member nations and the rest of the world. Trade agreements usually allow for exceptions to allow for regional economic integration.
- imports from poor countries are allowed at lower/zero tariffs (Generalised System of Preferences, GSP)
- India and Pakistan are specifically mentioned for a carve-out (exception) "Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis."

Measures adopted by India and Pakistan in order to carry out definitive trade arrangements between them, once they have been agreed upon, might depart from particular provisions of this Agreement, but these measures would, in general, be consistent with the objectives of the Agreement."

The clause aimed to enable India and Pakistan to integrate into a closer bilateral trade relationship than what MFN mandates. Ironically, it led to Pakistan denying India MFN even as India granted it to Pakistan.

S&D Provisions

WTO and developing countries

Developing countries comprise a majority of the WTO membership. They are grouped as "developing countries" and "least developed countries".

There are no WTO definitions of "developed" and "developing" countries. Members announce for themselves whether they are "developed" or "developing" countries. However, other members can challenge the decision of a member to make use of provisions available to developing countries.

Developing country status in the WTO brings certain rights.

There are for example provisions in some WTO Agreements which provide developing countries with longer transition periods before they are required to fully implement the agreement and developing countries can receive technical assistance.

When the WTO's intellectual property rights regime came into force in 1995, developing countries had 10 years time to implement certain provisions.

Agricultural subsidies can be given upto 10% of the value of produce while it is 5% for the developed countries.

There is a scheme called Generalized System of Preferences (GSP) and it is available to the developing countries. That a WTO member announces itself as a developing country does not automatically mean that it will benefit from the preference schemes of some of the developed country members such as the Generalized System of Preferences (GSP). It is the developed country which decides the list of developing countries that will benefit from the GSP.

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The WTO recognizes as least-developed countries (LDCs) those countries which have been designated as such by the United Nations. There are currently 47 least-developed countries on the UN list, 36 of which have become WTO members.

S&D

The WTO Agreements contain special provisions which give developing countries special rights and which give developed countries the possibility to treat developing countries more favourably than other WTO Members. These special provisions include, for example, longer time periods for implementing Agreements and commitments. They are referred to as "special and differential treatment" (S&D) provisions.

WTO Agreements

The WTO oversees about 60 different agreements which have the status of international legal texts. Member countries must sign and ratify all WTO agreements on accession. Important among the agreements are the following.

Agreement on Agriculture (AoA)

Its three pillars are:

- domestic support
- export subsidies
- market access

Domestic support means the subsidies that governments give to the farmers like food, fertilizer, power, water etc. The domestic subsidies are grouped into three classes called "boxes": Green Box, Amber Box and Blue Box- the first two being borrowed from the traffic light colours. The basis for classification is whether the subsidies distort trade and to what extent that should be allowed.

Green box includes subsidies on which there are no limits as they are not considered trade distorting. To qualify for the green box, WTO says a subsidy must not distort trade, or at most cause minimal distortion. These green box subsidies must be government-funded — not by charging consumers higher prices and they must not involve price support. They are programs that are not directed at particular products, and they may include direct income supports for farmers that are decoupled from current production levels and/or prices. Examples: environmental and conservation programs, research funding, extension services, food stamps and disaster relief. Rythu Bandhu Scheme of Telangana involving direct income support to farmers is another example.

Subsidies that are considered to be trade distorting but are given by governments for welfare or any other reason are subject to limitations and fall into the amber box. WTO members are required to such support to within five to 10 percent of their value of production- 5% for the developed countries and 10% for developing countries like India.

Blue box subsidies are direct payments under a production limiting program. There is no limit on them. For example, farmers are paid to limit their production so that the farm can be left fallow for it to regain top soil fertility.

India and the amber box

There has been an unfair limitation on India's food procurement policy by the WTO. The limitation on subsidy may not be objectionable but the calculation of subsidy is. India has MSP, minimum support price, programme under which Government pays the farmer for the grain he sells to the Food Corporation of India which is used to run the Public Distribution System (PDS).

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under which low income and poor people are supplied grain at cheap rates. The subsidy involved thus is to make agriculture investment-worthy, food security, price stabilization and so on. But the WTO put a cap on the subsidy which India is accused of having exceeded. India questions the methodology of calculating the subsidy. The 10% limit is acceptable to India but WTO takes 1986-88 as the base year from which inflation is calculated. The level of inflation allowed since then is very small but in reality prices have shot up on all inputs since then much more. But the WTO insists on calculating it with limited inflation. Thus, their and our numbers are at variance.

A temporary 'peace clause' was made at the WTO Bali conference in 2013 at the 9th ministerial. It stipulated that no country would be legally barred from food security programs for its own people even if the subsidy breached the limits specified in the WTO Agreement on Agriculture. Bali declaration stated that the peace clause was an interim arrangement, and a permanent solution should be negotiated by December 2017. India wants WTO to have the peace clause till a satisfactory permanent solution was in place.

India says export subsidies given by USA and Europe make their agricultural goods so cheap that their markets are virtually inaccessible to exports from developing countries. The earlier gains expected by the developing countries from a genuinely free international trade in agricultural goods have not come about as the advanced countries are least inclined to reduce the subsidies to the statutory levels. It is one of the 'implementational concerns' in WTO being discussed in the Doha round.

Export Subsidies

Agricultural export subsidies are to be limited by the developed countries either in value or volume terms so that international prices are not lowered below a point and exports and domestic markets of the developing countries are not priced out. Nairobi Ministerial in 2015 decided to phase them out.

Market Access

Market access means all member countries should throw open their domestic market to agricultural imports by reduction of tariffs and removal of or non-tariff barriers. Countries should undertake

- 'tariffication' - to convert non-tariff barriers (like quotas) to tariffs and
- "bind" their tariffs- to agree to a limit that is the 'bounded rate' and not increase the rates beyond them. The bounded rates are usually high

Special Products and Special Safeguard Mechanisms

Special Products (SP) and Special Safeguard Mechanisms (SSM) are the concerns of developing nations involved in WTO negotiations in agriculture. By using SP and SSM, these nations hope to ensure food security and protect small and marginal farmers and their livelihoods from the volatility in international trade in agriculture commodities.

Special Products (SPs)

Special Products (SPs) are agricultural products of particular importance to farming communities in developing countries for reasons of food security, livelihood security and rural development. Therefore, Doha Development Round of WTO negotiations allowed SPs to have higher tariffs.

SP is a component of the WTO's Special and Differential (S&D) provision and is available only to developing country members of the WTO.

But there is a divided opinion about the number of products to be given SP status and the modalities to select SPs.

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Special Safeguard Mechanisms (SSMs)

Special Safeguard Mechanisms or SSMs are a set of provisions through which a WTO member country can temporarily impose higher than bound tariff rates on the import of a particular agricultural product if there is a sudden surge in imports of that product into the country. The SSM provisions will be available to all developing and least developed country members of the WTO.

Sudden and sharp declines in the international price of an agricultural commodity could lead to an import surge which, in turn, could damage the viability of domestic production. In these cases, a temporary measure like SSM will allow developing countries to tide over crises. SSM will allow countries to raise tariffs above their bound levels for a limited duration.

G33

The G33 ("Friends of Special Products" in agriculture) is a group of 48 developing countries including India and China. It came into existence before the 2003 Cancun ministerial conference. They have common concerns in agriculture:

- limit the level of market opening to agri-imports of developing countries
- creation of a "special products" exemption, which would allow developing countries to exempt certain products from tariff reductions
- "special safeguard mechanism" which would permit tariff increases in response to import surges in agricultural goods

In 2017 the G-33 countries made two demands:

- a. MSP programmes to help farmers during times of distress should not be treated as trade-distorting
- b. Calculation of the quantum of subsidies on the basis of market prices prevailing in 1986-1988 is flawed and does injustice and should be dropped.

WTO and safeguard duty

The Agreement on Safeguards sets forth the rules for application of safeguard measures based on GATT 1994. Safeguard measures are defined as "emergency" actions with respect to increased imports of particular products, where such imports have caused or threaten to cause serious injury to the importing Member's domestic industry. It is imposed when there is a surge in imports of the commodity. Such measures, which in broad terms take the form of quantitative import restrictions or of duty increases to higher than bound rates. They are one of three types of contingent trade protection measures, along with anti-dumping and countervailing measures, available to WTO Members.

The guiding principles of the Agreement with respect to safeguard measures are that such measures must be temporary; that they may be imposed only when imports are found to cause or threaten serious injury to a competing domestic industry; that they (generally) be applied on a non-selective (i.e. most-favoured-nation, or "MFN") basis; that they be progressively liberalized while in effect; and that the Member imposing them (generally) must pay compensation to the Members whose trade is affected by the safeguards. Thus, safeguard measures, unlike anti-dumping and countervailing measures, do not require a finding of an "unfair" practice, must be applied on an MFN basis and must be "paid for" by the Member applying them.

Thus, safeguards are seen as responses to fair trade behaviour, as opposed to unfair trade practices such as

- Dumping
- Subsidy that attracts countervailing duty

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Safeguard duty in India

India imposed safeguard duty on steel imports as the country faced cheap steel imports flooding its market and thus protect the domestic steel sector in 2015. It aims to deter countries such as China, South Korea and Japan from undercutting local producers. Its initial rate was reduced and later it was ended in 2018. Critics say that it is counter productive as it promotes inefficiency but the answer is that it is temporary.

It was challenged by Japan in the WTO. WTO ruled in late in 2018 that India violated WTO norms in imposing the duty.

Countervailing Duties (CVDs)

Some countries subsidize their products and make them cheap to be exported. The domestic industry of the importing country is thus injured. The importing country then takes recourse to CVDs. Thus, CVDs are known as anti-subsidy duties. CVDs are imposed to neutralize the negative effects of subsidies. They are imposed after a domestic investigation finds that a foreign country subsidizes its exports, injuring domestic producers in the importing country. According to World Trade Organization rules, a country can launch its own investigation and decide to charge extra duties, provided such additional duties are in accordance with the GATT the GATT Agreement on Subsidies and Countervailing Measures.

The Commerce Ministry's investigation arm - Directorate General of Anti-Dumping and Allied Duties (DGAD) – is the probing agency. It is a country specific duty which is imposed to safeguard domestic industry against unfair trade subsidies provided by the local governments of the exporting nations. While DGAD recommends the duty, Finance Ministry imposes it.

Anti-Dumping Duty

Dumping in international trade means exporting a good at a price which is

- less than the price of the same product in a domestic market or
- less than the cost of production or
- less than fair/normal value (price in the domestic market of a third country)

Under the World Trade Organization (WTO) Antidumping Agreement, dumping is prohibited only if it causes or threatens to cause material injury to a domestic industry in the importing country. Otherwise it is not prohibited and anti dumping duty can not be imposed.

Dumping is a kind of predatory pricing in international trade. The objective of dumping may be to unfairly capture the foreign market; use the full capacity of the industry; dispose off the extra stock; drive out competition unilaterally dictate price and quality of the product.

The anti-dumping laws in India are in the Customs and Tariffs Act, 1975 (Amended 1995) and The Anti-dumping rules.

Till recently, under the trade defence mechanism in India, Directorate General of Anti-Dumping and Allied Duties (DGAD) dealt with anti-dumping and countervailing duty cases, while Directorate General of Safeguards (DGS) dealt with safeguard measures and DGFT dealt with quantitative restriction (QR) safeguards. The first two bodies were merged in 2018 into Directorate General of Trade Remedies (DGTR) under the Union Ministry of Commerce and Industry. Union Ministry of Finance had administrative control over Directorate General of Safeguards (DGS). It was transferred to the Union Commerce Ministry. DGTR also took over the safeguards (quantitative restrictions) functions of Directorate General of Foreign Trade (DGFT) into its fold.

TRIPS

Intellectual property (IP) is the work of intellect or mind to create products that have commercial uses- products like drugs, literature, paintings etc. It is protected like the physical property with trademarks, patents etc. Holders of the patents etc. are entitled to the commercial proceeds for a specified time period, exclusively.

Types of intellectual property rights:

- A patent may be granted for a new, useful, and non-obvious invention, and gives the patent holder an exclusive right to commercially exploit the invention for a certain period of time (20 years from the filing date of a patent application).
- Copyright is given for creative and artistic works (e.g. books, movies, music, paintings, photographs, and software) and give a copyright holder the exclusive right to control reproduction or adaptation of such works for a certain period of time.
- A trademark is a distinctive sign which is used to distinguish the products or services of different businesses.
- An industrial design right protects the form of appearance, style or design of an industrial object (e.g. spare parts, furniture, or textiles).

The need for agreement on IP arises from the fact that its creation takes substantial investment and should be incentivised; and the commercial proceeds from international trade in intellectual property are growing in worth.

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) of WTO

Agreement on TRIPS lays down legal standards for the member countries to protect intellectual property by way of copyright rights; geographical indications; industrial designs; integrated circuit layout-designs; patents; monopolies for the developers of new plant varieties; trademarks. It regulates dispute resolution procedures and enforcement procedures. But the brunt of TRIPS is for patents.

TRIPS and patents

A patent is an exclusionary right. It grants the right to exclude others from making use of the patented invention for the given period. In return for the patent, the inventor offers the knowledge with commercial use to be put in public domain after the expiry of the patent. Patent is an incentive to innovate and invent. It sustains research and development (R and D).

Product and process patents

Under WTO, patents can be granted for the process or product. Product patents provide for absolute protection of the product exhausting all the processes that may lead to the product, whereas process patents provide protection in respect of a specific process or method of manufacture. Protection for process patents would not prevent the manufacture of patented products by a process of reverse engineering, where a different process or method from that which has been invented (and patented) is used. For example, national legislation permitting only process patent protection allowed manufacturers in some countries like to make generic versions of patented medicines.

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TRIPS agreement allows both process and product patents, though only product patents must be awarded for food, pharmaceuticals and chemicals. Patents should be valid for 20 years. Developing countries had 10 years to adopt the TRIPS agreement standards from 1995 when the WTO and its agreements came into effect (by 2005) while the advanced countries adopted them by 1995 itself.

Members of WTO have to agree to all agreements or none. It is called single undertaking. Developing countries that had apprehensions about the product patents agreed to it because they benefited under other agreements- for example, services etc. They agreed also because they received concessional terms under TRIPS- grace period of 10 years to adopt product patents in food, pharmaceutical and chemical fields.

In line with WTO's TRIPS, India changed its patent laws.

Patents (Amendment) Act 2005

As mandated by the TRIPS, it introduced product patent regime for food, chemicals and pharmaceuticals.

Highlights of the Act

- Product patent protection to drugs, foods and chemicals
- availability of Pre-grant and Post-grant challenge
- Incremental innovation involving small scale improvements do not qualify for new patents
- Introduction of a provision for enabling grant of compulsory license and parallel imports to meet public health crises as provided for in TRIPS

Prior to 1970, 85 per cent of medicines available in India were produced and distributed by multinational corporations (MNCs) and the prices of drugs in the country were among the highest in the world. The 1970 Patents Act of India provided for process patents for pharmaceuticals and agro-chemical products. This enabled the growth of a strong local generic drug industry, which produced the same drugs as the MNCs at relatively low prices. When Indian generic manufacturers such as Cipla, Ranbaxy etc began manufacturing drugs, especially for Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (HIV/AIDS), at much lower prices, it served a public health cause. The demand for these drugs grew in countries that could not afford to buy these drugs from MNCs.

Indian government accepted TRIPS and product patents because Indian pharma industry is going global and TRIPS helps R and D to capture global pharma market. It attracts MNC investment also. TRIPS is a part of the larger WTO package.

There was a fear that prices of medicines would spiral due to product patents as it can lead to monopoly pricing. But on balance it was felt that because 97 per cent of all drugs manufactured in India are off-patent, prices would be protected. Add to that the fact that Government could control the prices of essential medicines, and the fears of price rise were seen to be largely unfounded. Drug Price Control order (DPCO) gives government the power to regulate the prices and make them affordable.

The other criticism is that patents being given for 20 years will stunt technological development in India.

On the positive side, the Act modernizes the law. It helps Indian pharma companies to grow into MNCs. Indian companies can take up contract research. FDI will flow in with all the technological benefits. Safeguard provisions help meet public health concerns. Generic manufacturers can continue in India for product patented drugs by paying a reasonable fee.

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(Generic medicines are unbranded drugs. They have the same active chemical content as the patented drug. They can be produced for drugs for which either there is a process patent or the product patent expired.)

TRIPS and Public Health Safeguards

While the TRIPS provisions are good in the long term for development of new medicines, they may go against availability of affordable medicines when there is a public health emergency. Therefore, there are two safeguards in TRIPS law that are incorporated into Indian law as well:

- compulsory licensing and
- parallel imports

Compulsory licensing means Government of the country facing public health crisis can ask for production and sale of the drugs in the country at concessional price based on a compulsory license that it issues. If the patent holder is ready, it gets the license. If not, it allows a government to temporarily override a patent and give license to another company. This allows generic copies of a patented product to be produced domestically, with compensation paid to the patent holder. Generic copies of patented drugs are much cheaper than the branded drugs thereby ensuring an adequate, affordable stock of the essential drugs. It works without the consent of the patent owner.

Multinational drug companies had demanded strong safeguards against the liberal use of the provision when India's patent law was being reframed, but the final legislation had kept the grounds for invoking this provision open-ended.

Parallel importation is the importation of drugs from another country because the country that is having a health emergency does not have the manufacturing capacity. When the pharma company that holds the patent for the drug is unwilling to price it affordably, parallel imports are the only recourse available.

India's first ever compulsory license was granted by the Intellectual Property Appellate Board (IPAB) in 2012 to Natco Pharma for the production of generic version of Bayer's Nexavar, an anti-cancer agent used in the treatment of liver and kidney cancer.

Health experts and NGOs have welcomed the order saying it would deter innovator companies from selling their drugs at exorbitant prices.

It was the only case when compulsory licensing was invoked.

US did not like it and so India was placed on the 'Priority Watch List' in the US Trade Representative's (USTR) Special 301 Review. Special 301 is a section in the US trade law that seeks to penalise the countries whose IP laws go against US interests.

Incremental Innovations

Section 3(d) of the Indian Patents Act disallows ever-greening of patents unless it differs significantly in properties with regard to therapeutic efficacy. In 2013, the Supreme Court in a landmark ruling rejected Swiss drug-maker Novartis' plea for a patent for its anti-cancer drug Glivec — beta crystalline of a known molecule called imatinib mesylate — saying it lacked novelty and failed to meet the country's patenting standards. Novartis enjoyed the patent for Glivec for 20 years and later without adequate value addition, applied for a new patent for the same drug with mere incremental innovation. It upholds India's policy stance that incremental innovations lacking "enhanced therapeutic efficacy" as assessed by the patenting authorities will not qualify for patents.

Voluntary Licensing

Gilead Sciences entered into licensing agreements with seven Indian generic manufacturers for its 'Sovaldi' (anti-Hepatitis C drug). This license allows the Indian companies to manufacture and sell the drug in any of the 91 voluntary licence (VL) countries at their own price but at a 7% royalty rate on sales. It also includes complete technology transfer of Gilead's manufacturing process. A further term is that manufacture of the active pharmaceutical ingredients (APIs) must be in India. Criticism is that the license restricts export to only the 91 listed countries. This excludes many important middle income countries, including China and Brazil which is a serious concern as over 70% of HCV patients are in middle income countries

However, the consensus opinion is that Gilead's licenses are an important victory for public health.

Anti-Counterfeiting Trade Agreement (ACTA)

MNCs of the advanced world did not accept the Indian patent laws that refused to allow ever greening and also invoked compulsory licensing provisions. They made a ACTA in 2011 - a multinational treaty for the purpose of establishing international standards for intellectual property rights enforcement.

The agreement was signed in 2011 EU, Australia, Canada, Japan, South Korea, United States and few of their friends.

Supporters described the agreement as a response to "the increase in global trade of counterfeit goods and pirated copyright protected works. What was described by ACTA supporters as TRIPS Plus is in fact seen as piracy as under the ACTA law, India generics being sent to other developing countries were sought to be confiscated under ACTA. It is anti-WTO and was watered down in course of time.

Sui Generis System

TRIPS agreement provides sui generis option regarding patent laws. Sui generis means generating by itself or of itself. It is a choice given to members in the place of TRIPS norms. That is, they can protect inventions either on the basis of TRIPS pattern of patents or any other indigenous system (sui generis) that has traditionally been in vogue in the country.

Geographical Indications (GI)

There are some goods that owe their properties to the region in which they originate and are nurtured. The climate, soil and the native efforts of the region account for their fame, utility and qualities. Some Indian examples are: Basmati Rice, Darjeeling Tea, Kanchipuram Silk Saree, Alphonso Mango, Nagpur Orange, Kolhapuri Chappal, Bikaneri Bhujia, Agra Petha, Mysore silk, Nilgiri tea, Coorg coffee, Mysore sandal products, Malabar pepper etc. They can apply for and obtain GI.

GI means any indications which identify the goods as originating in the territory of a country or a region or locality in that territory. It is used to identify agricultural, natural or manufactured goods. The manufactured goods should be produced or processed or prepared in that territory. It should have a special quality or reputation or other characteristics.

There are many benefits when a product or process is given a GI.

- It confers legal protection to Geographical Indications in India
- Prevents unauthorised use of a Registered Geographical Indication by others
- It provides legal protection to Indian Geographical Indications which in turn boost exports.

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- Protects the consumers
- It promotes economic prosperity of producers of goods produced in a geographical territory.

There are rules as to who can apply for a GI. Any association of persons, producers, organisation or authority established by or under the law can apply but the applicant must represent the interest of the producers. It is generally not granted to an individual. It is given to a product for a specific period of time (10 years in India). It can be renewed from time to time for further period of 10 years each.

GIs prevent spurious goods from entering the market. It helps maintain quality. There is greater accountability, too. It boosts exports.

GI is different from a trade mark. A trade mark is a sign which is used in the course of trade and it distinguishes goods or services of one enterprise from those of other enterprises. Whereas a geographical indication is an indication used to identify goods having special characteristics originating from a definite geographical territory. Basmati rice has GI but there are many companies that produce it with different trademarks.

In 1999, the Parliament passed the Geographical Indications of Goods (Registration and Protection) Act, 1999. This Act seeks to provide for the registration and protection of geographical indications relating to goods in India. The Act is administered by the Controller General of Patents, Designs and Trade Marks- who is the Registrar of Geographical Indications. The Geographical Indications Registry is located at Chennai. The Geographical Indications of Goods (Registration and Protection) Act, 1999 came into force in 2003. This is a sui generic legislation intended to give better protection to GIs of India.

326 products were registered as geographical indications (GI) by 2019 including 14 foreign GIs, according to Cell for IPR Promotions & Management (CIPAM) which is an arm of the Department of Industrial Policy and Promotion (DIPP). Some more examples: Kancheepuram silk and Darjeeling tea from various states enjoy the protection. Some such products are: Nagpur orange, Kangra painting, Moradabad Metal Craft, Firozabad Glass, Kannauj Perfume, Kanpur saddlery, Saharanpur wood craft, Dharmavaram handloom pattu sarees and paavadas, Warli painting, Kolhapur jaggery, Thewa art work and three Manipur-based knit works Moirang phee, Wangkhei phee and Shaphee lanphee.

Himachal Pradesh's Kangra Arts Promotion Society sought GI, saying the art form was in vogue in the foothills of western Himalayas and pigments used in Kangra paintings are derived from organic and inorganic sources. The central theme of Kangra paintings is love and the recurring themes are six seasons or music or Krishna-Radha or Shiva-Parvati.

Manipur government's department of commerce sought GI for Moirang phee, Wangkhei phee and Shaphee lanphee, which are shawls/fabric with unique needle work, to be worn as special recognition of honour.

Kolhapur jaggery seeks unique recognition for its white and golden chemical-free product having no added colour, chemicals, additives and flavours. Its application said the jiggery had natural sweetener and contained glucose, vitamins, calcium and minerals.

Bird's Eye Chilli, Mizo Chilli is given GI. The Hyderabad Haleem is one of the few Indian dish to have got a GI status. So is the famous traditional craft of Rajasthan: Blue Pottery made in Jaipur. Also, Pattachitra is a form of art that originated in Odisha. It is a pictorial narrative painted on a cloth-based scroll. Generally, the scrolls depict the tales of Hindu gods and goddesses.

Famous Banganapalle mangoes of Andhra Pradesh and Tulapanji rice of West Bengal are among the seven commodities that have been granted Geographical Indications 2017-18. Others who got

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the GI tag recently: Pochampally Ikat of Telangana; Gobindobhog Rice of West Bengal; Durgi Stone Carvings and Etikoppaka Toys of Andhra Pradesh; and Chakshesang Shawl of Nagaland. In 2016-17, as many as 33 items got GI registration.

Karnataka tops the national list followed by Tamil Nadu, Andhra Pradesh and Kerala.

French champagne and cognac, the USA's Napa Valley, the UK's Scotch whisky and Mexican Tequila are among foreign products that have acquired GI tag in India.

Joynagarer moa is a seasonal Bengali sweetmeat delicacy made of puffed rice and palm jaggery which got a Geographical Indication tag.

Sangli chi halad' (Sangli's turmeric) from Maharashtra got the GI in 2018. Geographical Indications Registry accepted the application seeking a GI tag for Erode Turmeric.

Rasgolla

In 2015, West Bengal applied for a Geographical Indication (GI) status for "Banglar Rasogolla" (Bengali Rasgulla). There was no conflict with Odisha as its application was only for a specific variant which was different in "both in colour, texture, taste, juice content and method of manufacturing" from the variant produced in Odisha. In 2017, the GI Registry of India granted West Bengal the GI status for Banglar Rasogolla.

The GI Registrar office at Chennai later clarified that West Bengal was given GI status only for the Bengali version of Rasgulla ("Banglar Rasogolla"), not for the sweet's origin. The office also stated that Odisha could also get Odisha Rasgulla's GI tag by presenting the necessary evidence.

Basmati rice

A variety of aromatic rice with short and long grains are cultivated in India. Basmati rice is globally known for its aroma and many unique cooking and eating properties owing to the agro-climatic conditions and farmers' efforts in the geographical areas of origin. In 2008, The Agricultural and Processed Food Products Export Development Authority (APEDA) applied for GI tag of Basmati rice. The Geographical Indication Registry approved the tag for the states of Punjab, Haryana, Himachal Pradesh, Delhi, Uttarakhand and parts of Western Uttar Pradesh and Jammu & Kashmir.

Madhya Pradesh filed an application for a GI tag on Basmati Rice for its thirteen districts. The place of origin for basmati rice is Indo-Gangetic Plain. Madhya Pradesh was unable to establish that it is a part of Indo-Gangetic plain. Therefore, the application was rejected by the Registry.

APEDA

APEDA is a non-trading, statutory body created under the Agricultural and Processed Food Products Export Development Authority Act, 1985 (APEDA Act), which provides for the development and promotion of export of certain agricultural and processed food products from India, including Basmati rice. The APEDA Act was amended in 2008 to confer it powers to protect intellectual property in special products such as Basmati rice. As such, APEDA is qualified to be an applicant under the Geographical Indications of Goods (Registration & Protection) Act, 1999 (GI Act).

IPR Policy 2016

GOI recently approved the National Intellectual Property Rights (IPR) Policy which lays down an institutional mechanism for implementation, monitoring and review. It aims to incorporate and adapt global best practices to the Indian scenario and to bring together the strengths of the Government, research and development organizations, educational institutions, corporate entities including MSMEs, start-ups and other stakeholders in the creation of an innovation-conducive

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environment, which stimulates creativity and innovation across sectors, as also facilitates a stable, transparent and service-oriented IPR administration in the country. The National Intellectual Property Rights (IPR) Policy endeavours for a "Creative India; Innovative India

Objectives:

The Policy lays down the following seven objectives:

- **IPR Awareness: Outreach and Promotion** - To create public awareness about the economic, social and cultural benefits of IPRs among all sections of society.
- **Generation of IPRs** - To stimulate the generation of IPRs.
- **Legal and Legislative Framework** - To have strong and effective IPR laws, which balance the interests of rights owners with larger public interest.
- **Administration and Management** - To modernize and strengthen service-oriented IPR administration.
- **Commercialization of IPRs** - Get value for IPRs through commercialization.
- **Enforcement and Adjudication** - To strengthen the enforcement and adjudicatory mechanisms for combating IPR infringements.
- **Human Capital Development** - To strengthen and expand human resources, institutions and capacities for teaching, training, research and skill building in IPRs.

DIPP is the nodal department to coordinate, guide and oversee implementation and future development of IPRs in India.

The Policy recognizes that India has a well-established TRIPS-compliant legislative, administrative and judicial framework to safeguard IPRs, which meets its international obligations while utilizing the flexibilities provided in the international regime to address its developmental concerns. It reiterates India's commitment to the Doha Development Agenda and the TRIPS agreement.

While IPRs are becoming increasingly important in the global arena, there is a need to increase awareness on IPRs in India, be it regarding the IPRs owned by oneself or respect for others' IPRs. The importance of IPRs as a marketable financial asset and economic tool also needs to be recognised. For this, domestic IP filings, as also commercialization of patents granted, need to increase. Innovation and sub-optimal spending on R&D too are issues to be addressed.

PPVFR Act

The Protection of Plant Variety and Farmers Right Act, 2001 (PPVFR Act) was made to set up an effective system for protection of plant varieties, the rights of farmers and plant breeders, and to encourage the development and cultivation of new varieties of plants. The Act was enacted to grant intellectual property rights to plant breeders, researchers and farmers who have developed any new or extant plant varieties. The rights granted under this Act are heritable and assignable and only registration of a plant variety confers the right. Essentially Derived Varieties (EDV) can also be registered under this Act and it may be new or extant. Farmers are entitled to save, use, sow, re-sow, exchange or sell their farm produce including seed of a registered variety in an unbranded manner. Farmers' varieties are eligible for registration and farmers are totally exempted from payment of any fee in any proceedings under this Act. The period of protection for field crops is 15 years and for trees and vines is 18 years and for notified varieties it is 15 years. The rights granted under this Act are exclusive right to produce, sell, market, distribute, import and export the variety. Civil and criminal remedies are provided for enforcement of breeders' rights and provisions relating to benefit sharing and compulsory licence in case registered variety is not made available to the public at reasonable price are provided. Compensation is also provided for village or rural communities if any registered variety has been developed using any variety in whose evolution such village or local community has contributed significantly.

TBT and SPS

The Agreement on Technical Barriers to Trade is an international treaty administered by the World Trade Organization.

TBT exists to ensure that technical regulations, standards, testing, and certification procedures do not create unnecessary obstacles to trade. The agreement prohibits technical requirements created in order to limit trade, as opposed to technical requirements created for legitimate purposes such as consumer or environmental protection. The TBT agreement is closely linked to the Agreement on the Application of Sanitary and Phytosanitary Measures.

The Agreement on the Application of Sanitary and Phytosanitary Measures - also known as the SPS Agreement is an international treaty of the World Trade Organization. Under the SPS agreement, the WTO sets constraints on member-states' policies relating to food safety (bacterial contaminants, pesticides, inspection and labelling) as well as animal and plant health (phytosanitary) about imported pests and diseases.

GATS

The General Agreement on Trade in Services (GATS) of the WTO is the set of regulations that governs trade in services among the WTO countries. GATS, which is one of the three agreements along with AoA and agreement on TRIPS has rules that cover a broad range of economic activity such as health care, education, telecommunications, banking, insurance, business process offshoring (BPO), tourism and so on. India is interested in these fields due to its core competence.

With GATS, multilateral trading system extends to services for the first time. GATT, its predecessor did not cover services.

In services, members of the WTO offer one another most favoured nation (MFN) status as they do for physical goods. MFN means grant of non-discriminatory trade: normal trade.

GATS negotiations are conducted among members bilaterally on the basis of requests and offers. Requests can be made by any WTO member in any service sector to any member. Each member makes bilateral requests to its major trading. These requests ask for full market access and national treatment commitments.

The GATS agreement covers four modes of supply for the delivery of services in international trade:

	Criteria	Supplier Presence
Mode 1: Cross-border supply	Service delivered within the territory of the Member, from the territory of another Member	Service supplier not present within the territory of the member
Mode 2: Consumption abroad	Service delivered outside the territory of the Member, in the territory of another Member, to a service consumer of the Member	
Mode 3: Commercial presence	Service delivered within the territory of the Member, through the commercial presence of the supplier	Service supplier present within the territory of the Member
Mode 4: Presence of a natural person	Service delivered within the territory of the Member, with supplier present as a natural person	

Trade Facilitation

Trade facilitation looks at how procedures and controls governing the movement of goods across national borders can be improved to reduce costs and maximise efficiency while safeguarding legitimate regulatory objectives. Trade facilitation is “the simplification, standardization and harmonisation of procedures and associated information flows required to move goods from seller to buyer and to make payment”. Occasionally, the term trade facilitation is extended to address a wider agenda in economic development and trade to include: the improvement of transport infrastructure, the modernization of customs administration etc.

Some examples:

Fiscal: Collection of customs duties, excise duties and other indirect taxes; payment mechanisms;

Safety and security: Vehicle checks; immigration and visa formalities.

Environment and health: Phytosanitary, veterinary and hygiene controls; health and safety measures;

Consumer protection: Product testing; labelling; conformity checks with marketing standards (e.g. fruit and vegetables)

Trade policy: Some organisations promoting trade facilitation emphasis the cutting of red tape in international trade as their main objective. Propagated ideas and concepts to reforming trade and customs procedures generally resonate around the following themes:

- Simple rules and procedures
- Avoidance of duplication
- Alignment of procedures and adherence to international conventions
- Transparent rules and procedures
- Mechanisms for corrections and appeals
- Fair and consistent enforcement
- Time-release measures
- Standardisation of documents and electronic data requirements
- Automation
- International electronic exchange of trade data
- Single Window System

A major milestone for the global trading system was reached on 22 February 2017 when the first multilateral deal concluded in the 21 year history of the World Trade Organization entered into force following its ratification by two-thirds of the WTO membership, including India.

World Trade Organization (WTO) and e-commerce

WTO members do not currently have a mandate to write new global rules on “e-commerce.”

India has been opposing attempts, mainly by the rich nations, to incorporate e-commerce in the ongoing Doha Round talks of the WTO on the grounds that it would lead to the ‘dilution’ of the ‘development agenda’ (that is to improve the trading prospects of developing countries) of the negotiations.

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Indian companies have reservations regarding a global, regional or bilateral pact on e-commerce fearing it would favour multinational firms. It involves policies on cyber security and hacking, fake goods and piracy, net-neutrality as well as safeguards to protect consumer data and ensure privacy.

Fear is that it could result in significant opening of markets for goods and services and curtail the policy space of governments to regulate and nurture its domestic producers.

Advanced countries at WTO want negotiations for "e-commerce," but developing countries oppose it. Proponents say small- and medium-sized enterprises (SMEs) will benefit using e-commerce. But SMEs are the least likely to be able to compete with giant transnational corporations, which enjoy the benefits of scale, historic subsidies, technological advances, strong state-sponsored infrastructure. The contentious issues are

- requirements to hold data locally (data localisation)
- taxation for digitally traded goods

Data is now the most precious resource- 'the new oil'. WTO will allow corporations to transfer data around the world without restrictions which would deny the right of countries to benefit from their own data and intelligence in the future. It also has serious implications for both data privacy and consumer protection. Critics of the developing countries' position call these objections "localization barriers" overlooking the legitimate concerns of the developing countries to ensure that they benefit from MNCs operating in their countries.

In the context of discussions on e-commerce, small and medium enterprises (SMEs) have come into focus. Some are saying that it will lead to gains for the MSMEs. But critics warn that MSMEs in India and in other developing countries face insurmountable problems in embracing e-commerce especially for international trade due to lack of e-commerce readiness.

India faces serious challenges in four areas in facilitating e-commerce especially international/cross border:

1. hard and soft infrastructure
2. legal framework
3. taxes and
4. administration.

For enabling e-commerce the entire logistics handling at ports/ airports has to be strengthened.

Singapore Issues

The first ministerial conference was held in Singapore in 1996. Rich countries introduced four issues that came to be known as the "Singapore issues"

- Investment by foreign companies on same terms as national companies
- Competition laws that deal with monopolies and cartels , price fixing, mergers etc. should be the same for all members on the basis of international agreement on competition
- Transparency in government procurement and creating a level playing field for all players- domestic and foreign
- trade facilitation which standardization and simplification of customs procedures

The last one came into force in 2017 but the other three continue to be opposed. Poor countries do not allow them to be brought into the agendas they feel that they might damage their economic interests.

The opposition of the poor countries rests on the following grounds.

- Doha agenda should not be overloaded and the existing issues need to be implemented first like cutting agricultural subsidies.
- large, multinational corporations dominate and threaten the young and growing domestic firms
- they are too intrusive
- policy should be the prerogative of the government. It should be made at its own discretion because such policy depends on a country's unique market conditions

The common theme of three of the issues (investment, competition, government procurement) is to maximise the rights of foreign enterprises to have market access to developing countries through their products and investment; to reduce to a minimum the rights of the host government to regulate foreign investors; and to prohibit government from measures that support or encourage local enterprises.

U.S. and the E.U support the introduction of the Singapore issues arguing that unfair competition/investment and procurement policies distort trade as much as tariffs do, and therefore should be regulated by the WTO rather than left up to individual country governments.

Doha Round

Doha Round of Trade talks under the WTO began in 2001 in Doha, the capital of Qatar. Doha was the fourth ministerial after the WTO came into force- Singapore, Geneva and Seattle being the earlier three. It is called Doha Development Round as it promised to address the issues that were important to the developing countries like India. It is yet to complete by 2019.

Developing countries believed that they were given many promises under the Marrakesh Treaty but were never delivered in matters related to agriculture, patents and so on. They insisted on having the commitments fulfilled and so opposed any further additions to the WTO agenda in the form of any new proposals. Thus, naming the Round as a Development Round was to pacify the developing countries.

Doha Round aims at further liberalizing international trade for agriculture, industry and services.

Doha round is taking so much time for many reasons

1. Developed countries are no more interested as the developing countries are resisting their agenda until the former's commitments are fulfilled
2. Also, WTO already served their purpose by having the basic rules of globalisation accepted by all and future of globalisation lies in regionalisation through RCEP etc.
3. Developments in the WTO, especially in the Doha Round negotiations, were forcing the big powers to share the economic pie with the emerging economies. For example, the public health concerns being addressed by invoking compulsory licensing; rejection of evergreening etc.
4. Set back to WTO from the protectionism of Donald Trump and his tariff and trade wars

India and Bilateral Investment Treaty (BIT)

A bilateral investment treaty (BIT) is an agreement establishing the terms and conditions for private investment by nationals and companies of one country in another. BITs are signed as part of trade pacts. Its terms include fair and equitable treatment, protection from expropriation and full protection and security. They document a country's obligations on the protection of foreign investment under international law. The unique feature of many BITs is that they allow for an

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alternative dispute resolution mechanism, whereby an investor whose rights under the BIT have been violated could have recourse to international arbitration, often under the auspices of the ICSID (International Center for the Settlement of Investment Disputes of World Bank Group), rather than suing the host State in its own courts. This process is called investor-state dispute settlement.

India terminated the bilateral investment treaties (BITs) it had signed with 58 countries—they were allowed to expire in 2017. The reason behind the termination is that India wants to renegotiate its investment treaties based on India's new model BIT. The ministry of finance is the nodal body dealing with BITs.

The recently adopted Indian model BIT tilts the balance towards the host state's regulatory power by severely limiting the substantive and procedural protection to foreign investment.

The new model BIT has clauses that are progressive for our sovereignty and policy space: reducing the extent of most-favoured nation status and national treatment clauses. The contentious change is India's insistence that foreign firms can turn to investor-State dispute settlement mechanisms — in other words, outside arbitration — only after exhausting local judicial remedies. GOI says this is necessary to stop the hundreds of arbitration cases filed against the government by foreign firms. Foreign firms say the cases are filed because the government is filing taxation and retrospective taxation and other cases against them.

As per Indian BIT's, investors can access ICSID (International Centre for Settlement of Investment Disputes) or can approach for arbitration under UNCITRAL (United Nations Commission on International Trade Law) rules. As India is not a party to ICSID convention, the Foreign investors can access Additional Facility Rules of ICSID for dispute resolution.

GOI set up a High Level Committee (HLC) in the Ministry of Law and Justice under Mr. Justice B. N. Srikrishna, Retired Judge, and Supreme Court in 2016 based on the Government's commitment to speedy resolution of commercial disputes and to make India an international hub of arbitration. Report was submitted in 2017.

Solar Panels

National Solar Mission is one of the several initiatives that are part of the National Action Plan on Climate Change with a solar power capacity target of 100 GW by 2022.

Guidelines for solar thermal mandated 30% project to have domestic content. A controversy emerged between power project developers and solar PV equipment manufacturers. The former camp prefers to source modules by accessing highly competitive global market to attain flexible pricing, better quality, predictable delivery and use of latest technologies. The latter camp prefers a controlled/planned environment to force developers to purchase modules from module manufacturers in India. Indian manufacturers want to avoid competition with global players at this nascent stage of development and the government wants to incentivise growth of local industry by mandating compulsory local content.

India's domestic content requirements were challenged in the WTO by US Trade Representative citing discrimination against US exports which is violative of WTO rules of national treatment and won the case.

H1B Visa Fee Hike and WTO-Compatibility

India launched a complaint against the US at the World Trade Organisation over the changes to visas for skilled workers that the US policy made. USA changed rules to raise fees for L1 and H1B working visas and also placed restrictions on the number of those visas awarded. India's complaint centres on a doubling in the fees for H1B and L1 visas as well as the cap that limits the number of visas awarded to 65,000 each year.

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India alleged that the U.S. is violating its obligations under General Agreement on Trade in Services (GATS), a binding agreement for all WTO member countries, as well as the GATS Annex on Movement of Natural Persons Supplying Services, to not discriminate against or between non-U.S. service providers. India contends that the fee increases do not comply with "most-favoured-nation (MFN) treatment" under the GATS, which prohibits a WTO member from treating the services and service suppliers of one WTO member less favorably than it treats comparable services and suppliers of another. While the fee hike does not specifically mention Indian companies, the provision has been tailored in such a manner that it impacts only Indian IT companies, India alleged.

The H-1B is a visa in the United States under the Immigration and Nationality Act which allows U.S. employers to employ foreign workers in specialty occupations like biotechnology, physical sciences, social sciences, medicine and health, etc in which foreign worker must possess at least a bachelor's degree.

An L-1 visa is a visa document used to enter the United States for the purpose of work from within the company- non-US to US. The visa allows such foreign workers to relocate to the corporation's US office after having worked abroad for the company.

Generalized System of Preferences (GSP) and India

Generalized System of Preferences (GSP) is a preferential tariff system extended by developed countries to LDCs and other developing countries. It involves reduced tariffs or duty-free entry of eligible products exported by beneficiary countries to the markets of donor countries.

Indian exporters benefit by way of reduced tariff or duty free entry of eligible Indian products.

This tariff preference helps new exporters to penetrate a market and established exporters to increase their market share and to improve upon the profit margins, in the donor country.

India, US and GSP

The United States Trade Representative (USTR) in 2018 announced that it is reviewing the GSP eligibility of India, along with few other countries after the US dairy industry and the US medical device industry requested a review of India's GSP benefits, given India's alleged trade barriers affecting US exports in these sectors. The GSP programme allows duty-free entry of 1,937 products worth \$5.6 billion from India into the US, benefitting exporters of textiles, engineering, gems and jewellery and chemical products.

India's response

1. Indian products exported to the US under GSP benefits such as steering wheels, parts and accessories of motor vehicles, are not finished goods but intermediaries, which find use in the making of downstream products. Providing GSP benefits to these intermediary products ensures the supply of price-competitive inputs to the US downstream industries. A withdrawal of GSP benefits and imposition of MFN tariffs on such products will only increase the import costs of such products into the United States.
2. For exporting dairy products to India, the US needs to certify that dairy products sourced from animals have not consumed feed containing internal organs or blood meal that India mandates for all countries on religious and cultural grounds. We had never closed dairy imports. Many countries like France, Germany and New Zealand are now giving the certification about the feed used and export dairy products to India. The US can also follow a similar route.

Trade relationships between India and the US have come under pressure under the Trump administration with US unilaterally raising tariffs on steel and aluminium imports from India and challenging India's export subsidy regime at the WTO. India also dragged the US to the WTO on higher steel and aluminium tariffs and threatened to impose retaliatory tariffs on US imports.

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Rules of Origin (ROO)

In international trade, Rules of origin are used to determine the country of origin of a product. Importance of ROO is derived from the fact that duties and restrictions in several cases depend upon the source of imports.

There are two types of ROO: preferential and non-preferential rules of origin. Non-preferential rules of origin are used to determine the country of origin for purposes like imposition of quotas, anti-dumping duties etc. Preferential RoO are part of a free trade area or preferential trade arrangement which includes tariff concessions. These trade arrangements might be unilateral, bilateral or regional trade arrangements. The rules of origin determine what products can benefit from the tariff concession or preference.

In FTAs, rules of origin are aimed at reserving, as far as possible, the benefit of the preferential system to the country for which it is intended, and to prevent third countries' goods from unduly exploiting the system.

For example, in South Asian Free Trade Area (SAFTA), each member country retains its external tariffs vis-à-vis non-members' goods and levies a lower tariff on the goods "originating" from the other SAFTA members. Rules of origin provide the basis for customs officials to make determinations about which goods are entitled preferential tariff treatment under the SAFTA.

In 2018, North American Free Trade Agreement (NAFTA) was recast as U.S.-Mexico-Canada Agreement (USMCA) which requires that 75 percent of automobile content be made in North America in order for automobiles to qualify for preferential, duty-free treatment.

Unless certain value addition is made in the member countries, FTAs and PTAs do not accord tariff concession.

The reason is simple: when countries forge closer economic ties, the aim is that they should develop with greater investment, employment and so on.

Regional Trading Arrangements (RTA) and Multilateralism under WTO

There are many trade blocs in the world and they existed even when the WTO took birth in 1995. There are different types of trade blocs depending on the levels of tariff concession among the members.

Preferential trade agreements (PTA) and free trade agreements (FTA) should be understood in the context of economic integration among countries.

Preferential Trade Arrangement is the first step towards integration wherein the members agree to trade with one another at a concessional tariff. The same concessional tariff is denied to non-members.

The next step is duty-free trade and elimination of quotas. It is called FTA.

The customs union is a form of economic integration involving two or more sovereign states that stipulates that there be free trade among the member states and a common tariff policy on trade with non-member states.

Later comes common market where there is a free movement of labour, capital, goods and services.

Economic union is one in which members have a common currency and fiscal and monetary policies. Presently, the EU is the only example of an economic union.

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If the economic union members have the same currency, it is called a monetary union. Some members of the European Union have formed EMU- the monetary union with common currency called Euro.

RTAs are allowed under the WTO. The reason is that the aims of the two are the same: economic integration on a wider and deeper scale. Tariffs being a barrier to trade, reducing and removing them boosts trade

- complementarities are established among the regional members
- trade creation is another argument- that is, due to free trade among members more trade is created
- higher production and greater efficiency due to enhanced competition
- free trade within a region is a beginning towards globalization as it prepares the countries to face global competition and secure benefits
- in fact, FTAs catalyse globalization as the benefits at the regional level will accelerate the pace towards a larger scale
- non-economic factors are another major incentive as more peaceful relations among the regional countries will have a virtuous effect.

The following are the problems

- Trade diversion takes place. It means trade is not created but is merely diverted. Imports are made from the FTA member due to price advantage even if a non-member is more efficient
- Also, these arrangements have other undesirable fallout like loss of revenue due to tariff reduction or removal.

Regional economic integration without prejudicing globalization and multilateralism is carried forward with 'open regionalism'. "Open regionalism" is defined as external liberalization by trade blocs (PTAs and FTAs) that is, the reduction in barriers on imports from non-member countries that is undertaken when member countries liberalize the trade among themselves.

While the regional trade blocs erode the MFN principle, the following arguments are advanced to show that they promote globalization

- regional free trade is easier to implement in comparison to globalization as the latter is difficult to be accepted by the people of the country
- domestic lobbies for protectionism can be resisted more successfully by the government at the regional level initially and later at the global level
- scope for deeper integration at the regional level- not only trade but also comprehensive economic cooperation (investment, collaborations etc.)
- open regionalism is a step towards making regional trade blocs global.

Some regional trading arrangements in force and in negotiations:

- The Trans-Pacific Partnership (TPP) was a proposed trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam, and United States from which the United States withdrew and so the agreement could not enter into force. The remaining nations negotiated a new trade agreement called Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which incorporates most of the provisions of the TPP.

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- Regional Comprehensive Economic Partnership (RCEP) is a Free Trade Agreement (FTA) scheme of the 10 ASEAN Member States and its FTA Partners (Australia, China, India, Japan, Korea and New Zealand) that is under negotiation. It is Asean- led.
- African Continental Free Trade Agreement was signed in Kigali, Rwanda in March 2018 by 44 African countries. It will make Africa the world's largest free trade area: 55 countries merging into a single market of 1.2 billion people with a combined GDP of \$2.5 trillion.
- The United States–Mexico–Canada Agreement (USMCA referred to as "NAFTA 2.0" to distinguish it from the predecessor North American Free Trade Agreement (NAFTA). Compared to NAFTA, the agreement gives the U.S. more access to Canada's dairy market, incentivizes more domestic production of cars and trucks, increases environmental and labor regulations, and introduces updated intellectual property protections.
- European Free Trade Association (EFTA) between Iceland, Norway, Switzerland and Liechtenstein
- South Asia Free Trade Agreement (SAFTA) between India, Pakistan, Nepal, Sri Lanka, Bangladesh, Bhutan ,Afghanistan and the Maldives
- Mercosur is a Regional Trade Agreement (RTA) between Brazil, Argentina, Uruguay and Paraguay.
- The Andean Community of Nations (CAN) is a trade bloc comprising the South American countries like of Bolivia, Colombia, Ecuador and Peru. Its headquarters are located in Lima, Peru.
- The Economic Community of West African States (ECOWAS) is a regional group initially of sixteen countries, founded in 1975 on the basis of Treaty of Lagos.
- The Southern African Development Community (SADC) seeks to further socio-economic cooperation and integration as well as political and security cooperation among 14 southern African countries.

India and WTO

India gained in multiple ways:

- MFN status in the 164 member body
- The one country one vote system of decision making makes WTO a democratic body where rich do not command greater voting weightage
- Rule based trading system
- Impartial trade dispute settlement process unlike earlier when there was bilateral pressures and threats to fall in line (Super and Special 301 of the USA)
- Definitive schedule for trade liberalization with special protection so as to calibrate alignment with global economy
- Opportunity to throw up MNCs in the pharma and other sectors
- To become a global hub for R&D investment with the acceptance of TRIPS
- The globalization process that WTO ensures is the course chosen by India as a part of the economic reforms launched in 1991.
- India has advantage in the services sector and will benefit from its opening up

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The opponents argue the following

- While globalization adds value, its pace must be set by the sovereign government
- The agreement on TRIPS works against affordable medicines
- Multinational corporations influence the agreements and their working in WTO to their advantage
- Farmers may lose their livelihood as agriculture is compulsorily thrown open to imports at lower import duties
- Rich countries are not following their treaty obligations and reduce agricultural subsidies and tariffs

The benefits quoted above are becoming scarce as there is retreat of globalisation under Donald Trump, President of the USA. The dispute settlement body is also being weakened with non-appointment of members as they retire. Tariffs are being raised by the USA and trade wars are being fought without any accountability to the WTO. For steel and aluminium tariff hikes, an unprecedented clause was invoked by Trump which is national security.

Groups

G-10 are major food-importing economies like Japan, South Korea, Taiwan, Norway, Switzerland Israel etc. It has rich and poor representatives (Bulgaria etc.)

Group of 20 (also called G20+) is a bloc of developing nations established in the 5th Ministerial WTO conference, held in Cancun in 2003. It stands for drastic reduction in agricultural subsidies by industrialized nations and opposed further liberalization. It is different from the G20 that is having annual summits since 2008 after the Lehman bankruptcy.

G-33 comprises developing countries like India, Indonesia etc. with defensive farm interests that involves protecting farmers from imports. It is an alliance of developing countries on Special Products (SP) and Special Safeguard Mechanism (SSM) in the ongoing agriculture negotiations.

While G-20 consists of developing countries with exporting interests as well as defensive interests, the G-33 includes only those developing countries with defensive interest in agriculture.

G-90 is the group of Least developed countries (LDCs) along with other countries from Africa, the Caribbean and Pacific formed G-90 during the Cancun conference in 2003.

Protectionism

When a country protects its domestic producers with high tariffs and quantitative restrictions on imports it is called protectionism. Protectionism seeks to discourage foreign participation in local markets. Protectionism "protects" domestic businesses and workers within a country. It contrasts with free trade in which government barriers to trade are kept to a minimum.

Critics say its costs outweigh the benefits: it is unfair as lack of competition makes domestic industry uncompetitive, unproductive and costly; restricts consumer choice, hurts growth, inhibits innovation etc. However, on a temporary basis it does provide security of operations.

For example, policies being followed by Britain after Brexit vote; Donald Trump's isolationism; US restrictions on H1B visas etc. Protectionism is associated with import substitution.

US followed post-recession in 2008 'buy American' philosophy and still follows "America first" policy. The basis for it is the loss of jobs due to globalization in the west.

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Due to relocation of western industries to China, there were job losses in those economies which was deeply resented by people.

Later, since 1990's not only the blue-collar jobs were lost to foreign competition but there was offshore outsourcing and the loss of white-collar jobs as well.

There are three types of protectionism:

- help protect infant industries as India followed them in the pre-reform period. It allows domestic industries to grow and become strong before they are opened up for competition
- protectionism for public interest and social good like SP and SSM mechanisms under WTO
- the third variety is when the economy is in crisis and politically it becomes necessary to close the economy for imports to save jobs. For example, many countries in the global recession (2008-09). These are temporary measures lasting till the crisis lasts.

A variety of policies can be used to achieve protectionist goals. These include:

- Tariffs
- Import quotas
- Domestic Subsidies: Government subsidies are given to national businesses that cannot compete well against foreign imports. These subsidies aim to secure domestic jobs, and to help local companies to withstand competition.
- Export Subsidies
- currency manipulation: A government may intervene in the foreign exchange market to lower the value of its currency by selling its currency to discourage imports and make exports attractive.
- imposing labor or environmental standards to keep out foreign goods (non-tariff barriers apart from QRs)
- imposition of restrictive certification procedures on imports are seen in this light.

Trade war

When two countries impose higher tariffs and QRs on each other in order to protect their own economies and also to hurt the economy of the other, it is called trade war. It is the opposite of economic integration with lesser and no tariffs and restrictions.

Recent examples are the Trump tariffs imposed by the US President Donald Trump as part of his economic policy. They are

1. tariffs on solar panels and washing machines of 30 to 50 percent
2. tariffs on steel (25%) and aluminum (10%) from most countries including India
3. tariff of 25% on hundreds of categories of goods imported from China

Trading partners implemented retaliatory tariffs on U.S. goods.

Trump tariffs were a part of the trade war waged by the US as a part of its overall economic policy of 'America First' in which American economic interests like growth, investment and jobs are sought to be protected even if it meant waging a trade war. It is a response to the loss of blue and white collar jobs consistently for three decades of globalisation and the sharpening inequalities- social and economic – as a result ; and also the anxieties bred by automation that could spell job losses in future. These policies are populist as their economic rationality is

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negative as they hurt US consumers due to higher cost; global trade will slow down that will also hurt the US. The policies may have popular appeal but that is only in the short term.

For example, steel and aluminium imports began to harm the US economy as large companies like the GM was downsizing its labour force due to highest input costs. Companies were relocating outside the US as imports were costing more and thus pushing up cost of production.

Threats to the WTO

The main threats are

- US opposition to multilateralism expressed by way of tariff and trade wars and blocking appointments to the DSB of the WTO which belittles the credibility of the multilateral body
- Globalisation itself is being questioned by some nationalist parties in various nations as it means opening up to world flows more than the countries are ready for. For example, Brexit
- As globalisation is unfair to some nations, there is resentment among them against WTO

Previously it was thought that regional bodies like RCEP etc. are threats but no longer so as their pace is slowing and also they stand as the goals that WTO itself has for future integration.

Asian Clearing Union

The Asian Clearing Union (ACU) was established with its headquarters at Tehran, Iran in 1974 at the initiative of the United Nations Economic and Social Commission for Asia and Pacific (ESCAP), for promoting regional economic co-operation. The Central Banks of Iran, India, Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka, Myanmar and Maldives are currently the members of the ACU.

The main objectives of a clearing union are to facilitate payments among member countries for eligible transactions on a multilateral basis, thereby economizing on the use of foreign exchange reserves and transfer costs, as well as promoting trade among the participating countries.

The Asian Monetary Units (AMUs) is the common unit of account of ACU and is denominated as 'ACU Dollar' and 'ACU Euro', which is equivalent in value to one US Dollar and one Euro, respectively. All instruments of payment under ACU have to be denominated in AMUs.

WTO Words

- ACP countries - About 70 African, Caribbean and Pacific (developing) countries that have preferential access to the EU market.
- AMS – Aggregate Measure of Support shows the extent of support- provided by governments to the agricultural sector, including direct payments to farmers and intervention in the market, e.g. through setting minimum prices. There are limits set on AMS under the AOA of WTO.
- Beggar thy neighbour it is a policy by which one nation develops at the expense of others. Beggar thy neighbor is an attempt to solve the economic problems in one country by means which hurt the economies of others. China is accused of following it by deep devaluation of renminbi and boosting its exports. Its competitors lost out to it in the process. They were deindustrialized and lost jobs. China's devaluation of currency and dumping practices have hurt Indian economy severely. Many MSMEs had to close down.
- Cairns Group – A group formed in 1986, comprising 17 WTO members dedicated to the fundamental reform of the agricultural trading system. The Chair is Australia. Other members are New Zealand, Argentina, All but three – New Zealand, Australia and Canada – are developing countries.

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- Multilateral – among many parties, e.g. the WTO is a multilateral organisation involving 164 economies. Plurilateral means some of the members in a wider body.
- NAMA: Non-Agricultural Market Access. Non Agricultural Market Access (NAMA) relates to trade negotiations on non-agricultural or industrial products. In the NAMA negotiations, WTO Members discuss the terms or modalities for reducing or eliminating customs tariff and non-tariff barriers on trade in industrial products. NAMA 11 is a coalition of strong developing countries. They are fighting to get a fair deal from the north countries. India is a member.
- Natural persons - People, as distinct from juridical persons such as companies and organisations. 'Movement of natural persons' concerns the ease of travel through and ability to live and work in other countries.
- Non-tariff barriers – government measures others than tariffs that restrict trade flows. Examples include quantitative restrictions, import licensing, standards and conformance regulations.
- Round – the process of multilateral trade negotiations. Each of the eight sets of negotiations prior to the Doha Development Agenda (DDA) has been called a Round, e.g. the Uruguay Round, the Tokyo Round.
- Safeguard action - temporary measures to allow countries to adjust to heightened competition from foreign suppliers, even where the competition is not a result of dumped or subsidised product.
- Tariff escalation - tariff rates that increase with each additional level of processing, thus penalising value added products, as is often the case with our wood exports.
- Tariff peaks – tariffs on particular products that are significantly higher than the general tariff that the country levies on the full range of imports.
- Tariff rate quotas - allow a certain volume of product access at a lower tariff level. A higher tariff is charged on products imported outside the tariff quota.

BRETTON WOODS INSTITUTIONS: INTERNATIONAL MONETARY FUND

The United Nations Monetary and Financial Conference, commonly known as Bretton Woods conference, held in Bretton Woods, New Hampshire, USA in 1944 to regulate the international monetary and financial order after the conclusion of World War II concluded agreements to set up the International Bank for Reconstruction and Development (IBRD) - popularly known as World Bank; and the International Monetary Fund (IMF). The two institutions are known as the Bretton Woods twins. They are specialized agencies of the United Nations. The IMF was set up to promote and maintain monetary stability at global level. The IBRD was created for post-war reconstruction.

IMF

The International Monetary Fund has 189 members (2017). India is a founding member. It is headquartered in Washington and its Managing Director is Christine Lagarde serving her second five-year term starting on from 2016.

IMF Objectives

IMF objectives are:

- To promote international monetary cooperation
- To facilitate balanced growth of international trade for the economic growth of all member countries
- To promote exchange rate stability; maintain orderly exchange rate arrangements; and to advise against competitive exchange rate revaluation
- To help members in times of balance of payments crisis

The functions that the IMF performs that we will see ahead are all meant to achieve the objectives.

Governance Structure

The Board of Governors is the highest decision-making body of the IMF. It consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the head of the central bank. While the Board of Governors has delegated most of its powers to the IMF's Executive Board, it retains the right to approve quota increases, special drawing right (SDR) allocations, the admittance of new members and amendments to the Articles of Agreement and By-Laws. The Board of Governors also elects or appoints executive directors.

The IMF Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC) and the Development Committee. The IMFC meets twice a year, during the Spring and Annual Meetings. The Committee discusses matters of common concern affecting the global economy and also advises the IMF on the direction its work.

The Development Committee is tasked with advising the Boards of Governors of the IMF and the World Bank on issues related to economic development in emerging and developing countries.

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The Boards of Governors of the International Monetary Fund (IMF) and World Bank Group (WBG) normally meet once a year to discuss the work of their respective institutions. The Annual Meetings generally take place in September/October. The Annual Meetings include meetings of the International Monetary and Financial Committee, the Development Committee, the Group of Ten, the Group of Twenty-Four, and various others.

In addition to the Annual Meetings, the IMF's International Monetary and Financial Committee (IMFC) and the joint World Bank-IMF Development Committee (DC) hold meetings each spring to discuss progress on the work of the institutions.

International Monetary and Financial Committee (IMFC)

The IMFC has 24 members who are central bank governors, ministers, or others of comparable rank and who are usually drawn from the governors of the Fund's 189 member countries. The IMFC advises and reports to the IMF Board of Governors on the supervision and management of the international monetary and financial system, including on responses to unfolding events that may disrupt the system. Although the IMFC has no formal decision-making powers, in practice, it has become a key instrument for providing strategic direction to the work and policies of the Fund. The IMFC usually meets twice a year, at the Bank-Fund Annual and Spring Meetings.

Development Committee

Development Committee, was established in 1974 to advise the Boards of Governors of the IMF and World Bank on critical development issues and on the financial resources required to promote economic development in developing countries. The Committee usually meets twice a year following the IMFC meeting. The Development Committee has 25 members.

Functions of IMF

In order to achieve the above objectives, the IMF monitors the world's economies, lends to members in economic difficulty on the external account and provides technical assistance.

To elaborate, the work of the IMF is of three main types:

- Lends to countries with balance of payments difficulties.
- Surveillance which involves the monitoring of economic and financial developments of every member country and the provision of policy advice, aimed especially at crisis-prevention and resolution. Also, appraisal of the exchange rate policies of member countries. In the absence of surveillance, the financial volatility in the world today can become worse. Provides countries with technical assistance and training in its areas of expertise.
- plays an important role in the fight against money-laundering and terrorism

Benefits to member countries of the IMF are many. Basically, they get BoP assistance as IMF is like a lender of last resort. They have access to information on the economic policies of all member countries, the opportunity to influence other members' economic policies, technical assistance in banking, fiscal affairs, and exchange matters, financial support in times of payment difficulties, and increased opportunities for trade and investment

IMF Quota

Upon joining, each member of the IMF is assigned a quota- the amount that the country has to pay to the IMF. It is based broadly on its relative size in the world economy. A member's quota guides:

- subscriptions: the amount the member is obliged to provide to the IMF.
- voting power
- the amount of financing a member can obtain from the IMF when it has need.

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Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. Upon joining the IMF, a country normally pays up to one-quarter of its quota in the form of widely accepted foreign currencies (such as the U.S. dollar, euro, yen, or pound sterling) or Special Drawing Rights (SDRs). The remaining three-quarters are paid in the country's own currency. The largest member of the IMF is the United States. The IMF reviews members' quotas once in five years.

The IMF's Board of Governors conducts general quota reviews at regular intervals (no more than five years). Any changes in quotas must be approved by an 85 percent majority of the total voting power, and a member's own quota cannot be changed without its consent. Two main issues addressed in a general quota review are the size of an overall quota increase and the distribution of the increase among the members. A general review allows for realignments in members' quota shares to reflect changes in their relative positions in the world economy. A quota formula is used to help assess members' relative position in the world economy and it can play a role in guiding the distribution of quota increases.

The 15th Review is underway and it provides an opportunity to assess the appropriate size and composition of the IMF's resources and to continue the process of governance reforms to realign quota shares with members' relative positions in the world economy, while protecting the poorest members. India benefits from it.

The reforms also increase the financial strength of IMF, by doubling its permanent capital resources to about 500 billion SDRs. For the first time, four emerging market countries — BRIC will be among the 10 largest members of the IMF. Other top 10 members include the US, Japan, and the four largest European countries (France, Germany, Italy, and the UK).

Special Drawing Rights (SDRs)

IMF lends in its own artificial currency unit called the SDR. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of five key international currencies—dollar, euro, yen, pound and Chinese Yuan which was included in 2016. Five currencies with their weights in descending order are: U.S. dollar; Euro; Renminbi (Chinese yuan); Japanese yen; and British pound. The basket composition is reviewed every five years to ensure that it reflects the relative importance of currencies in the world's trading and financial systems.

Some criteria for inclusion in the basket: that the issuing country is among the largest exporters in the world and that its currency is "freely usable." A currency is determined to be freely usable when it is widely used to make payments for international transactions and widely traded in the principal exchange markets.

The SDR value in USD terms in November 2017 is US\$1.38 by the end of 2018.

SDRs can be exchanged for national currencies. SDRs are not traded in the forex market like other national currencies but can be exchanged between countries. Private parties do not hold or use them. SDR is neither a currency, nor a claim on the IMF. It is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs.

SDRs as global reserve currency

The international monetary system needs reform as was made evident by the 2008 global financial crisis. Dollar as a global reserve currency is neither as viable nor desirable to the same degree as before the great recession of 2018.

John Maynard Keynes once proposed a global currency, the Bancor, to be placed at the centre of the international monetary system. It did not find favour as every large economy wants its own

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currency as a global reserve currency. US dollar dominates the global reserve system. This has disadvantages. It creates tension due to the use of a national currency, the dollar, as the global currency. This can lead to global volatility as a result of growing US twin deficits. US monetary policy impacts the whole world though it is made with the US interests in mind. Nor is there any other currency that can replace the USD.

Some experts argue that the global role of SDRs should be increased as it would help diversify the risk from forex holdings; lessen chances of global financial volatility; make US policies relatively less important for the world etc. Global stability enhances as dollar worries recede.

However, SDRs can only supplement the dollar and other global reserve currencies and gold as the SDR is the creation of US and the west within the IMF. If SDR becomes a rival to dollar and yen, it may not receive the support of these countries. Nor are the SDRs created in such huge numbers as is warranted to play the larger role that some are recommending.

IMF Borrowing Arrangements

While quota subscriptions of member countries are its main source of financing, the IMF can supplement its resources through borrowing if it believes that resources might fall short of members' needs. Such additional funds are raised through

General Arrangements to Borrow (GAB) and

New Arrangements to Borrow (NAB)

GAB and NAB are credit arrangements between the IMF and a group of members and institutions to provide supplementary resources to the IMF to prevent or cope with problems of the international monetary system or to deal with an exceptional situation that poses a threat to international monetary stability. General Arrangement to Borrow (GAB) has a life that ends by the end of 2018.

India funded IMF for bailouts in financially-stricken Europe, marking a historic role reversal from 1991 when it had to borrow International Monetary Fund (IMF) to avert a balance of payments crisis.

India provided loans of US\$12 billion to New Arrangements to Borrow (NAB) when the sovereign debt crisis in Europe worsened.

How the IMF lends

A core responsibility of the IMF is to provide loans to member countries experiencing balance of payments problems. This financial assistance enables countries to rebuild their international reserves; stabilize their currencies; continue paying for debt servicing and imports; and restore conditions for strong economic growth while undertaking policies to correct the underlying problems. Unlike development banks, the IMF does not lend for specific projects.

The changing nature of IMF lending

The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF lending. In the 1990s, the transition process in Central and Eastern Europe and the crises in emerging market economies led to further surges of demand for IMF resources. IMF lending rose again in late 2008 in the wake of the global financial crisis.

IMF Facilities

Over the years, the IMF developed various loan instruments, or facilities, that are tailored to address the specific circumstances of its diverse membership.

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Low-income countries may borrow at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF).

The Exogenous Shocks Facility (ESF) provides policy support and financial assistance to low-income countries facing global shocks. For example, due to commodity prices falling etc.

Non-concessional loans are provided mainly through Stand-By Arrangements (SBA) for members who are in a BOP crisis. When a member takes SBA, he may opt for a long term Extended Fund Facility (EFF) which requires basic changes in the economic policy orientation to open up the economy; or he may not opt out of such EFF having used the SBA funds well and not needing any further assistance. The IMF also provides emergency assistance to support recovery from natural disasters and conflicts, in some cases at concessional interest rates.

Except for the PRGF and the ESF, all facilities are subject to the IMF's market-related interest rate. The amount that a country can borrow from the Fund—its access limit—varies depending on the type of loan, but is typically a multiple of the country's IMF quota. This limit may be exceeded in exceptional circumstances.

In 2018, IMF agreed to give about 57 billion US\$ to Argentina as a bailout assistance which is the largest ever assistance to a single country in the history of IMF.

The IMF's analysis of global economic developments, contained in its World Economic Outlook, provide finance ministers and central bank governors with a common framework for discussing the global economy.

Twice a year, it publishes the Global Financial Stability Report.

The IMF's performance is assessed on a regular basis by an Independent Evaluation Office.

IMF and Conditionality

IMF conditionality is a set of policies or conditions that the IMF wants the debtor country to adopt in exchange for the loan. The IMF requires the government seeking assistance to correct its macroeconomic imbalances in the form of policy reform. Fund is delivered in tranches (installments) linked to policy changes. If the conditions are not met, the funds are withheld. Some conditionalities enforce structural adjustment wherein the economy is opened up to globalization and privatization. Some are of short term significance like expenditure cuts. Some of the conditions include:

- Cutting expenditures, also known as austerity.
- Devaluation of currencies,
- Trade liberalisation, or lifting import and export restrictions,
- open up to foreign direct investment
- allow foreign participation in domestic stock markets
- Balancing budgets and not overspending,
- Removing price controls and state subsidies,
- Privatization
- deregulate the exchange rate
- currency convertibility
- downsize the government
- enact flexible labour sector reforms
- Enhancing the rights of foreign investors vis-a-vis national laws
- Improving governance and fighting corruption.

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These conditions are known as the Washington Consensus.

These loan conditions ensure that the borrowing country will solve its balance-of-payment problems and have access to enough foreign currency to be able to repay the IMF and that the country will

These conditionalities need not be followed rigidly but must be adopted for the growth of the economy. Most countries can not follow these policies with popular support as they hit poor.

Conditionalities thus created controversy. The Fund admitted that too many conditions were imposed on borrowers and it created backlash.

Another criticism about the conditionalities is that the reforms suggested are the same for all countries irrespective of the causes of the crisis.

India suggested that the IMF conditionalities must be more sensitive to the domestic realities of the member countries.

IMF and the global financial crisis

The great recession that followed the Lehman Brothers bankruptcy was the worst crisis since the Great Depression of 1929-39. The institution that rose to global expectations to rescue the countries affected by the BoP crisis was the IMF which mobilized on many fronts to support its member countries, increasing its lending, using its cross-country experience to advise on policy solutions and introducing reforms to become more responsive to member countries' needs. It stepped up crisis lending, including a sharp increase in concessional lending to the world's poorest nations and provided analysis and targeted advice.

The IMF created a broad financial safety net to limit the spread of the crisis.

Since 2010 the IMF focused largely on Europe after the outbreak of the sovereign debt crisis that has threatened the euro, though it did give attention to other countries as well, for example, Pakistan in 2018.

IMF and social protection

Social protection refers to policies designed to ensure income security of the poor and the vulnerable. Universal social protection includes: adequate cash transfers for all who need them, especially children; benefits and support for people of working age in case of maternity, disability, work injury or for those without jobs; and pensions for all older persons. This protection can be provided through social insurance, tax-funded social benefits, social assistance services, public works programs and other schemes guaranteeing basic income security.

To incorporate social protection considerations into IMF operational work, it works with relevant partner institutions. The relevant institutions include: the World Bank, in the areas of poverty assessment, provision of social safety nets and basic social services, and improving the effectiveness and pro-poor orientation of public expenditures; the International Labour Organization (ILO), in the area of labor market and related social policy reforms; United Nations Children's Fund (UNICEF); the Organization for Economic Cooperation and Development (OECD); regional development banks; and bilateral aid agencies etc.

IMF, Money-laundering and terror finance

Money laundering is the process of hiding the link between financial and physical assets generated by criminal activity and their illegal origins. Terror financing raises money to support terrorist activities. Both these activities exploit the same vulnerabilities in financial systems that allow for an inappropriate level of anonymity and opacity in carrying out transactions. The IMF is concerned because these illicit activities can discourage foreign investment and distort

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international capital flows. They may also result in welfare losses, draining resources from more productive economic activities, and even have destabilizing effects on other countries. In an increasingly interconnected world, the harm done by these activities is global.

Since 2000, the IMF responded to calls from the international community to expand its work on anti-money laundering (AML). After the tragic events of 9/11 in 2001, the IMF intensified its AML activities and extended them to include combating the financing of terrorism (CFT). IMF set up a fund to finance AML/CFT capacity development in its member countries. IMF helped shape domestic and international AML/CFT policies. The IMF also analyzes global and national AML/CFT regimes and how they deal with issues such as virtual currencies, Islamic finance, costs of and mitigating strategies for corruption etc.

FATF

The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

The FATF has developed a series of Recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They form the basis for a co-ordinated response to these threats to the integrity of the financial system and help ensure a level playing field.

The FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter measures, and promotes the adoption and implementation of appropriate measures globally. In collaboration with other international stakeholders, the FATF works to identify national level vulnerabilities with the aim of protecting the international financial system from misuse.

To help national governments set up effective AML/CFT regimes, the FATF issued a list of recommendations that set out a basic, universally applicable framework of measures covering the criminal justice system, the financial sector, certain non-financial businesses and professions, transparency of legal persons and arrangements, and mechanisms of international cooperation.

The FATF's decision making body, the FATF Plenary, meets three times per year.

Its headquarters are in Paris.

India and the IMF

India is one of the IMF's original members. India and the IMF have had a symbiotic relationship, which has been beneficial for both

The IMF provided India with loans over the years and this helped the country in times of BOP pressure. IMF credit has been instrumental in helping India respond to balance of payments problems on two occasions. In 1981-82, India borrowed SDR 3.9 billion. In 1991-93, India borrowed a total of SDR 2.2 billion under two stand-by arrangements (SBA), and in 1991 it borrowed SDR 1.4 billion under the Contingency Compensatory Financing Facility (CCFF).

India subscribes to the IMF's Special Data Dissemination Standard. Countries belonging to this group make a commitment to observe global accounting standard in government finance and to provide information about their data and data dissemination practices.

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The relationship between the IMF and India has grown strong over the years. In fact, the country turned into a creditor to the IMF and has stopped taking loans from it. India lent to the IMF in 2012 to bail out the Eurozone countries. India needs IMF as its globalizing economy carries risks like any other; it also needs IMF for technical training and capacity building; it needs to contribute to global monetary stability for its own enlightened self interest; it needs the SDR to diversify its forex holdings for greater safety.

Reforming the IMF

Role of IMF was criticized for the following reasons

- One size fits all policy under which it gives the same recipe for all ills
- Conditionalities that go with the loans that it disburses demand that spending on social sector be curtailed
- IMF Managing Director is invariably from a European country as a convention (the current MD, Christine Lagarde is from France) and India and other emerging markets are demanding that it should not be geographically confined and be merit – based
- India wants that its economic power, as it is emerging, should be recognized and so is given greater voting rights
- IMF failed to predict the global recession in 2008-09, let alone prevent it with its surveillance role

Reforms have taken place after the global crisis in some of these matters.

Chiang Mai Initiative

The Chiang Mai Initiative (CMI) is a multilateral currency pooling arrangement among the ten members of the Association of Southeast Asian Nations (ASEAN), the People's Republic of China (including Hong Kong), Japan, and South Korea. It draws from a foreign exchange reserves pool worth US\$240 billion that was launched in 2010.

After 1997 Asian Financial Crisis, member countries started this initiative to manage regional short-term liquidity problems and to facilitate the work of other international financial arrangements and organisations like International Monetary Fund. It has never been used as there has not been a crisis since 1997 Asian financial crisis.

BRICS CRA

The BRICS Contingent Reserve Arrangement (CRA) is a pool of foreign currency reserves for the member countries to draw from, when they face any balance of payments crisis- actually or potentially. Each member contributes to the pool which is a safety net. It was established in 2015 by the BRICS countries Brazil, Russia, India, China and South Africa after being signed at Fortaleza, Brazil in 2014. It became operational in 2016.

The objective of this reserve is to provide protection against global liquidity pressures when members' national currencies are adversely affected by global financial pressures. It is an example of south-south cooperation- that is cooperation among developing countries. It plays a role similar to the IMF and thus is complementary to the IMF. Some see CRA as a competitor to the International Monetary Fund (IMF). That is debatable though.

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CRA has a capital of \$100 billion which is distributed as follows:

Country	Capital contribution (billion USD)	Access to Funds (billion USD)	Voting Rights
Brazil	18	18	18.10
China	41	21	39.95
India	18	18	18.10
Russia	18	18	18.10
South Africa	5	10	5.75
Total	100	85	100.00

Under the terms of the arrangement of CRA, each country can only borrow a part of its contribution before going to the IMF for a stand-by arrangement with the IMF. It works out to a very small amount when compared to the IMF resources.

G-10

The Group of Ten (G10) refers to the group of countries that have agreed to participate in the General Arrangements to Borrow (GAB), a supplementary borrowing arrangement that can be activated if the IMF's resources are not enough to meet a member's needs. The GAB was established in 1962 to make resources available to the IMF.

G-15

The Group of Fifteen (G15) was established at the Ninth Non-Aligned Summit Meeting in Belgrade, then Yugoslavia, in 1989. It is composed of countries from Latin America, Africa, and Asia with a common goal of enhanced growth and prosperity. The G15 focuses on cooperation among developing countries in the areas of investment, trade, and technology. The membership of the G15 has since expanded to 17 countries but the name has remained unchanged. India is a founding member.

G-20

The Group of 20 (G20) is a group of advanced and emerging market economies. In the aftermath of the financial crises in the late 1990s in East Asia, the G20 was created in 1999 to strengthen policy coordination between its members, promote financial stability, and modernize the international financial architecture.

Before the outbreak of the global financial crisis in 2008, G20 meetings of Finance Ministers and Central Bank Governors were held to discuss international financial and monetary policies, reform of international financial institutions, and issues surrounding economic development. The first G20 Leaders' Summit at the level of Heads of State and Government was held in 2008. Since then, following the Lehman meltdown, G20 assumed an increasingly active role on global economic issues. This culminated in leaders designating the G20 as "the premier forum for our international economic cooperation". The IMF works closely with the G20, particularly on issues related to global economic growth and international monetary and financial stability.

The membership of the G20 includes the European Union, which is represented by the rotating Council Presidency and the European Central Bank. To ensure that global economic forums and institutions work together, the Managing Director of the IMF and the President of the World Bank, plus the Chairs of the IMFC and the Development Committee, also participate in G20 meetings on an ex-officio basis. Argentina is the 2018 chair of the G20, to be followed by Japan in 2019.

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G-24

The Group of Twenty-Four (G24) was established in 1971 to coordinate the positions of emerging markets and developing countries on international monetary and development finance issues and to ensure that their interests were adequately represented at the Bretton Woods Institutions, particularly in the IMFC and Development Committee meetings of the IMF and World Bank. The group is not an organ of the IMF but the IMF provides secretariat services for the Group. The Ministers of the Group meet twice a year, prior to the IMFC and Development Committee meetings. Although membership in the G24 is strictly limited to 24 countries, any developing country that is a member of the G77 can participate in the meetings as an Observer. China has been a "special invitee" since 1981.

G-77

The Group of Seventy-Seven (G77) was established in 1964, by Seventy-Seven Developing Countries at the end of the first session of the United Nations Conference on Trade and Development (UNCTAD) in Geneva. It was formed to articulate and promote the collective economic interests of its members and to strengthen their joint negotiating capacity on all major international economic issues in the United Nations system. The membership of the G77 has since expanded to 134 member countries but the original name has been retained because of its historical significance. Egypt held the Chairmanship of the Group of 77 for the year 2018. State of Palestine is Chair for the year 2019.

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WORLD BANK GROUP

The World Bank Group (WBG) is a family of five international organizations:

- International Bank for Reconstruction and Development (IBRD)
- International Development Association (IDA)
- International Finance Corporation (IFC)
- Multilateral Investment Guarantee Agency (MIGA)
- International Centre for Settlement of Investment Disputes (ICSID)

Of the five, the most important is the IBRD that was conceived as a multilateral UN body for post-war reconstruction in 1945 following international ratification of the Bretton Woods agreements, which emerged from the United Nations Monetary and Financial Conference (1944). It undertook post-war reconstruction of western Europe. After the historic task was completed, its attention was focused for some decades on developing countries to alleviate poverty.

World Bank Group (WBG) has its headquarters in Washington. Its head is called President and is Jim Yong Kim, South Korean-American physician and anthropologist who has served as the 12th President of the World Bank since 2012 and is on second 5 year term. The President of the World Bank is conventionally an American. There are 189 countries in the WB presently.

It is responsible for the preparation of the World Development Report.

World Bank Group is owned by its member governments which subscribe to its basic share capital, with votes proportional to shareholding. Membership gives certain voting rights that are the same for all countries but there are also additional votes which depend on financial contributions to the organization. Thus, members have a weighted voting based on their contribution to WB's financial resources. WB raises finances from the global credit markets as well unlike the IMF.

A country has to first join IMF before it can be a member of the WB.

IBRD and IDA

The term "World Bank" refers to the IBRD and IDA, whereas the World Bank Group is used to refer to all the five institutions collectively. All the five did not come into force at the same time.

The World Bank's (i.e. the IBRD and IDA's) activities are focused on developing countries, in fields such as human development (e.g. education, health- Swachh Bharat Mission, Sarva Shiksha Abhiyan etc), agriculture and rural development (e.g. irrigation, rural services -Pradhan Mantri Krishi Sinchayee Yojana (PMKSY), Watershed Management Project "Neeranchal" etc), poverty alleviation (Deen Dayal Antyodaya Yojana-National Rural Livelihoods Mission (DAY-NRLM)), environmental protection (e.g. pollution reduction, establishing and enforcing regulations- National Ganga River Basin Project etc), infrastructure (e.g. roads, urban regeneration, electricity, ports Port Modernization & New Port Development under Sagarmala), and governance (e.g. anti-corruption, legal institutions development).

The IBRD and IDA provide loans at soft rates to member countries, as well as grants to the poorest countries. Loans or grants for specific projects are often linked to wider policy changes in the economy. For example, a loan to improve coastal environmental management may be linked to development of new environmental institutions at national and local levels and the implementation of new regulations to limit pollution.

The IBRD focuses on middle income and creditworthy poor countries, while IDA focuses on the poorest countries in the world.

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IDA

The International Development Association (IDA) helps the world's poorest countries.

IDA was created in 1960 and is responsible for providing long-term, interest-free loans to the world's about 80 poorest countries. IDA repayments are stretched over 25 to 40 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress. In addition to concessional loans and grants, IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

While the IBRD raises most of its funds on the world's financial markets, IDA is funded largely by contributions from the governments of its richer member countries. Additional funds come from IBRD's and IFC's income and from borrowers' repayments of earlier IDA credits.

Donors meet every three years to replenish IDA funds and review IDA's policies. The most recent replenishment of IDA's resources, the eighteenth (IDA18), has a size of \$75 billion to finance projects over the three-year period from 2017 to 2020.

IDA loans address primary education, basic health services, clean water supply and sanitation, environmental safeguards, business-climate improvements, infrastructure and institutional reforms. These projects are intended to pave the way toward economic growth, job creation, higher incomes and better living conditions.

Eligibility for IDA support depends on a country's relative poverty, defined as per capita income below an established threshold and updated annually (\$1,165 in fiscal year 2018). IDA also supports some countries, including several small island economies, that are above the operational cutoff but lack the creditworthiness needed to borrow from the International Bank for Reconstruction and Development (IBRD). Some countries, such as Nigeria and Pakistan, are IDA-eligible based on per capita income levels and are also creditworthy for some IBRD borrowing. They are referred to as "blend" countries.

IDA has 173 members.

IFC

The International Finance Corporation (IFC) promotes private sector investment in its member countries, particularly developing countries as a way to reduce poverty and improve people's lives.

IFC shares the primary objective of all World Bank Group institutions: to improve the quality of the lives of people in its developing member countries.

IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world.

India is one of the founder members of the IFC. IFC finances investments with its own resources mobilizing capital in the International financial markets. India represents IFC's single-largest country exposure. IFC is working in the following areas:

- investment climate for private sector development and inclusive growth;
- financial inclusion by working on financial services and initiatives related to the sustainability of the MFI sector including micro-credit bureau, risk mitigation initiatives, code of conduct setting etc;
- renewable energy (solar and biomass) and cleaner production as well as key subsectors like agribusiness; and

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- developing PPP transactions with focus on social services (health and education) and climate change impact projects.

IFC floated a rupee bond, masala bond in the global credit market to fund the Indian companies in 2014.

MIGA

The Multilateral Investment Guarantee Agency (MIGA) promotes foreign direct investment into developing countries by insuring investors against non-commercial and political risk, advising governments on attracting investment etc. India is a member.

ICSID

The International Centre for Settlement of Investment Disputes (ICSID) provides facilities for the conciliation and arbitration of investment disputes between member countries and individual investors. India is not a member.

India and the World Bank

India is a founding member of the WB group and has benefited immensely from its operations in multiple ways- funds, advice, cross-country experience etc. Most of GOI's and many state governments' flagships have been funded by the WB. The advantage of borrowing from the World Bank is the low cost and stable financing it provides with longer maturity periods. Financing through the International Development Association (IDA), the Bank's concessional lending arm, is very attractive to India.

India has been borrowing from the World Bank (through IBRD and IDA) for various development projects in areas of poverty alleviation, infrastructure, rural development, human resource development, etc. IDA funds are one of the most concessional external loans for GOI and are used largely in social sector projects that contribute to the achievement of SDGs. IBRD funds are semi - concessional and of a longer maturity and therefore, cheaper than commercial external borrowings.

WB's cumulative commitment to India stands at more than US\$ 100 billion.

Indian Constitution does not allow the states to borrow from the WB directly and so GOI borrows and on lends to the states.

IMF and WB

There are similarities and differences between them. Both are owned and directed by the governments of member nations. Both institutions concern themselves with broadening and strengthening the economies of their member nations. The two institutions hold joint annual meetings. Unless a country is a member of IMF, it can not be admitted to WB. Both have headquarters in Washington, D.C.

Despite these similarities, however, the Bank and the IMF remain distinct. The fundamental difference is this: the Bank is primarily a development institution; the IMF seeks to maintain an orderly system of payments and receipts between nations. Each has a different purpose, a distinct structure, receives its funding from different sources, assists different categories of members and strives to achieve distinct goals.

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IMF and WB Group :Differences

International Monetary Fund

- Single institution
- oversees the international monetary system
- promotes exchange rate and monetary stability in its member countries and globally
- assists with BoP bailout funds by providing short- to medium-term credits
- draws its financial resources principally from the quota subscriptions of its member countries

World Bank Group

- five institutions
- seeks to promote the economic development of the world's poorer countries
- assists developing countries through long-term financing of development projects and programs
- encourages private enterprises in developing countries through its affiliate, the International Finance Corporation (IFC)
- acquires most of its financial resources by borrowing on the international bond market
- has insurance and arbitration wings(MIGA and ICSID respectively)

Bretton Woods 2.0

The original Bretton Woods conference purpose was post-WWII reconstruction. The arrangements need redefinition and refocus in the post-recession world since 2008. The broad mandate should be

- The two institutions need to be democratised
- Merit based appointment to the two institutions
- IMF should have an expanded role and be the lender of last resort.
- SDRs should be more central to global monetary system
- World Bank should be refocused with clear goals: helping the poorest countries achieve the SDGs to reduce poverty, hunger and disease.
- global trade agenda should be reoriented to help the poorest countries to be more productive;promote environmental sustainability, to help enforce compliance with reduced carbon emissions and protection of endangered biodiversity
- the new global financial structure should help to rescue the world from human-induced climate change.

Groups and Institutions

G-7

- The Group of Seven (G7) is a group consisting of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. These countries, with the seven largest advanced economies in the world, along with The European Union that is also represented at the G7 summit, meet annually at the summit level. The 2018 summit took place in Canada. The summits from 2019 till 2021 will be held respectively in France, USA and UK.

The G-7 conducts dialogue and seeks agreement on current economic issues on the basis of the comparable interests of those countries.

International Financial Architecture

The financial and monetary stability along with growth and alleviation of poverty are important for global progress. There are many old and new institutions for these goals to be achieved. They are

- G-20
- FSB: In response to the global financial crisis, the international financial community established the Financial Stability Board (FSB). The FSB aims to address vulnerabilities and develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. It is based in Basel.
- BIS, Basel.
- WB and ADB provide economic assistance so that the long term economic underpinnings of global economy are strengthened
- IMF

ADB

The **Asian Development Bank (ADB)** is a regional development bank headquartered in Manila, Philippines. It admits the members of the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) and non-regional developed countries. ADB has 67 members, of which 48 are from within Asia and the Pacific and 19 from outside. The ADB was modeled on the World Bank, and has a similar weighted voting system where votes are distributed in proportion with members' capital subscriptions. ADB is an official United Nations Observer.^[8] Japan and United States hold the largest proportion of shares followed by China, India and Australia.

ADB's mission is to help its developing member countries from Asia and Pacific, to reduce poverty and improve the quality of life of their people. ADB's main partners are governments, the private sector, nongovernment organizations, development agencies, community-based organizations, and foundations.

Under Strategy 2020, a long-term strategic framework adopted, ADB follows three complementary strategic agendas: inclusive growth, environmentally sustainable growth, and regional integration. In pursuing its vision, ADB's main instruments comprise loans, technical assistance, grants, advice, and knowledge.

The Asian Development Outlook is an annual publication produced by the Asian Development Bank (ADB). It offers economic analysis and forecasts, as well as an examination of social development issues, for most countries in Asia. It is similar to Global Economic Prospects, a similar publication by the World Bank Group and World Economic Outlook, a publication by the International Monetary Fund.

ECB

The eurozone (euro area) is a monetary union of 19 of the 27 European Union (EU) member states which have adopted the euro (€) as their common currency and sole legal tender. The other nine members of the European Union continue to use their own national currencies. The monetary authority of the eurozone is the ECB. It makes and administers the monetary policy of the 19 EU Eurozone member states. It is thus one of the world's most important central banks. The bank was established by the Treaty of Amsterdam in 1998, and is headquartered in Frankfurt, Germany.

OECD

The Organisation for Economic Co-operation and Development (OECD) is an international economic organisation of 34 developed countries to stimulate economic progress and world trade. It defines itself as a forum of countries committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identifying good practices, and co-ordinating domestic and international policies of its members. Its membership includes non-European states. The OECD's headquarters are in Paris. India is on the Governing Board of the OECD's Development Centre and it also participates as an observer in some OECD Committees.

NDB

The New Development Bank (NDB), BRICS Bank, is a multilateral development bank owned and managed by the BRICS states. During the sixth BRICS Summit in Fortaleza (2014), the leaders signed the Agreement establishing the New Development Bank (NDB). In the Fortaleza Declaration, the leaders stressed that the NDB will strengthen cooperation among BRICS and will supplement the efforts of multilateral and regional financial institutions for global development, thus contributing to collective commitments for achieving the goal of strong, sustainable and balanced growth. NDB intends to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries.

NDB seeks to support public or private projects through loans, guarantees, equity participation and other financial instruments.

NDB is a 21st-century multilateral development bank that builds on the experiences of existing bodies. The creation of the Bank is an expression of the growing role of BRICS and other emerging market and developing countries (EMDCs) in the world economy; and their greater willingness to act independently in matters of international economic governance and development. NDB's mandate is that it will mobilize resources for infrastructure and sustainable development projects in BRICS and other EMDCs. The Bank will make use of the proven financial model of multilateral development banks (MDBs)—financial institutions created by governments to leverage capital for development purposes—to contribute to the investment needs of the founding members and other EMDCs.

The initial authorized capital of the bank is \$100 bln. The initial subscribed capital of the NDB is \$50 bln which is equally distributed among the founding members unlike CRA of Brics. Voting power of each member is equal.

K. V. Kamath, the President of the NDB. The bank is headquartered in Shanghai, China. The first president is from India. Inaugural Chairman of the Board of directors comes from Brazil. Inaugural chairman of the Board of Governors is Russian.

NDB is financing of US\$ 350 million for Development and Upgradation of Major District Roads Project in Madhya Pradesh. This is the First Loan Agreement for NDB assisted project in India.

NDB will also provide a loan of USD 175 million to Madhya Pradesh Bridges Project. The objective of the Project is to tackle the weak links of the road network, the bridges of Madhya Pradesh State, to realize the full benefits of upgrading the state highways and major districts roads, through constructing and upgrading about 350 bridges in the State of Madhya Pradesh. The positive impacts of the project include promoting inclusive development of the rural communities of the State of Madhya Pradesh and stimulating regional economic development through improved connectivity, enhanced accessibility and increased job opportunities.

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AIIB

The AIIB was established as a new multilateral financial institution aimed at providing “financial support for infrastructure development and regional connectivity in Asia.” It has its headquarters in Beijing. Its goals are also to boost economic development in Asia, create wealth, provide infrastructure and promote regional cooperation and partnership. AIIB will “provide or facilitate financing to any member, or any agency, instrumentality or political subdivision thereof, or any entity or enterprise operating in the territory of a member, as well as to international or regional agencies or entities concerned with economic development of the Asia region.”

The starting capital of the bank was \$100 billion, equivalent to two third of the capital of the Asian Development Bank and about half that of the World Bank. China, India and Russia are the three largest shareholders of AIIB with China holding almost 30% of the share and India about 7.5% and Russia even less.

It was launched in 2016 and today has 87 members, at the end of 2018. AIIB's third Annual Meeting was held in Mumbai, India in 2018.

AIIB approved six projects worth \$1.2 billion in loans to India for infrastructure related projects and additional \$1.9 billion is under review, The fund will invest in six projects, including \$500 million in the Mumbai Metro and \$455 million in rural roads in Andhra Pradesh. This also includes \$200 million to the National Investment and Infrastructure Fund. Also, a loan of US\$160 million in support of the Andhra Pradesh – 24x7 Power for All project with the objective to strengthen the power transmission and distribution system in the State of Andhra Pradesh.

AIIB as having potential for “scaling up financing for sustainable development” and to improve the global economic governance.

EBRD

Launched in 1991 after the cold war ended, European Bank for Reconstruction and Development (EBRD) is an international financial institution. As a multilateral developmental investment bank, the EBRD uses investment to build market economies. It began to assist the countries of the former Eastern Bloc but expanded to support development in more than 30 countries from central Europe to central Asia. EBRD has membership from all over the world (North America, Africa, Asia and Australia), with the biggest shareholder being the United States. It gives loans regionally in its countries of operations. It helps countries that have multiparty democracy as a rule, unlike other similar bodies.

Its headquarters are in London.

It is owned by 69 countries and two EU institutions (European Union and European Investment Bank), 69th being India that joined in 2018. Though it has public sector shareholders, it invests in private enterprises, together with commercial partners.

The EBRD is separate from the European Investment Bank (EIB), which is owned by EU member states and is used to support EU policy.

India and EBRD

India became the 69th shareholder of the European Bank for Reconstruction and Development (EBRD) in 2018, paving the way for more joint investment with Indian companies across the EBRD's regions. India takes a shareholding in the EBRD but it will not be a recipient of EBRD financing.

With the country's impressive economic growth over the years and enhanced international profile, it was considered appropriate that India should expand its presence on the global

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developmental landscape beyond its association with the Multi-lateral Development Banks (MDBs) such as the World Bank, Asian Development Bank and African Development Bank.

India's global economic influence is already expanding with its leadership role in AIIB and NDB.

Benefits from EBRD membership:

- Membership of EBRD would enhance India's international profile and promote its economic interests. Access to EBRD's Countries of Operation and sector knowledge.
- India's investment opportunities would be more.
- It would increase the scope of cooperation between India and EBRD through co-financing opportunities in manufacturing, services, Information Technology, and Energy.
- provide an enhanced access to international markets in terms of business opportunities, procurement activities, consultancy assignments etc.
- open up new vistas for Indian professionals on the one hand, and give a fillip to Indian exports on the other.
- Increased economic activities would have the employment generating potential.
- It would also enable Indian nationals to get the employment opportunity in the Bank.

The EBRD has been working with the Indian companies on investments in the EBRD's countries of operations, which comprise 38 economies stretching across three continents. The Bank has cooperated with Indian enterprises on joint projects worth almost €1 billion, including investments with Tata, Jindal and Mahindra and Mahindra. The EBRD is also working closely with leading Indian organisations, such as FICCI, the Confederation of Indian Industry (CII), the Associated Chambers of Commerce & Industry of India (ASSOCHAM), and the International Solar Alliance (ISA).

New Delhi

POVERTY: CONCEPTS, DATA, POLICY and ANALYSIS

Poverty is deprivation of basic human needs -food, clothing, shelter, safe drinking water etc. It also includes the deprivation of opportunities to health, education, skills, employment etc. The inadequate availability of the above goods and services means that the quality of life is also degraded.

There are many reasons for poverty which include:

- Colonial destruction of economy
- Uncontrolled population
- Growth is not rapid to eradicate poverty
- Models of growth may be unsuitable for poverty alleviation. For example, capital-intense growth in a labour surplus country like India
- Poverty is a vicious circle where parental poverty leads to poverty of children and so on
- Poor educational base and lack of other vocational skills also perpetuate poverty.
- Small land holdings and their low productivity are the cause of poverty among households dependent on land-based activities for their livelihood.
- Geographic factors, for example lack of fertile land and access to natural resources.
- Anti-poverty schemes not being effective due to institutional and other inadequacies
- Insurgencies as in the north-east of India and naxalism as in the eastern corridor
- Due to the poor physical and social capital base, a large proportion of the people are forced to seek employment in vocations with extremely low levels of productivity and wages.
- gender discrimination

Agricultural wage earners, small and marginal farmers and casual workers engaged in non-agricultural activities, constitute the bulk of the poor.

Types of Poverty:

Human Poverty is the lack of essential human capabilities- literacy and nutrition.

Income Poverty is the lack of sufficient income to meet minimum consumption needs.

Extreme Poverty The World Bank defines extreme poverty as living on less than \$1.90 a day

Relative Poverty is the condition in which people lack the minimum amount of income needed in order to maintain the average standard of living in the society in which they live. It is defined in terms of the society in which an individual lives and therefore differs between countries and over time. That is, poverty is relative to the country and its standard of living. Richer countries have higher poverty line as the per capita is more.

Absolute Poverty is defined as "a condition characterized by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also on access to services. It is defined in relation to consumption of one or more goods and services.

Poverty Line

It is the level of income below which one cannot afford to purchase all the resources one requires to have a certain minimum quality of life.

Poverty lines are defined as the per capita monetary requirements an individual needs, to afford the purchase of a basic set of goods- food and other goods.

Some definitions include only certain calories of intake and convert it into monetary value. In India monetary requirement to consume 2100 calories in urban areas and 2400 calories in rural areas per day per person was the absolute poverty line but was changed later by the Tendulkar committee in 2010. Other definitions include more goods and services in the basket. The monetary value is determined and indexed to inflation and the line is drawn dynamically.

Headcount Ratio

The incidence of poverty is revealed by this ratio. It shows the percentage of the population whose per capita incomes are below the poverty line, that is, the population that cannot afford to buy a specified basic basket of items.

Poverty Gap (PG)

PG is a measure of the intensity of poverty among the poor: the difference between the average income among the poor and the poverty line. This indicator measures the magnitude of poverty as well as its intensity- number of poor and how poor, poor are. The Poverty Gap Index is the combined measurement of incidence of poverty and depth of poverty. PG is also called the Foster-Greer-Thorbecke (FGT) index.

Misery Index

The misery index was initiated by economist Robert Barro in the 1970's. It is the unemployment rate added to the inflation rate. It is based on the belief that both a higher rate of unemployment and a worsening of inflation cause and intensify the misery. A mix of high inflation and more unemployed people (stagflation) means a rise in the misery index.

World Bank and poverty definitions

WB defined the extreme poverty at \$1.9 a day. In an attempt to be more precise with its classifications, the WB in 2017 November added new standards of poverty for people living in middle- and high-income countries. The new standards are set at \$3.20 a day for people in "lower-middle-income" countries, such as Egypt or India; \$5.50 a day for "upper-middle-income" countries, such as Russia; a third standard for high-income countries, like the US, at \$21.70 a day.

Planning Commission and Poverty

The Planning Commission when it existed was the nodal agency in the Government of India for estimation of poverty has been estimating the number and percentage of poor at national and state levels. Estimates of poverty are made from the large sample survey data on household consumer expenditure conducted by the National Sample Survey Organization (NSSO) of the Ministry of Statistics and Programme Implementation.

NSSO and Poverty Estimates

National Sample Survey Office (NSSO) collects household consumer expenditure data every five years on a large sample. Household consumer expenditure surveys are also conducted annually but the sample size is much smaller. Every five years full surveys on 1,20,000 households are carried out. In the intervening period, "thin" samples of around 20,000 households are surveyed. The "thin" samples do not indicate trends fully.

Committees

Planning commission initially gave poverty numbers and related data ratios since 1979 based on the Alagh Committee Report of that year. This procedure was subsequently modified by the Lakdawala Committee (1993). The commission appointed an expert group led by Suresh Tendulkar to suggest a new poverty line for rural areas. It submitted its report in 2009. It used the latest data to construct a new basket to define poverty line. It moved away from the calorie intake as anchor for poverty estimation and included health and education. Arjun Sengupta Commission on Unorganised Enterprises estimated 77% of the population can be categorised poor and vulnerable. The Tendulkar poverty line in 2009-10 was 4,298 per month for a family in urban and 3,364 per month for a family in rural areas.

NC Saxena Committee

The Ministry of Rural Development in 2008 appointed a committee headed by NC Saxena to calculate the rural BPL figures in the states. It recommended that 50% of India's population be given below-poverty-line cards. Thus, it suggested expansion of the social security net involving fiscal and administrative challenges.

While advocating exclusion of large number of families from the BPL lists, the committee recommended that those families having double the land of the district average of the agricultural land or two wheeler or one running bore well or income tax payers would be deleted from the BPL lists. The panel recommended that some disadvantaged communities be given BPL cards automatically. These include chronically vulnerable groups, such as households with members having tuberculosis, leprosy, disability, mental illnesses or HIV/AIDS and others, designated 'primitive tribe', designated dalit groups, homeless household etc.

It recommended 13 new parameters for defining Below Poverty Line (BPL) category of people in the country. It had done away with the earlier definition based on food calories. The revised definition is based on landholding, type of dwelling, clothing, food security, hygiene, and capacity for buying commodities, literacy, minimum wages earned by the household, means of livelihood, education of children, debt, migration and priority for assistance.

Urban Poverty

S. R. Hashim Committee

The Planning Commission had constituted an expert group under S. R. Hashim in 2010 to recommend detailed methodology for identification of BPL families in urban areas in the context of the 12th Five Year Plan. The expert group recommended that poverty in urban areas be identified through specific vulnerabilities in residential, occupational and social categories.

It said that those who are houseless, live in temporary houses where usage of dwelling space is susceptible to insecurity of tenure and is affected by lack of access to basic services should be considered residentially vulnerable.

Houses with people unemployed for a significant proportion of time or with irregular employment or whose work is subject to unsanitary or hazardous conditions or have no stability of payment for services should be regarded occupationally vulnerable.

Households headed by women or minors or where the elderly are dependent on the head of household or where the level of literacy is low or members are disabled or chronically ill should be considered socially vulnerable.

Pronab Sen Committee

The Ministry of Housing and Urban Poverty Alleviation set up a committee to look into various aspects of Slum statistics /Census and issues regarding conduct of slum census 2011 under Pronab Sen Committee. The committee submitted its in 2010.

The salient finding / recommendations of the committee are: -

- The committee projected slum population in the country for the year 2011 at 93.06 million.
- The committee recommended a definition of slum as: "A compact settlement of at least 20 households with a collection of poorly built tenements, mostly of temporary nature, crowded together usually with inadequate sanitary and drinking water facilities in unhygienic conditions."

The committee suggested adoption of the following as slum-like characteristics for the purpose of identification of the slum areas: -

- Predominant roof material: any material other than concrete
- Availability of drinking water source: not with premises of the census house
- Drainage facility: no drainage or open drainage

SECC

The Socio Economic and Caste Census 2011 (SECC) was conducted for the 2011 Census of India. SECC 2011 is the first paperless census in India. GOI is using the SECC data for

- Pradhan Mantri Ujjwala Yojana (PMUY) — the scheme to give free LPG connections to the poorest households
- PM Awas Yojana to build low-cost houses to the poor
- electricity connection under the Deen Dayal Upadhyaya Power Scheme build toilets under the Swachh Bharat Mission
- prepare Labour Budgets under the MNREGA and
- Ayushman Bharat

SECC 2011 was the first-ever caste-based census since 1931 Census of India

SECC 2011 was conducted by three separate authorities, but under the overall coordination of Ministry of Rural Development in the Government of India:

- Census in Rural Area has been conducted by the Ministry of Rural Development.
- Census in Urban areas is under the administrative jurisdiction of the Ministry of Housing and Urban Poverty Alleviation.
- Caste Census is under the administrative control of Ministry of Home Affairs: Registrar General and Census Commissioner of India.

Rangarajan Committee

A new expert committee under C Rangarajan went into revisiting the methodology for estimation of poverty and identification of the poor after the Tendulkar poverty line was found unsatisfactory in its methodology. The panel also looked into the issue of linking poverty estimates with providing benefits under the government's social welfare schemes. That is, it dealt with the question of whether entitlements are to be given only to the poor or more people.

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For Rangarajan committee household is poor if it is unable to save. It defined poverty based on criteria of adequate nourishment, clothing, house rent, conveyance, education etc. It also refined calories' intake by way of including calories from protein and fats based on ICMR norms differentiated by age and gender. Based on this methodology, it redefined the poverty line in 2014. According to the the committee, the new poverty line should be Rs 32 in rural areas and Rs 47 in urban areas at 2011-12 prices. The earlier poverty line figure was Rs 27 for rural India and Rs 33 for Urban India. The Rangarajan report added 94 million more to the list of the poor as its line was drawn higher. The total number of poor became 363 million from 269 million in 2011-12. Rangarajan committee estimated the number of poor were 19 per cent higher in rural areas and 41 per cent more in urban areas than what was estimated using Tendulkar committee formula.

Eradication of Poverty

The strategy of the Government includes the following elements

- Growth of economy is the primary source of poverty eradication
- Government interventions focused on MSMEs for inclusive growth
- welfare State. For example, food security Act 2013. Energy security through through schemes like Saubhagya, Ujjwala etc.
- Progressive taxation to garner fiscal resources for spending on poor
- Social safety net like the National Social Assistance Programme (NSAP)
- Anti-poverty programmes – Pradhan Mantri Awas Yojana, Deendayal Antyodaya Yojana (DAY) etc.
- Massive social sector expenditure for skill building
- Decentralization through PRIs and Nagarapalikas for better delivery models

The 2018 Multidimensional Poverty Index (MPI) of Oxford Poverty and Human Development (OPHI) report said that nearly 271 million people were lifted out of poverty in the period between 2005-06 to 2015-16 in India. The poverty rate, down from 55 per cent to 28 per cent, has nearly halved in the period.

Niti Aayog Task Force on Poverty Elimination

Constituted in 2015 under the Chairmanship of Dr. Arvind Panagariya, Vice Chairman, NITI Aayog, the report of the Task Force primarily focuses on issues of measurement of poverty and strategies to combat poverty. Regarding estimation of poverty, the report could not reach a consensus. With respect to strategies to combat poverty, the Task Force made recommendations on faster poverty reduction through employment intensive sustained rapid growth and effective implementation of anti-poverty programs: ---

MDGs and SDGs

MDGs 2000

The Millennium Development Goals (MDGs) were the eight international development goals for the year 2015 that had been established following the Millennium Summit of the United Nations in 2000, following the adoption of the United Nations Millennium Declaration. Following are the MDGs:

- To eradicate extreme poverty and hunger
- To achieve universal primary education
- To promote gender equality and empower women

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- To reduce child mortality
- To improve maternal health
- To combat HIV/AIDS, malaria, and other diseases
- To ensure environmental sustainability
- To develop a global partnership for development

SDGs

The Sustainable Development Goals (SDGs), officially known as Transforming our world: the 2030 Agenda for Sustainable Development is a set of seventeen aspirational "Global Goals" with 169 targets between them. Spearheaded by the United Nations, involving its 193 Member States, as well as global civil society, the goals inspired by United Nations Secretary-General Ban Ki-moon that "there can be no Plan B, because there is no Planet B" They were adopted at the UN Sustainable Development Summit in 2015

Goal 1. End poverty in all its forms everywhere

Goal 2. End hunger, achieve food security and improved nutrition, and promote sustainable agriculture

Goal 3. Ensure healthy lives and promote well-being for all at all ages

Goal 4. Ensure inclusive and equitable quality education and promote life-long learning opportunities for all

Goal 5. Achieve gender equality and empower all women and girls

Goal 6. Ensure availability and sustainable management of water and sanitation for all

Goal 7. Ensure access to affordable, reliable, sustainable, and modern energy for all

Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all

Goal 9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation

Goal 10. Reduce inequality within and among countries

Goal 11. Make cities and human settlements inclusive, safe, resilient and sustainable

Goal 12. Ensure sustainable consumption and production patterns

Goal 13. Take urgent action to combat climate change and its impacts*

Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development

Goal 15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss

Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels

Goal 17. Strengthen the means of implementation and revitalize the global partnership for sustainable development.

Similarities and Differences between MDGs and SDGs

Outline of the similarities and differences between the Millennium Development Goals (MDGs) launched in 2000, and the Sustainable Development Goals (SDGs) in 2015 when the MDGs expired

- **Zero Goals:** The MDG targets for 2015 were set to get us “half way” to the goal of ending hunger and poverty, with similar proportional goals in other fields. The SDGs are designed to finish the job – to get to a statistical “zero” on hunger, poverty, preventable child deaths and other targets. This approach will call for very different strategies: getting “halfway there” encouraged countries to “do the easiest parts first.” Getting to zero requires a real focus on the empowering the poorest and hardest to reach.
- **More Comprehensive Goals:** There were 8 MDGs. There are 17 SDGs
- **Inclusive Goal Setting:** The MDGs were created through a top-down process. The SDGs are being created in one of the most inclusive participatory processes the world has ever seen
- **Distinguishing Hunger and Poverty:** In the MDGs, Hunger and Poverty were joined together in MDG1 – as if solving one would solve the other. So much has been learned about nutrition since that time, and the SDGs treat the issue of poverty separately from Food and Nutrition Security.
- **Funding:** The MDGs were largely envisioned to be funded by aid-flows – which did not materialize. The SDGs put sustainable, inclusive economic development at the core of the strategy, and address the ability of countries to address social challenges largely through improving their own revenue generating capabilities.
- **Peace Building:** The inclusion of peace-building in SDGs is critical to the success of ending hunger and poverty – yet was totally ignored in the MDGs.
- **Data Revolution:** The MDGs said nothing about monitoring, evaluation and accountability – the SDGs target by 2020 to “increase significantly the availability of high-quality, timely and reliable data disaggregated by income, gender, age, race, ethnicity, migratory status, disability, geographic location and other characteristics relevant in national contexts.”
- **Quality Education:** The MDGs focused on quantity (eg, high enrollment rates) only to see the quality of education decline in many societies. The SDGs represent the first attempt by the world community to focus on the quality of education – of learning – and the role of education in achieving a more humane world: “education for sustainable development and sustainable lifestyles, human rights, gender equality, promotion of a culture of peace and non-violence, global citizenship, and appreciation of cultural diversity and of culture’s contribution to sustainable development.”

Niti Aayog and SDGs

NITI Aayog was entrusted with the role to co-ordinate ‘Transforming our world: the 2030 Agenda for Sustainable Development’ (called as SDGs). The task is not merely to periodically collect data on SDGs but to act proactively to pursue the goals and targets not only quantitatively but also maintaining high standards of quality. Ministry of Statistics and Programme Implementation (MoSPI) is also involved.

To achieve these tasks, Centrally Sponsored Schemes (CSSs), including the ‘core of the core’, ‘core’ and ‘optional’ Schemes being implemented by the States have been mapped along with some of the recent initiatives undertaken by the Central Government.

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As a signatory to the SDGs, India is committed to participate in the international review of progress of Sustainable development Goals (SDGs) on a regular basis. The central platform for international follow-up and review of the 2030 Agenda is the High-Level Political Forum (HLPF), which met annually since 2016 under the auspices of the UN Economic and Social Council (ECOSOC). In the HLPF, UN member countries are expected to present their Voluntary National Review (VNR) on implementation of SDGs. The VNRs thus serve as a basis for international review of progress of SDGs.

NITI Aayog has presented the first Voluntary National Review on implementation of SDGs in the country to the 2017 HLPF in 2017

The report details various measures and programmes being implemented across India towards achieving the core objectives of the 17 ambitious global goals, including poverty eradication, economic growth, ending hunger and achieving food security, gender equality, promoting inclusive and sustainable industrialisation and climate action. The programmes highlighted in the report are the 'Mahatma Gandhi National Rural Employment Guarantee Act', 'Beti Bachao Beti Padhao', 'Sagarmala', 'Clean India' campaign and the Aadhaar Act.

The report said that externally, the country played a key role in shaping the SDGs and ensuring the balance among its three pillars - economic, social and environmental. Internally, it launched many programmes to make progress towards these goals. India said it will continue to pursue the implementation of the SDG agenda through close collaboration between the national and sub-national governments as well as active participation of all other relevant stakeholders. It also said that apart from integrating the SDGs into its on-going national and sub-national policies and programmes, India will continue to focus on nurturing partnerships at the regional and global levels.

India's VNR

Government sees SDG 1 as the most important goal, which needs continued economic growth to be achieved. The key programmes were: PM Jan Dhan Yojana (world's largest financial inclusion programme), National Rural Drinking Water Programme, Swachh Bharat Mission (Clean India Mission), Housing for All by 2020, and PM's rural roads programme.

SDG 2 on ending hunger, improving nutrition programmes: doubling farmers income by 2022, Integrated Child Development Services, Public Distribution System, and the mid-day meal programme.

SDG 3 on health and wellbeing programmes: National Health Mission, National Vector Borne Disease Programme, and National Programme for Prevention of Non-communicable Diseases.

SDG 5 on gender equality ("the most important SDG as well, in addition to the eradication of poverty"): Save the Girl Child, Educate the Girl Child, Maternity Benefit Programme, Women Transforming India, and Stand Up India.

SDG 9 on Infrastructure and Innovation: Rural Electrification scheme (reached 99% of Indian homes already), Make in India, (building roads and infrastructure, FDI), Atal Innovation Mission.

SDG 14 on life under the water: Mangroves for the Future, National Oil Spill Contingency Plan 2015, National Policy on Marine Fisheries 2017, and Sagarmala (port-led development).

SDG 17 on global partnership for sustainable development: Direct tax reform, GST, public private partnerships, south-south cooperation, Aadhar, direct benefits transfer, and having 2% of company profits being spent on social programmes.

India expects developed countries to help developing ones to reach these goals, especially in the area of curbing illicit financial flows.

Universal Basic Income (UBI)

A universal basic income is a form of social security in which all citizens or residents of a country receive a regular, unconditional sum of money, from government. It is being debated across the world as automation threatens jobs; growth being low needs to be stimulated with basic income and as a form social security. There are advantages:

Transparency: Basic income is a much simpler and more transparent welfare system than the one existing in the welfare states around the world today. Instead of having numerous welfare programs, it would be one universal unconditional income. This strategy for introducing basic income is controversial because some basic income supporters argue that it should be added to the existing welfare system rather than a replacement for it. Also, money may not buy goods where people are in remote areas and markets have not developed. Further, there are questions about quality of goods and services and inflation.

Administrative efficiency: One of the benefits of a basic income is lower overall cost than that of the current one. For example, aadhaar linkage and direct transfer. However, if basic income does not deliver and is reversed, there is neither the original welfare infrastructure like PHCs, PDS shops etc. nor the basic income.

Poverty reduction: Basic income is advocated because of its potential to reduce poverty, or even eradicate poverty. But the claims are contested as the fiscal space available in a country like India is limited and markets have not penetrated.

Basic income and growth: Basic income allows economic growth: there is assured demand because of the transfers. This is also debatable as unless UBI is given based on an irreversible parliamentary Act with federal consensus, the continuation is not guaranteed and so investors confidence may not be high to put up additional production capacities.

Freedom: Beneficiaries can use the income for whatever they want. The down side is that it will open up the fault lines like girls and women being sidelined. There is also a belief among critics that if people have free and unconditional money, they will not work (as much). Less work means less tax revenue and hence less money for the state and cities to fund public projects. There are also concerns that some people will spend their basic income on alcohol and drugs

Basic income in India

It was piloted with the project organized by India's Self Employed Women's Association (SEWA) with support from UNICEF in 2011.

In total there are 20 villages in the project. According to pilot projects, positive results were found. Villages spent more on food and healthcare, children's school performance improved in 68% of families, time spent in school nearly tripled, personal savings tripled, and new business startups doubled.

In India the existing subsidies may be pruned by aadhaar linkage and the fiscal savings thus generated may be used for basic income whether it is for schemes like buying internet time or for health expenditure etc. But enormous care should be taken not to be overrun by the exuberance for UBI as that may lead to the existing structures for welfare being replaced by adhoc schemes. Economic Survey 2017 began the debate about the pros and cons of UBI.

Multidimensional Poverty Index (MPI)

Until Tendulkar and Rangarajan Committees, in India poverty was defined by one-consumption of food calories and the income required for it. But no one indicator alone can capture the multiple aspects that constitute poverty. Therefore, the Multidimensional Poverty Index (MPI) was developed in 2010 by Oxford Poverty & Human Development Initiative and the United

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Nations Development Programme and uses different factors to determine poverty beyond income-based lists. It replaced the previous Human Poverty Index.

The index uses the same three dimensions as the Human Development Index: health, education, and standard of living. These are measured using ten indicators.

Dimension	Indicators
Health	• Child Mortality • Nutrition
Education	• Years of school • Children enrolled
Living Standards	• Cooking fuel • Toilet • Water • Electricity • Floor • Assets

Each dimension and each indicator within a dimension is equally weighted.

The MPI is an index of acute multidimensional poverty. It shows the number of people who are multi-dimensionally poor (suffering deprivations in 33% of weighted indicators) and the number of deprivations with which poor households typically contend.

MPI helps in identifying sources of poverty. For example, there are people who have income but have no access to health or education. It thus alerts government to providing those goods and services that are necessary to comprehensively alleviate poverty and build human capacity. Angus Deaton who was given Nobel prize in economics in 2015 said that quantity as well as quality of data matters for right public policy.

Non-monetary aspects of poverty

The assumption that poverty is exclusively bred by income deficiency is flawed. Researchers found that more than income based poverty, it is illiteracy that makes people unhealthy. Using data on income, education, and under-five and infant mortality, the researchers suggested that policymakers concerned with poverty and public health should focus on literacy levels rather than average income. They found that the increase in income should be many times more than the increase in literacy to save one child per thousand live births.

It is also suggested that female literacy rates capture poverty much better than income: The more educated a mother is, the less the MMR and IMR and malnutrition. Births of her children are more likely to be registered and child marriages are unlikely as children are far more likely to be educated. Children will be vaccinated, go to school, not be child labour or malnourished; marry later and thus have much less reproductive span and thus have less number of children. Female literacy is thus the metric to work on not so much income. Thus, there is humungous role for public intervention.

All evidence shows that investment in literacy for women yields high development dividends.

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Poverty is a cognitive tax

Chronic (long term) poverty causes health difficulties, educational failure, mental health challenges, and impoverished aspirations. Poverty causes cognitive depletion and thus is a "cognitive tax" on the poor. Researchers suggest that people who find themselves poor spend an enormous amount of mental energy managing the state of poverty. The constant preoccupation with the difficulty generated as a result of not having appropriate resources narrows down thinking, focusing attention on the concern at hand. This intense and concentrated use of energy reduces a person's "mental bandwidth", preventing them from managing effectively other areas of their lives, because worry is consuming them.

A variety of studies point to a correlation between poverty and counterproductive behavior. The poor use less preventive health care, fail to adhere to drug regimens, are less likely to keep appointments, are less productive workers, less attentive parents, and worse managers of their finances. These behaviors are troubling because they can further deepen poverty. Some explanations of this correlation focus on the environmental conditions of poverty. Predatory lenders in poor areas, for example, may create high-interest-rate borrowing, and unreliable transportation can cause absenteeism. Lower levels of formal education, for example, shows as financial illiteracy.

The condition of poverty imposed, as one study showed, a mental burden similar to losing 13 IQ points, or comparable to the cognitive difference that's been observed between chronic alcoholics and normal adults.

Being poor means coping with not just a shortfall of money, but also with a concurrent shortfall of cognitive resources. Poverty being the cause, it strengthens the case for welfare state and inclusive growth.

New Delhi

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INFRASTRUCTURE

Infrastructure is the foundation for economic growth. It includes both the physical, natural and organizational structures which are the preconditions for sustainable economic development: roads, ports, airports, bridges, railways, water supply, sewers, power, telecommunications, irrigation etc.

Infrastructure facilitates the production of goods and services; distribution of final products to markets as well as basic social services such as schools and hospitals.

Infrastructure can be physical or social or natural. It can be hard or soft. "Hard" infrastructure refers to the large physical networks like roads, ports, airports, pipelines etc. which necessary for the functioning of a modern industrial nation, whereas "soft" infrastructure refers to the bodies which are required to maintain the economic system: financial, education, health care, law enforcement etc. Soft essentially means social infrastructure.

Various types of Infrastructure

Transport infrastructure

- Road and highway networks, including structures (bridges, tunnels, culverts)
- Mass transit systems (Commuter rail systems, subways, tramways, and bus transportation)
- Railways (rail track, railway stations), level crossings, signalling and communications systems
- Canals and navigable waterways (inland waterways)
- Seaports
- Airports

Adequate transportation infrastructure is always essential for economic development and growth. Apart from facilitating cheaper and more efficient movements of goods, people and thus enabling growth, it also helps in national integration. Transportation infrastructure impacts the distribution of economic activity and development across regions; helps business to multiply; consumer welfare; productivity enhancement; balanced regional development; employment; demand; and makes the government access higher levels of fiscal resources for direct and indirect taxes. It is seen in the case of Golden Quadrilateral, Bharat Mala, PMGSY- the latter accounting for benefits for agriculture too.

Energy infrastructure

- Electrical power network, including generation plants, electrical grid, substations and local distribution.
- Natural gas pipelines, storage and distribution terminals
- Petroleum pipelines
- Specialized coal handling facilities for washing, storing, and transporting coal.
- Renewable energy infrastructure like wind, solar power, hydro power, geothermal power and biomass or biofuel facilities
- Coal mines, oil wells and natural gas wells (may also be classified as being part of the mining and industrial sector of the economy)

Water management infrastructure

- Drinking water supply

- Sewage collection, and disposal of waste water
- Drainage systems
- Major irrigation systems (reservoirs, irrigation canals)
- Major flood control systems

Communications infrastructure

- Postal service
- Telephone networks including mobile phone networks
- Television and radio transmission stations
- Internet
- Communications satellites
- Undersea cables

Critical infrastructure

It consists of those assets on which rest of the economy depends:

- electricity generation, transmission and distribution;
- gas production, transport and distribution;
- oil and oil products production, transport and distribution;
- telecommunication;
- water supply (drinking water, waste water/sewage, stemming of surface water (e.g. dikes and sluices));
- agriculture, food production and distribution;
- public health (hospitals, ambulances);
- transportation systems (fuel supply, railway network, airports, harbours, inland shipping);
- financial services (banking, clearing);
- Security services (police, military).

Urban infrastructure

Urban or municipal infrastructure refers to hard infrastructure systems owned and operated by municipalities, such as streets, water distribution, and sewers. It may also include some of the facilities associated with soft infrastructure, such as parks, public pools and libraries.

Green infrastructure

Green infrastructure is a concept that highlights the importance of the natural environment in decisions about land use planning. In particular there is an emphasis on the "life support" functions provided by a network of natural ecosystems, with an emphasis on interconnectivity to support long-term sustainability. Examples include green belts, wild life sanctuaries; eco sensitive regions; Tiger, lion, and elephant reserves; bird sanctuaries; western ghats being conserved etc.

Natural infrastructure

It may be used synonymously with green infrastructure. Natural infrastructures are planned and managed natural or semi-natural systems, which can provide benefits : forests, agricultural lands,

estuaries, coastal landscapes and wetlands. These solutions comprise coastal ecosystem (mangroves, coral reefs) for coastline protection from storms; watershed restoration (by sustainable land management) for water quality regulation; afforestation for carbon sequestration; habitat restoration or conservation for pollination; phytoremediation to rehabilitate contaminated soil and water. In India, about 800 million people were affected by around 288 weather-related disasters during 1995-2015. In order to avoid risk and damage, and to build resilience to these disasters, natural infrastructure solutions are increasingly being considered and implemented. It helps in achievement of Sustainable Development Goals (SDGs) and the Paris Climate Agreement targets Intended Nationally Determined Contributions (INDCs).

National Critical Information Infrastructure Protection Centre (NCIIPC)

NCIIPC is an organisation of the Government of India created under the Information Technology Act, 2000. Based in New Delhi, India, it is designated as the National Nodal Authority in respect of Critical Information Infrastructure Protection. The Information Technology Act, 2000 defines Critical Information Infrastructure (CII) as "those computer resource, the incapacitation or destruction of which, shall have debilitating impact on national security, economy, public health or safety". NCIIPC broadly identified the following as 'Critical Sectors':

- Power & Energy
- Banking, Financial Services & Insurance
- Telecom
- Transport
- Government
- Strategic & Public Enterprises

NCIIPC functions and duties

- National nodal agency for all measures to protect nation's critical information infrastructure.
- Protect and deliver advice that aims to reduce the vulnerabilities of critical information infrastructure, against cyber terrorism, cyber warfare and other threats.
- Identification of all critical information infrastructure elements for approval by the appropriate Government for notifying the same.
- Provide strategic leadership and coherence across Government to respond to cyber security threats against the identified critical information infrastructure.
- Coordinate, share, monitor, collect, analyze and forecast, national level threat to CII for policy guidance, expertise sharing and situational awareness for early warning or alerts. The basic responsibility for protecting CII system shall lie with the agency running that CII.
- Assisting in the development of appropriate plans, adoption of standards, sharing of best practices and refinement of procurement processes in respect of protection of Critical Information Infrastructure.
- Evolving protection strategies, policies, vulnerability assessment and auditing methodologies and plans for their dissemination and implementation for protection of Critical Information Infrastructure.
- Undertaking research and development and allied activities, providing funding (including grants-in-aid) for creating, collaborating and development of innovative future technology for developing and enabling the growth of skills, working closely with wider public sector

industries, academia et al and with international partners for protection of Critical Information Infrastructure.

- Developing or organising training and awareness programs as also nurturing and developing audit and certification agencies for protection of Critical Information Infrastructure.
- Developing and executing national and international cooperation strategies for protection of Critical Information Infrastructure.
- Issuing guidelines, advisories and vulnerability or audit notes etc. relating to protection of critical information infrastructure and practices, procedures, prevention and response in consultation with the stakeholders, in close coordination with Indian Computer Emergency Response Team (CERT-In) and other organisations working in the field or related fields.
- Exchanging information on cyber attacks and vulnerabilities with Indian Computer Emergency Response Team and other concerned organisations in the field.
- In the event of any threat to critical information infrastructure the National Critical Information Infrastructure Protection Centre may call for information and give directions to the critical sectors or persons serving or having a critical impact on Critical Information Infrastructure.

NCIIPC functions under the guidance of National Technical Research Organization (NTRO). NCIIPC is the nodal agency which coordinates the cyber security operations related to critical infrastructures in India. NCIIPC will set up sectoral Computer Emergency Response Teams (CERTs) and will also install sensors on critical systems for getting real-time information regarding cyber attack of any kind for preparing a quick response.

Financing Infrastructure

Investment in infrastructure builds capital stock needed for economic development. Traditionally, infrastructure was financed by government. However, given the scarcity of public resources and the need to shift scarce public resources into health and education, efforts have been made to bring in private participation in the development of infrastructure.

Currently, the source of financing varies significantly across sectors: some are government monopolies : railways and nuclear power. Some sectors are dominated by government spending, others by overseas development aid (ODA) and yet others by private investors. PPP is emerging as the dominant model.

Debt and equity are, like anywhere else, the ways of raising resources.

The total investment in infrastructure sectors in the Twelfth Plan (2012-17) is estimated to be Rs.55.7 lakh crore. The share of private investment in the total investment in infrastructure was 48 per cent during the Twelfth Plan.

Infrastructure may be owned and managed by governments or by private companies, such as sole public utility or railway companies. Or it can be a joint operation of construction, management and ownership (PPP) in which there are many models as we will see ahead.

India Infrastructure Finance Company Limited (IIFCL)

IIFCL was incorporated in 2006 for providing long-term loans for financing infrastructure projects that typically involve long gestation periods. IIFCL provides financial assistance both through direct lending to project companies and by refinancing banks and financial institutions as also take out financing. IIFCL raises funds from both domestic and overseas markets on the strength of government guarantees.

IIFCL is a wholly-owned Government of India company.

The sectors eligible for financial assistance from IIFCL mainly are - transportation, energy, water, sanitation, communication, social and commercial infrastructure.

IIFCL has been registered as a NBFC with RBI.

By 2017, IIFCL made cumulative gross sanctions of Rs 77,000 Crore to 442 projects under direct lending and cumulative disbursements of Rs 56,000 Crore under Refinance and Takeout Finance.

PPPs

Governments in most developing countries face the challenge to meet the growing demand for new and better infrastructure services. As available funding from the traditional sources and capacity in the public sector to execute and maintain many projects at one time remain limited, governments have found that partnership with the private sector is a viable alternative to increase and improve the supply of infrastructure services.

Government and private partners, in a PPP, through a legally binding contract, agree to share responsibilities related to execution and operation and management of an infrastructure project. This collaboration is based on appropriate allocation of:

- Resources
- Risks
- Responsibilities, and
- Rewards

The availability of high-quality infrastructure and the overcoming of India's infrastructure deficit is crucial to attaining and sustaining rapid growth that generates the gainful jobs. It is urgently required for India to grow rapidly. The Government of India identified public-private partnerships (PPP) as a way of developing the country's infrastructure for its economic growth. PPPs in infrastructure represent a valuable instrument to speed up infrastructure development in India. Since first half of the 2000s, PPPs were successfully implemented. India offers today the world's largest market for PPPs.

PPPs have become attractive to governments for infrastructure development as:

- They can enhance the supply of much-needed infrastructure services.
- They provide relief from the burden of the costs of design and construction.
- They allow transfer of many project risks to the private sector.
- They promise better project design, choice of technology, construction, operation and service delivery.
- Rationalize tariff for services like power and roads without any resistance from public

Kelkar Committee defines PPPs as : Public Private Partnerships (PPPs) in infrastructure refer to the provision of a public asset and service by a private partner who has been conceded the right (the "Concession") for the purpose, for a specified period of time, on the basis of market determined revenue streams, that allow for commercial return on investment.

Investment Models in PPP

There are many models of PPPs being followed in India.

Build-operate-transfer (BOT) or build-own-operate-transfer (BOOT) is a form of project financing in which a private entity receives a project(concession) from the corporate or public sector to finance, design, construct, own, and operate(collect toll) a facility stated in the

concession contract. This enables the concessionaire to recover investment, operating and maintenance expenses in the project. Due to the long-term nature of the arrangement, the fees is usually raised during the concession period.

BOT has uses in infrastructure projects as a form of public-private partnership. In the BOT project, Government delegates to a private sector entity the responsibility to design, build infrastructure and to operate and maintain these facilities for a certain period. During this period the private party is entitled to retain all revenues generated by the project. The facility will then be transferred to government at the end of the concession agreement.

V-BOT In a BOT project, there are instances where the contractor realizes the investment and profit ahead of the contract period and there are cases where he does not realize it even after the contract period is over. There should thus be flexibility taking the variability into consideration.

The government is considering offering a "rolling contract" for road development that will have the above said flexibility through the model—variable build operate and transfer (V-BOT). Under this model, the projects will be bid out on the basis of total cost (including construction, financing, operation and maintenance) for a defined contract period. The lowest bidder will get the project and will build, operate and collect toll. If toll collection increases beyond the projection due to high traffic growth, the contractor will recover the cost before the quoted period and NHAI will terminate the contract. NHAI will then collect toll to recover the land cost. When that amount is recovered, toll will be cut. All such projects will compulsorily have 100% electronic toll collection, installation of automatic traffic count and classifier system, video image detection and other systems.

Delhi-Noida Direct (DND) Flyway Allahabad High Court in 2016 scrapped the toll levied on commuters using the Delhi-Noida Direct (DND) Flyway, a major traffic artery connecting southeast Delhi with Noida across the Yamuna in Uttar Pradesh. Noida Toll Bridge Company Ltd (NTBCL) is the special purpose vehicle to develop, construct, operate and maintain DND. The Allahabad High Court order was caused by a public interest litigation (PIL) petition. The court considered several aspects of the case before ruling that NTBCL had "recovered all reasonable returns" on its investment, and was no longer entitled to collect toll.

Concession

A concession or concession agreement is a grant of rights, land or property by government, corporation, individual or other legal entity. Public services such as roads, hospitals may be operated as a concession. In the case of a public service concession, a private company enters into an agreement with the government to have the exclusive right to operate, maintain and carry out investment in a public utility for a given number of years.

In concessions, payments can take place both ways: concessionaire pays to government for the concession rights and the government may pay the concessionaire, which it provides under the agreement to meet certain specific conditions. Usually, such payments by the government may be necessary to make projects commercially viable and/or reduce the level of commercial risk taken by the private sector, particularly in a developing or untested PPP market. Typical concession periods range between 5 to 50 years.

A BOOT structure differs from BOT in the way that the private entity owns the works in the former. During the concession period the private company owns and operates the facility with the prime goal to recover the costs of investment and maintenance while trying to achieve higher margin on project. The private entity has additional rights being owner- raise loans against it as collateral.

Hybrid-Annuity Model (HAM)

HAM was introduced in 2016 essentially for road infrastructure projects awarded by the National Highway Authority of India (NHAI).

As per HAM model, 40% of the capital cost quoted is paid upfront by government while the remaining 60% of the cost will be paid over the life of the project as annuities. That is the meaning of "hybrid".

HAM is a financial innovation in funding for infrastructure that emerged from a practical need. The BOT model was not considered viable by the private players to invest as the private player had to fully mobilise finances and bear the risk. Banks were unwilling to lend to these projects as they accumulated NPAs. Risks were unevenly distributed between government and private builder as developers had to take the entire risk of low passenger traffic. Projections on traffic go wrong affecting returns. Hence the reluctance to commit large sums of money in such models.

It helps by distributing the risk between developers and the Government.

Government has many incentives: builds roads, enables businesses, boosts tax buoyancy as it triggers economic growth, land prices go up in the vicinity that helps the owners etc. There is less traffic congestion. HAM projects are also being tested in urban infra developments such as metro rail projects.

In 2017, Hybrid Annuity based PPP model was adopted for the first time in the country in sewage management sector in two major cities in Ganga river basin - Varanasi and Haridwar.

Toll-Operate-Transfer (TOT)

The government approved a model under which toll highways operated by the National Highways Authority of India (NHAI) for over two years will be leased out to entities which will collect toll and operate the project for a specified duration, in a return for an upfront fee. The money raised will be used to invest in developing more highways.

GOI identified 75 national highway projects adding up to 4,500 km for the toll-operate-transfer model. Projects under the TOT model will be awarded through international competitive bidding where foreign funds can also take part.

TOT model will bring new investments to the highways sector. Under the TOT model, the investor will collect toll and be responsible for operation and maintenance of the project.

Proceeds from TOT auctions will free up valuable taxpayer capital and augment resources for new infrastructure projects.

The model is likely to help NHAI raise capital to fund road projects based on the engineering, procurement and construction (EPC) and hybrid annuity models. It will also be an opportunity for pension funds and infrastructure investors to invest in India's road sector profitably.

Swiss Challenge

Under the Swiss challenge method any party with credentials can submit a infrastructure development proposal to the government. That proposal will be put online and a second party can suggest to improve and better that proposal. In case the original proposer is able to match the more attractive and competing counter proposal, the project will be awarded to him. An expert committee will decide on the best proposal. The Swiss challenge method is one that has been used in India by various states including Karnataka, Andhra Pradesh, Rajasthan, Madhya Pradesh, Bihar, Punjab and Gujarat for roads and housing projects.

This method can be applied to projects that are taken up on a PPP basis, EPC etc. The Union cabinet gave its approval to redevelop 400 railway stations using the Swiss challenge method. It

helps in passenger service, modernization, mega investments, job creation etc.

The advocates of Swiss Challenge cite the following benefits: efficiency in the use of capital; good citizen services; transparency; genuine competition; cost saving for the government ; speeds up the process of awarding projects.

The critics of this method point to absence of real competition as in reality unsolicited bidder may not be in reality unsolicited because of the politics-business nexus.

In an age of crony capitalism, companies may employ questionable means to win mega projects. Thus this method has a potential to encourage large-scale corruption and erosion of precious public resources.

Effective legal and regulatory regime is necessary to make the most of the Swiss Challenge method.

Kelkar Committee report on 'Revisiting and Revitalising the PPP model of infrastructure development,' presented GOI in 2015 discouraged the government from following the 'Swiss Challenge' model of auctioning infrastructure projects.

Viability Gap Funding

The VGF Scheme aims to enhance the financial viability of infrastructure projects, which do not have commercial viability to be taken up by the private parties. Under the scheme, grant assistance of up to 20 per cent of capital costs is provided by the Union Government to PPP projects undertaken by any Central Ministry, State Government, statutory entity or local body, thus leveraging budgetary resources to access a larger pool of private capital. An additional grant of up to 20 percent of project costs may be provided by the sponsoring Ministry, State Government or project authority.

UDAN (Ude Desh ka Aam Naagrik) is an ambitious regional air connectivity scheme for which GOI set up a trust for disbursing viability gap funds to the participating airline companies. Airports Authority of India (AAI) is the nodal authority for the scheme that aims to connect unserved as well as underserved airports and make flying affordable for the masses. As at least half of the seats in UDAN flights are to be offered at subsidised fares, the participating carriers would be provided a certain amount of Viability Gap Funding (VGF) -- an amount shared between the Centre and the state concerned.

Take out financing

Banks attract deposits whose average life is about 3-5 years and so can not be lent to finance infrastructure whose returns will have to wait for much longer. But take out financing can be helpful as banks lend long term but after 3-5 years, a firm like India Infrastructure Finance Company Limited (IIFCL) takes out the account from the banks' books. It pays the bank what the borrower owes it and collects the money from the borrower. It is an accepted international practice of releasing long-term funds for financing infrastructure projects. It can be used to effectively address the Asset-Liability mismatch of commercial banks arising out of financing infrastructure projects and also to free up capital of banks for financing new projects.

Objectives of the Takeout Finance Scheme:

- To boost the availability of longer tenor debt finance for infrastructure projects.
- To address issues of asset-liability mismatch.
- To expand sources of finance for infrastructure projects by facilitating participation of new entities i.e. medium / small sized banks, insurance companies and pension funds.

Plug and play model

The Union Budget 2015-16 proposed a 'plug-and-play' model for big-ticket infrastructure projects such as power plants, airports and roads, where all regulatory clearances will be put in place before they are awarded to private developers through a transparent auction.

'Plug-and-play' model means winners of the contract can start implementing the project immediately, without worrying about all the regulatory clearances and coal or gas linkages - the cause for so many stalled projects in the country. This should unlock investments to the extent of lakhs of crores. It will help the government attract foreign and domestic investments into much-needed infrastructure projects as it will significantly cut down project implementation time and cost and time overruns.

Infrastructure Debt Fund

Infrastructure projects are capital intensive and have long payback periods, and, therefore, require long-term funds at comparatively low costs. Infrastructure projects in India are financed mainly by commercial banks and NBFCs. The present bond market lacks depth to address the needs for a long-term debt. With a view to overcoming these shortcomings, Infrastructure Development Funds (IDFs) are being set up for channelising long-term debt from domestic and foreign pension and insurance funds, as well as from other sources. The Reserve Bank of India, and the Securities and Exchange Board of India (SEBI) have already laid down regulatory framework for the IDFs.

An IDF can be structured either as a company or as a trust. If set up as a trust, it would be regulated by SEBI under the Mutual Fund Regulations. If set up as a company, the IDF would be structured as a Non-Banking Finance Company (NBFC) and will be under the regulatory oversight of RBI. Some infra debt funds have been set up.

An IDF-NBFC would issue either rupee or dollar denominated bonds to mobilise money to be invested in infrastructure PPPs.

Infrastructure Investment Trust (InvITs)

Infrastructure Investment Trust (InvITs) is like a mutual fund, which enables direct investment of small amounts of money from individual/institutional investors in infrastructure to earn income as return. InvITs work like mutual funds or real estate investment trusts (REITs). InvITs can be treated as the modified version of REITs designed to suit the specific circumstances of the infrastructure sector. They are regulated by SEBI.

Masala Bonds (discussed elsewhere)**Engineering, Procurement, Construction (EPC) Contract and Turnkey**

EPC contracts make the contractor responsible for design and construction on a turnkey basis and for a fixed price. Turnkey is a traditional procurement model for infrastructure facilities where the contract is given to build a project and the party that gives the contract as the entire project delivered and has to 'turn key' for its operation. Generally, a private contractor is selected through a bidding process. The private contractor designs and builds a facility for a fixed payment. The contractor assumes risks involved in the design and construction phases. This type of private sector participation is also known as Design-Build. Both EPC and Turnkey projects for general purposes are similar.

Lease

In this category of arrangement, the operator (the leaseholder) is responsible for operating and maintaining the infrastructure facility (that already exists) and services, but generally the

operator is not required to make any large investment. However, often this model is applied in combination with other models such as build-operate-transfer. Under a lease, the operator retains revenue collected from customers/users of the facility and makes a specified lease fee payment to the contracting authority. Generally, the government undertakes the responsibility for investment and thus bears investment risks. The operational risks are transferred to the operator.

Suitability and Selection of model

Each model has its own pros and cons and can be suitable for achieving the major objectives of private-private partnership to a varying degree.

There is no single PPP model that can satisfy all conditions.

A typical PPP structure can be quite complex involving contractual arrangements between a number of parties, including the government, project sponsor, project operator, financiers, suppliers, contractors, engineers and customers. The creation of a separate commercial venture called a Special Purpose Vehicle (SPV) is a key feature of most PPPs. The SPV is a legal entity that undertakes a project and negotiates contract agreements with other parties including the government.

SPV has many advantages. Protected finance is available. That is, the funds available for the project through the SPV can not be diverted. A project may be too large and complicated to be undertaken by one single investor considering its investment size, management and operational skills required and risks involved. In such a case, the SPV mechanism allows joining hands with other investors who could invest, bring in technical and management capacity and share risks, as necessary. The government may also contribute to the long-term capital of the SPV.

Other than its strategic, financial and economic interest, the government may also like to directly participate in a PPP project. The main reasons for such direct involvement may include:

- To hold interest in strategic assets;
- To address political sensitivity and fulfill social obligations;
- To ensure commercial viability of the project;
- To provide greater confidence to lenders; and
- To have better insight to protect public interest.

PPP in Urban Infrastructure

Private sector participation needs to be encouraged in urban infrastructure sectors like water supply and sewerage and solid waste management. In urban transport, private sector can provide more efficient transport services, construct and maintain modern bus terminals with commercial complexes, over bridges, city roads and so on. PPP initiatives are also being undertaken to develop metro rail systems in Indian cities.

PPP in Ports

The government has encouraged private sector participation in port development and operations. Foreign direct investment up to 100 per cent is permitted under the automatic route for port development projects. Private investment has been envisaged on PPP basis in ports of Kolkata, Haldia, Paradip, Vizag, Ennore, Chennai, Tuticorin, Cochin, New Mangalore, Mormugao, Mumbai, JNPT and Kandla.

PPPs in Social Sectors

GOI lays special emphasis on the development of social sectors in view of their impact on human development and quality of life, especially of the underprivileged sections. The physical

targets set by GOI cannot be met out of public resources alone. It is, therefore, imperative that resources have to be attracted from the private sector to ensure that targets, in physical and financial terms, are met.

In the social sectors, it may not be possible to adopt the user-charge-based concessions, although they may not be completely ruled out. However, concessions which would provide reimbursement of service costs could attract considerable private investment. The main advantages of adopting the PPP approach in the social sectors would be enhanced investment, reduction in time and cost over-runs, improvement in efficiencies and better quality of performance.

PPP in Education

A scheme for setting up 2,500 schools under PPP mode was rolled out in the Twelfth Plan. The purpose of the scheme is to meet the government's objective of establishing world-class schools for providing quality education to underprivileged children who cannot afford to pay the tuition fee that good private schools charge. It is expected that the scheme will help in creating capacity for providing quality education to 40 lakh children, out of which 25 lakh will be from the underprivileged category.

The respective rights and obligations of the private entity and the government are codified in an agreement with the former undertaking to deliver the agreed service on the payment of a charge by the government. Recurring tuition support would be provided for up to 1,000 students from underprivileged categories at par with the amount that the Central Government spends on a student in Kendriya Vidyalaya.

The objective is to combine the respective strengths of the public and private sectors to complement each other in pursuit of the shared goal of good education for all. In particular, adoption of the PPP mode would lead to rapid expansion of access to world-class education by low-income families.

In 2012, GOI approved a scheme for setting up 20 IITs in PPP mode. While land for the purpose was made available free of cost by state governments concerned, an IIT was established capital cost being contributed in ratio of 50:35:15 by centre, state and industry partner respectively.

Areas that come under PPP might include almost every aspect of education, including evaluation and implementation, ownership, management, funding, running of institutions, academic aspects, special education programmes, like bridge courses, teacher training services, extra academic aspects, examinations, including entrance examinations, support services, hostels, healthcare, transport, maintenance, security, and so on, though policy formulation is normally considered as an exclusive prerogative of the state. In recent years several hybrid partnerships have also evolved, involving new combinations and permutations of state and non-state sectors engaged in a range of activities in education.

Criticism: Most partnerships of the recent period are based on market-oriented logic, while many models prevalent during earlier periods were not so. There is a main difference between the earlier models and the recent ones. The government was interested in PPP, when it proposed, for example, university-industry collaborations, essentially for academic reasons, to improve the relevance of curriculum, increase employability of graduates etc. Nowadays, the main objective of proposing PPP is to raise private funds and save public resources.

PPP models do not feel the need to view education, as a social good, a public good and a social merit good, as distinct from production of normal commercial goods and infrastructure. It is widely felt that as a result, PPP adversely influences the publicness of education. PPP then may lead to gradual or rapid shrinking of the state sector and an expansion of private sector which may eventually emerge as the sole player in education displacing public sector altogether.

In other words, public-private partnerships often end in favour of privatisation of Education and diminution of the role of the government.

PPP in Health Care Services

Several State Governments are experimenting with delivery of health services through different models. Planning Commission also considered a scheme for setting up secondary and tertiary care hospitals through PPPs at various District Headquarters. The principal objective of the scheme is to create a health care delivery mechanism comprising multi-specialty hospital to meet the growing health care needs of the poor, and for supplementing human resources in the sector by setting up nursing schools and medical colleges.

National Health Policy, 2017 advocates the case of increased role for private sector in the urban areas: "Given the large presence of private sector in urban areas, the policy recommends exploring the possibilities of developing sustainable models of partnership with for profit and not for profit sector for urban health care delivery."

NITI Aayog and the Union ministry for health and family welfare have proposed a model contract to increase the role of private hospitals in treating non-communicable diseases (NCDs) in urban India. According to the model contract, the district hospitals will need to share their back-end services such as blood banks and ambulance services with the private players. The state government could also provide part of the funds needed by these private players to set up the new hospitals. Under the model contract, these private hospitals will provide secondary and tertiary medical treatment for cancer, heart diseases and respiratory tract ailments at prices that are not higher than those prescribed under government health insurance schemes.

The rationale for coming up with this model is the fact that these three diseases do account for almost 35-40 per cent of total mortality in the country. It is also a fact that three-quarters of the specialists, equipment and beds are in the private sector. Partnership with them is therefore inevitable.

Pros

PPP is justified on the following grounds:

- Rampant absenteeism of government doctors — ranging from 28 per cent to 68 per cent in different states.
- The increase in government expenditure to 2-2.5 percent of GDP for the expansion of public health services fails to fructify, and has hovered in the range of 0.9-1.3 percent from 1990 till date.
- Community Health Centres report a 65 per cent vacancy rate of specialists since governments are simply unable to attract and retain talent.
- Private sector continues to grow at 15 per cent per annum, accounting for 58 per cent of rural and 68 per cent of urban in-patient care with 80-90 per cent of health facilities and a five-fold higher doctor density.
- Non-communicable diseases account for 60 per cent of the premature mortality in India and cardiovascular diseases, pulmonary diseases, cancer, as well as hypertension, diabetes and stroke are among the leading killers, accounting for four of the top five causes of death
- The aim is to ensure that district hospitals provide basic services for the diagnosis and treatment of NCDs at affordable rates or free of cost for those patients for whom the government chooses to cover such costs through insurance or through budgetary grants. This will help decongest tertiary level health facilities, help in the geographic dispersal of skills required for NCD care and provide quality care to people closer home at a lower cost.

Cons

- One-sidedness of the agreement, with the government bearing all the risk and the private partner having all the profits. Risk is unequally spread.

• The challenge in the Niti Aayog hybrid model is its implementation. How do public and private managements coexist in the same physical space? A hospital is a living institution that cannot be dismembered. Salary streams, motivation levels, working methods, prescription practices, monitoring and accountability systems, work expectations, all vary. Everyday, there are instances of patients being denied treatment in private hospitals till payment is made or preferring paying patients to the government insured ones or levying additional charges in addition to the sum reimbursed. Private hospitals are also known to overcharge devices like stents and drugs that are the key revenue earning centres. It is difficult for the government to operate its low-cost generics Jan Aushadhi pharmacies alongside the private entity pharmacies. In other words, such a model will have conflicts of interest.

(Primary healthcare is the first level of contact between patient with the health system: immunization, treatment of common diseases or injuries, provision of essential facilities, health education, provision of food and nutrition and adequate supply of safe drinking water.

Secondary Healthcare means patients from primary health care are referred to specialists in higher hospitals for treatment.

Tertiary Health care involves specialized consultative care provided on referral from primary and secondary medical care. Specialised Intensive Care Units, advanced diagnostic support services and specialized medical personnel on the key features of tertiary health care.)

PPP in Skill Development

As part of the government's initiative to augment the programmes for skill development, GOI announced setting up of 1,500 ITIs through PPP in unserved blocks. The objective is to create centres of excellence in vocational education especially for the youth from low-income families in order to improve their prospects of gainful employment. A major proportion of the costs incurred by an ITI are of a recurring nature, and GOI therefore, provides support for the recurring expenditure incurred by an ITI towards training students from underprivileged families. Further, GOI provides capital grant to meet a part of the cost of creating the infrastructure for setting up the ITIs. Under Phase I of Pradhan Mantri Kaushal Vikas Yojana (PMKVY), the government has trained millions. Thousands of new industrial training institutes (ITIs) have been established. Cabinet approved a national apprenticeship promotion scheme under which five million people are to be trained by 2019-20.

In 2013, the Companies Act mandated all organizations with a minimum net worth of Rs 500 crores or a turnover of Rs 1,000 crores or a net profit of at least Rs 5 crores, to spend at least 2% of their profits on CSR. Leading corporations have taken an active role in working with ITIs to strengthen them and improve the quality of learning outcomes from the institutions.

PPP in Digital India

Digital India is a campaign launched by the Government of India in 2015 which includes plans to connect rural areas with high-speed internet networks. Digital India consists of three core components. They are:

- Development of secure and stable digital infrastructure
- Delivering government services digitally
- Universal Digital Literacy

The BharatNet project, earlier National Optical Fibre Network or NOFN, seeks to bring high-speed broadband to all 2.5 lakh gram panchayats through optical fibre. It was approved by Cabinet in 2011. It is to be funded by Universal Service Obligation Fund (USOF). The project intends to enable the government of India to provide e-services and e-applications nationally.

(USOF The NTP of 1999 had Universal Service as one of its main objectives. The resources for meeting the Universal Service Obligation (USO) were to be generated through a Universal Access Levy (UAL), at a prescribed percentage of the revenue earned by the telecom licensees (telcos).)

PPP in Swachh Bharat

Swachh Bharat Abhiyan (SBA) was started in 2014 with the objectives that include eliminating open defecation through the construction of household-owned and community-owned toilets and establishing an accountable mechanism of monitoring toilet use. It aims to achieve an Open-Defecation Free (ODF) India by 2 October 2019, the 150th anniversary of the birth of Mahatma Gandhi, by constructing 12 million toilets in rural India at a projected cost of ₹ 1.96 lakh crore.

It is India's largest cleanliness drive to date with 3 million government employees, school students, and college students from all parts of India participating in 4,041 statutory cities, towns and associated rural areas.

The mission contains two sub-missions: Swachh Bharat Abhiyan ("Gramin" or rural), which operates under the Ministry of Drinking Water and Sanitation; and Swachh Bharat Abhiyan (Urban), which operates under the Ministry of Housing and Urban Affairs.

The government has stressed on promoting PPP. Community cleanliness projects can be funded via the PPP model.

Waste-to-energy projects can be taken up by PPP model. Mumbai has the potential to set up a 120-MW power station based on garbage the city generates, fetching Rs.1,000 crore a year. The PPP model can also be brought in by roping in corporates in such power projects.

Swachh Bharat is a very important part of CSR and Public Private Partnership (PPP). The Government's commitment that every person should have access to safe drinking water, a toilet and a hygiene facility by 2019 needs CSR and PPP framework for funds as well as quality interventions and programs, which can maximize social impact and the focus on behavior change to influence positive behaviors.

Concerns

Resort to PPPs in the social sector often raises concerns about the commercialisation of services that are normally expected to be provided free or highly subsidised. These are important concerns but they can be addressed by well-drafted concession agreements and strict monitoring to ensure that PPP concessionaires abide by their commitments. This must be reinforced with penalties for non compliance.

While extending the concept of PPP to social and urban sector projects, the need for people's participation in the design and monitoring of PPP schemes becomes crucial. Local citizens are direct stakeholders in such projects and therefore their support becomes crucial. Therefore, some cities and States have begun to shape PPPs in the social and urban sectors as People-Public-Private Partnerships (PPPPs). This is a valuable innovation which should be applauded.

PUBLIC SECTOR

Evolution, Reforms and Performance

Public sector units –also called enterprises or undertakings that are owned by the Government - Central or state- either wholly or at least the majority of shares in each. Public sector enterprise normally has forms of organisational structure like departmental undertakings (Railways etc); statutory corporations which are set up by an Act of Parliament (Oil and Natural Gas Corporation Limited); companies registered under the Companies Act 2013 (Bharat Heavy Electricals Limited -BHEL) mainly.

Departmental undertakings like Railways are not formed by or with the consent of the legislative authority. These are set up by the executive decisions of government (for example, Cabinet ministers) and carry out specially defined commercial functions. These undertakings are a part of government and are managed by civil servants. They do not have separate finances but their receipts go into and their expenditure comes from the Consolidated Fund of India unlike all other forms of PSEs. That is, they are financed by annual budgets. A departmental undertaking is best suited where the main purpose of the enterprise is to collect revenue for the state and to provide public utilities and services at fair prices in larger public interest. Some examples of departmental undertakings are the Railway, Postal Department etc.

Statutory corporations are enterprises normally engaged in economic or manufacturing activities and are set up by act of legislature. These corporations are legal entities separate from the government and also the persons who conduct their affairs. ONGC, IOC etc are some examples. Statutory corporations enjoy extensive legal autonomy, and their rules, objectives, functions and duties are defined and specified in the Parliamentary Act. Financing statutory corporations is not part of the Budget and therefore, they can retain their revenues, and also spend as per the rules laid down by the statute.

Control Boards are set up to manage government projects- for example, the river valley projects- Bhakra Management Board.

Government Company is one where the government owns 50% plus one or more of the paid up capital, according to Companies Act 2013.

Rarely, PSE can be in the form of cooperative society to support cooperative movement- Indian Farmers Fertilizer Cooperative Ltd (IFFCO), Krishi Bharati

Cooperative Ltd (KRIBHCO) etc. They are registered under Multi State Cooperative Societies Act.

In India, we have all these types of PSEs.

Since the beginning of socio-economic planning after the Independence, public sector played a preeminent role in India. Commanding heights of the economy were to be in the hands of the public sector – basically infrastructure and basic industries like heavy engineering, power, metals etc. PSEs dominated the Industrial Policy Statement 1948 and IP Resolution 1956. They were opted for by the Government partly as the Government wanted to steer the economy towards planning goals rapidly and also because of pragmatic compulsions like the presence of the private sector in manufacturing was negligible and they were not willing to take up the unprofitable work of investing in infrastructure.

The objectives of the PSUs are

- To build a self reliant economy
- To prevent/reduce concentration of private economic power

- Establish sound economic infrastructure
- Set up industries in the backward regions and thus help bring about balanced regional development
- Assist in ancillarization and thus spread the benefits of industrialization
- Create sufficient levels of employment and set standards in labour welfare
- Selling goods and services at reasonable prices so as to serve consumer, keep prices affordable and help non inflationary growth process.
- Invest in areas where the private sector would not invest like in roads, transport and so on.

Performance

Since planning began in 1951, public sector has been the main engine of inclusive growth as can be seen below.

The Public Enterprises (PE) Survey is a consolidated annual report on the performance of all Central Public Sector Enterprises (CPSEs) and their subsidiaries for the financial year 2015-16 which was made public in 2017. It is laid in both the Houses of Parliament every year during the Budget Session.

The overall performance of CPSEs in India showed improvement during the financial year 2015-16 over the previous year with the overall net profit of the 244 operating CPSEs at Rs.1,15,767 crore in 2015-16.

The CPSEs have been making a substantial contribution to the Central Government through payment of dividend, interest, corporate taxes, excise duties etc. The contribution by the CPSEs through these avenues increased to Rs.2,78,075 crore in 2015-16. The survey excludes excluding insurance, finance and other companies.

The importance of the PSEs is

- The record of the PSUs in supplying many goods and services like coal, transport, power, irrigation and so on is commendable
- The PSUs are a model employer providing various facilities like education, housing and so on.
- Establishing industries in MP, Rajasthan, Bihar and so on, the efforts of the PSUs to reduce regional economic imbalances are not insignificant
- Non-inflationary growth process is facilitated because of the PSEs as prices of their goods and services can be administered.

Public sector enterprises have been set up to serve the broad macro-economic objectives of higher economic growth, self-sufficiency in production of goods and services, long term equilibrium in balance of payments and low and stable prices. While there were only five Central Public Sector Enterprises (CPSEs) with a total investment of Rs. 29 crores at the time of the First Five Year Plan, there are as many 244 CPSEs today (2017).

A large number of CPSEs have been set up as Greenfield projects consequent to the initiatives taken during the Five Year Plans. CPSEs such as National Textile Corporation, Coal India Ltd. (and its subsidiaries) have, however, been taken over from the private sector consequent to their 'nationalization'. Industrial companies such as Indian Petrochemicals Corporation Ltd., Modern Food Industries Ltd., Hindustan Zinc Ltd., Bharat Aluminium Company and Maruti Udyog Ltd., on the other hand, which were CPSEs earlier, ceased to be CPSEs after their 'privatization'.

Along with other public sector majors such as Indian Railways in transportation, the CPSEs are leading companies of India with significant market-shares in sectors such as petroleum, (e.g. Coal India Ltd. and NMDC), power generation (e.g. NTPC and NHPC), power transmission (e.g. Power Grid Corporation of India Ltd.), heavy engineering (e.g. BHEL), aviation industry (e.g. Hindustan Aeronautics Ltd. and Air India Ltd.) storage and public distribution system (eg. Food Corporation of India and Central Warehousing Corporation), shipping and trading (eg. Shipping Corporation of India Ltd. and State Trading Corporation Ltd.) and telecommunication (eg. BSNL and MTNL).

With economic liberalization, post-1991, sectors that were exclusive preserve of the public sector enterprises were opened to the private sector. The CPSEs, therefore, are faced with competition from both domestic private sector companies (some of which have grown very fast) and the large multinational corporation (MNCs).

While considering the performance of the PSUs, it must be recognised that most of them had locational disadvantage; sold the product at administered prices (government fixed price); did not have access to the best of technology; had excess of manpower; operated in areas not meant for profit making like Railways; were subject to multiple controls and excess of accountability and so on. Even while sick PSEs are reducing in number, the problems are compounded by : resource crunch, erosion of net-worth due to continuous losses incurred by the PSUs; reluctance of financial institutions to provide funds for revival of PSUs, heavy interest burden, old and obsolete plant and machinery, outdated technology, low capacity utilisation, excess manpower, weak marketing strategy, etc. Inadequate autonomy is one reason. Populism and the absence of rational pricing of goods and services is another reason for the low levels of efficiency in PSUs.

Public Sector and Economic Reforms

Economic reforms were made necessary to make the economy competitive through market forces. It was expected to post higher growth rates; make industry yield higher productivity, profits and taxes which can contribute to poverty alleviation. Public sector was in need of competition to unlock its value. Therefore, domestic and foreign capital was invited to force the PSEs to compete and perform. Government recognized the need for PSE reform during the 7th FYP (1985-1990).

The New Industrial Policy 1991 made significant changes like de-reserving many areas with only 3 areas being reserved today; equity disinvestment; managerial revamp with greater autonomy; referring a sick PSU to the Board of Industrial and Financial Reconstruction (BIFR) and so on.

List of industries reserved for the public sector-

1. Atomic Energy.
2. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.
3. Railway passenger transport.

The period since 1991 when reforms were launched saw many reforms in the way PSEs should function-

- Dereservation
- Government must withdraw from commercial and other areas like hotels, bakery, cycles etc.
- Disinvest a portion of the PSU equity in favour of retail public, employees, domestic and foreign financial institutions, for a variety of purposes

- Strategic sale where a PSE is sold over to a strategic partner who buys majority equity and takes over management and may extend to complete ownership in due course.
- Increasingly they are being subject to market discipline primarily by listing on the stock exchanges which is the direct outcome of divestment
- Globalization - liberal FDI norms and import of capital goods, compel the PSUs to perform.
- The MOU system is being improved with greater weightage being given to the criterion of financial performance
- Navaratnas (1997) are granted financial and managerial autonomy for global competitiveness (Read ahead)
- Mini ratnas were taken up for similar reforms
- Maharatnas have been recognized since 2011
- Professionalization of boards
- ETF (Bharat-22) 2017

As mentioned above, the reforms have paid off and the performance improved.

Disinvestment and Privatization

The New Industrial Policy 1991, as mentioned above, talked of disinvestment and the Finance Minister's Budget Speech in 1999-2000 talked of privatization for the first time.

Definitions

Disinvestment is the sale of shares of the Government to the retail public or employees or mutual funds or the domestic financial institutions or FPIs. In other words, in disinvestment (divestment), there is no change in the management from public to private hands because either the government holds majority equity (51%) or even if the government holds less than 51% of equity, rest of it is sold to various individuals and institutions none of whom holds enough to take over management. It is essentially money-raising exercise with some accompanying benefits. Holding less than 51% is technically possible but so far has never been done because at that level, the PSE ceases to be a public sector company.

If the Government sells chunk of equity to a single buyer- 26% or 51% or more- to whom the management is also handed over, it is called strategic sale and the buyer is called strategic partner. It is usually a case of privatization. The buyer is one who has presence in the sector and can add value to the unit. For example, IPCL being sold to Reliance Industries Ltd (RIL) and BALCO sold to Sterlite.

Government may also sell off a unit to a strategic buyer- entire equity.

Strategic buyer is one who not only buys the chunk of entire equity- in one tranche or more- but also takes over management. That is the 'strategic' part of the sale. It is unlike usual disinvestment where sale of shares is unaccompanied by management control transfer. The strategic partner gives higher price for the shares as he gets management control along with it (management premium). Also, running of the unit improves.

Privatization and strategic sale are the same if the sale of equity and transfer of management takes place in favour of private owner.

The advantages with strategic sale (privatization) are that it gets investment; the strategic partner with management control will invest further for diversification and technological improvement; market perception will improve as it is no longer a government company; and shareholder value

will increase. With the improvement of the functioning of the company, workers' protection will also be guaranteed.

Corporatization is a related term. It means: government units are reorganized along business lines. Typically they are required to pay taxes, raise capital from the market (with no government backing, explicit or implicit), and operate according to commercial principles. Even government corporations should focus on maximizing profits and achieving a favorable return on investment. They have to operate in a level playing field along with the private sector without any special advantages, more or less.

There are however cases where the government sells equity to a public sector body. It is a case of strategic sale but not privatisation. Examples are sale of Hindustan Petroleum Corporation (HPCL) to Oil & Natural Gas Corporation Limited (ONGC); Power Finance Corporation (PFC) to Rural Electrification Corporation (REC); Life Insurance Corporation of India (LIC) buying a majority stake in IDBI Bank.

Advantages of Disinvestment/Privatization

- it raises finances for the government that can be spent on restructuring the PSEs
- makes additional finances available for the social sector priorities
- exposes the enterprises to market discipline, thereby forcing them to become more efficient and survive on their own financial and economic strength
- when units become more professionalized and profitable, budgetary support for them can be minimized freeing resources for social and infrastructural needs
- results in wider distribution of wealth through offering of shares to small investors and employees.
- beneficial effect on the capital market: the increase in floating stock would give the market more depth and liquidity and facilitate raising of funds by the PSEs for their projects or expansion, in future.
- Opening up the public sector to appropriate private investment would increase economic activity and benefits the economy, employment and tax revenues in the medium to long term.
- Reducing the public debt that is threatening to assume unmanageable proportions.
- In many areas, e.g. the telecom sector, the end of public sector monopoly brought relief to consumers by way of more choices and cheaper and better quality of products and services. Competition made them perform better as outlined above.

Criticism of Divestment

While the advantages are convincing, the criticism is not to be dismissed either-

- They constitute family silver and should not be liquidated
- PSEs check the private sector in the wider market place and so are crucial to economy. For example, if PSEs are not there, private enterprises may cartelise etc
- PSEs contribute by way of dividends and profits and thus are important sources of public finance
- The exercise is essentially meant to garner resources for filling the revenue deficit

A prudent middle path needs to be adopted by way of extent of divestment; unit chosen; pace of the process; method adopted – IPO, strategic sale etc; valuation debate etc.

Disinvestments worth about Rs. 3.63 lakh crore have taken place since 1991. The government has set a target of Rs. 80,000 crore of disinvestments for 2018- 19.

Valuation of Shares

Fixing the price of shares for PSEs is done on the basis of the discounted cash flow (DCF) model. The DCF model is a method of valuing a business today based on the stream of its future profits or cash flows. It is said to be the best of the given methods.

Net asset valuation is not adopted as it applies only to the units that are being wound up and not for running businesses.

Government Policy on Disinvestment/Privatization

As a part of reforming the PSEs, Government's policy on disinvestment and privatization is evolving since the beginning of the reforms in 1991.

Its main elements are: -

- Divest to raise money and other advantages
- List all unlisted public sector enterprises and sell a minimum of 25 percent of equity to the public as mandated by SEBI
- Buyback of shares, for example, CIL and EIL in 2017
- Profit-making PSUs will not be privatized
- Restructure and revive potentially viable PSUs;
- Close down PSUs which cannot be revived or sold
- Fully protect the interests of workers.

NITI Aayog recommended strategic disinvestment of many sick public sector units.

Strategic & Non-strategic Classification

Government classified the Public Sector Enterprises into strategic and non-strategic areas for the purpose of disinvestment. It was decided that the Strategic Public Sector Enterprises would be those in the areas of:

- Arms and ammunitions and the allied items of defence equipment, defence aircrafts and warships;
- Atomic energy (except in the areas related to the generation of nuclear power and applications of radiation and radioisotopes to agriculture, medicine and non-strategic industries);
- Railway transport.

All other Public Sector Enterprises were to be considered non-strategic.

Buyback of Shares

Buy-Back is a corporate action in which a company buys back its own shares from the existing shareholders usually at a price higher than market price. When it buys back, the number of shares outstanding in the market reduces.

A buyback allows companies to gain name and also material advantages. By reducing the number of shares outstanding on the market, buybacks increase the proportion of shares a company owns that is in percentage terms. Companies buy back shares on the open market over an extended period of time.

The advantages of buy-back:

- To provide an additional exit route to shareholders when shares are undervalued or are thinly traded;

- To enhance consolidation of stake in the company;
- To return surplus cash to shareholders;
- To support share price during periods of sluggish market conditions;

The government encouraged cash surplus PSUs to go for share buybacks to meet its disinvestment target. Engineers India Ltd did share buyback in 2017. The funds for the buyback were met out of internally generated cash resources of the company. The government was the largest beneficiary as it sold its shares in the company. EIL is a Navratna public sector unit under the administrative control of the Ministry of Petroleum and Natural Gas. It is an engineering consultancy company providing design, engineering, procurement, construction and integrated project management services, principally focused on the oil and gas, petrochemicals, fertiliser and LNG industry segments in India and internationally. The company also operates in other sectors including non-ferrous mining and metallurgy, waste water and infrastructure. It is also a primary provider of engineering consultancy services for the government's energy security initiative under its Integrated Energy Policy for strategic crude storages.

Coal India Ltd did a buyback of shares from GOI in 2016.

Cross-Holdings

State-owned companies like Coal India, NTPC and NHPC, have significant cash on their balance sheets. It can be used by them to buy shares of one another as the companies are related and have synergies. Similarly, oil companies. When they buy shares of one another in bulk, they can guide each other and work with a common purpose. Government benefits as such purchase is done from the promoter.

PSE-ETF

GOI in 2014 sold some of its equity to a private fund manager in 10 PSEs. The fund that bought the shares of the 10 PSUs is listed on the stock exchanges. When the units of the fund issued to the public are traded in the stock market, the buyer of the unit gets shares of all the ten together. The advantage is that the average valuation of 10 PSEs is reflected and thus the risk is less though so is the reward. It is called exchange traded fund (ETF).

An ETF is a mutual fund.

Bharat 22

Bharat 22 is an ETF that was launched by GOI in 2017 comprised of 22 stocks of Central Public Sector Enterprises (CPSE), Public Sector Banks and private companies of Strategic Holding of Specified Undertaking of Unit Trust of India (SUUTI). The said 22 stocks are spread across six sectors (Basic Materials, Energy, Finance, FMCG, Industrials and Utilities).

SUUTI

UTI Mutual Fund was carved out of the erstwhile Unit Trust of India (UTI) as a SEBI registered mutual fund. The Unit Trust of India Act 1963 was repealed, paving way for the bifurcation of UTI into – Specified Undertaking of Unit Trust of India (SUUTI); and UTI Mutual Fund (UTIMF). UTI Mutual Fund is promoted by the four of the largest Public Sector Financial Institutions as sponsors, viz., State Bank of India, Life Insurance Corporation of India, Bank of Baroda and Punjab National Bank. Government holds stake in 51 companies in SUUTI. GOI has significant shareholdings in three companies, ITC, Axis Bank (erstwhile UTI Bank) and Larsen & Toubro, earlier held by the erstwhile Unit Trust of India before its breakup.

Methods of Disinvestment of Minority Stake in CPSEs

- Initial Public Offering (IPO) – offer of shares in an unlisted CPSE by the Government to the

public for subscription for the first time.

- Further Public Offering (FPO) – offer of more shares of a listed CPSE by the Government to the public for subscription.
- Offer for sale (OFS) of shares by promoters through Stock Exchange mechanism – to institutional investors by auction on the platform provided by the Stock Exchange; extensively used by the Government since 2012.
- Strategic sale – explained above.
- CPSE Exchange Traded Fund (ETF).
- Cross holdings
- Sale of the entire shareholding by the government in one PSU to another PSU

Use of Disinvestment Proceeds

The proceeds of disinvestment are credited to National Investment Fund (NIF) in Public Account constituted in 2005 and are used for the approved purpose, as decided from time to time. The NIF is utilized for the following purposes:

- Subscribing to the shares being issued by the CPSEs on rights basis, so as to ensure that 51% ownership of the Government in CPSEs is not diluted.
- Preferential allotment of shares of the CPSE to promoters so that Government shareholding does not go down below 51% in all cases where the CPSE is going to raise fresh equity to meet their capex (capital expansion) program.
- Recapitalization of public sector banks and public sector insurance companies so as to strengthen them through further capital infusion towards achieving the Basel III norms.
- Investment by Government in RRBs/IFCL/NABARD/Exim Bank
- Equity infusion in various Metro projects.
- Investment in Bharatiya Nabhikiya Vidyut Nigam Limited and Uranium Corporation of India Ltd.
- Investment in Indian Railways towards capital expenditure.

DIPAM

The Department of Disinvestment was set up as a separate Department in 1999 and was later upgraded as Ministry of Disinvestment in 2001. From 2004, it again became a department and was placed under the Ministry of Finance. The Department of Disinvestment has been renamed as Department of Investment and Public Asset Management (DIPAM) in 2016. Its functions are

1. All matters relating to management of Central Government investments in equity including disinvestment of equity in Central Public Sector Undertakings.
2. Decisions on the recommendations of Administrative Ministries, NITI Aayog, etc. for disinvestment including strategic disinvestment.
3. a. Decisions in matters relating to Central Public Sector Undertakings for purposes of Government investment in equity like capital restructuring, bonus, dividends, disinvestment of government equity and other related issues.
b. Advise the Government in matters of financial restructuring of the Central Public Sector Enterprises (CPSEs) and for attracting investment in the said Enterprises through capital market.

Maharatna, Navaratna and Miniratna Companies

Maharatnas

The Government introduced Maharatna scheme in 2010 with the objective to delegate enhanced powers to the Boards of identified large sized Navratna CPSEs so as to facilitate expansion of their operations, both in domestic as well as global markets.

Eligibility criteria for grant of Maharatna status: - The CPSEs fulfilling the following criteria are eligible to be considered for grant of Maharatna status:-

- Having Navratna status
- Listed on Indian stock exchange
- An average annual turnover during the last 3 years of more than Rs.25,000 crore
- An average annual net worth during the last 3 years of more than Rs.15,000 crore
- An average annual net profit after tax during the last 3 years of more than Rs.5,000 crore
- Significant global presence or international operations.

Delegation of powers to Maharatna CPSEs :- The Maharatna CPSEs in addition to having Navratna powers have been delegated additional powers in the area of investment in joint ventures/ subsidiaries and human resources development. The Maharatna CPSEs can invest 5,000 crore in one project (1,000 crore for Navratna CPSEs).

The Government has granted Maharatna status to 8 CPSEs :

1. Bharat Heavy Electricals Limited
2. Coal India Limited
3. GAIL (India) Limited
4. Indian Oil Corporation Limited
5. NTPC Limited
6. Oil & Natural Gas Corporation Limited
7. Steel Authority of India Limited.
8. Bharat Petroleum Corporation Limited (BPCL)

BPCL, India's second largest fuel retailer, was accorded Maharatna status in 2017- the third Oil Company to be accorded the Maharatna status, Indian Oil Corporation (IOC) and Oil and Natural Gas Corporation (ONGC) were accorded Maharatna status in 2010.

Navaratnas

Economic reforms subject PSEs to market competition from domestic players; imports; and MNCs. Globalization makes the competition more intense. To perform in such conditions, PSEs need a level playing field with the private players. Hence, the Navaratna package that gives autonomy to PSEs. Government introduced the navaratna concept in 1997. It granted enhanced autonomy to nine selected PSEs referred to as "Navaratnas". Eight more CPSEs were made navaratnas since then. Totally, there are 17.

Navaratna CPSEs

- Bharat Electronics Limited
- Bharat Petroleum Corporation Limited
- Container Corporation of India Limited

- Engineers India Limited
- Hindustan Aeronautics Limited
- Hindustan Petroleum Corporation Limited
- Mahanagar Telephone Nigam Limited
- National Aluminium Company Limited
- National Buildings Construction Corporation Limited
- NMDC Limited
- Neyveli Lignite Corporation Limited
- Oil India Limited
- Power Finance Corporation Limited
- Power Grid Corporation of India Limited
- Rashtriya Ispat Nigam Limited
- Rural Electrification Corporation Limited
- Shipping Corporation of India Limited

The government has a quantitative system to confer the status of "Navaratna" on PSE. According to the system, every PSE is rated on the following parameters:

- Net Profit to Net Worth
- Total Manpower Cost as a Percentage of Total cost of Production
- Profit before Depreciation, Interest and Taxes (PBDIT) on Capital Employed
- PBDIT on turnover
- Earning per Share
- Inter-sectoral performance

To gain Navaratna status, a PSE must score at least 60 out of 100 based on these parameters. Additionally, a company must first be a miniratna and must have four independent directors on its board before it can be made a navaratna.

The navaratnas, subject to certain guidelines, have autonomy to -

- incur capital expenditure
- decide upon joint ventures
- set up subsidiaries/offices abroad
- enter into technological and strategic alliances
- raise funds from capital markets (international and domestic)
- enjoy substantial operational and managerial autonomy
- Boards of these PSEs have been broad-based with induction of nonofficial part-time professional directors.

Miniratna Companies

There are over 70 such companies. Miniratnas can also enter into joint ventures, set subsidiary companies and overseas offices but on a lesser scale compared to Navratnas and with certain conditions.

Autonomy for PSEs

Managerial and financial autonomy is important for the PSEs to function well in a market economy where there is severe competition and the companies are also listed on the stock exchanges. Steps for rendering autonomy to the PSEs are :

- Maharatnas, Navaratna and miniratna status
- MOU
- Disinvestment
- Professionalization of boards

Professionalisation of PSU Boards

- MOU
- outside professionals should be inducted in the boards of PSU in the form of non-official Directors whose number should be at least 1/3 of the Actual strength of the Board
- Under the Navratna/Miniratna package, the board of select PSUs have been professionalised by inducting a minimum of 4 non-official Directors in case of Navratnas and 3 in case of Miniratnas.
- number of Government Directors on the Board should not be more than two

Focus Areas For PSU Restructuring**Art.12**

Art.12 of the Constitution of India defines State and PSEs make up a part of it. State under the Constitution has certain obligations to welfare of citizens and employees of PSEs. Thus, the autonomy of the management is curtailed in HR policies. This provision requires suitable amendment to make the PSEs dynamic.

Tenure of the CEO and Board of Directors:

The managerial problems in the PSU can be effectively dealt with if the tenure of CEO and the Board of Directors is assured. The selection, service conditions and the tenure of the Board of Directors is subject to the Government rules and regulations. Unlike the corporate sector where CEO has almost a decade to manage the company, in PSU the rules with respect to superannuation tends to focus attention on short term strategies- co-terminus with CEO's tenure. There is, thus a need to provide continuity in the management by appointing CEO and other members in the Board of Directors for longer tenure with representation of shareholders other than GoI Shareholders.

Multiple-Audit

The business decision in PSUs gets influenced by a number of agencies, such as the Ministry, parliamentary committees, CAG, CVC etc. The end result of this is recourse to a risk-averse approach to business. For example, there is a decision related to purchase of second hand equipment where on the spot decision is required and transparent processes such as global bid are not available. It helps the company to save if it can take quick decision. In some cases there could be loss which needs to be out of the purview of CVC as otherwise it will dampen the decision making process in commercial matters.

Role of Administrative Ministry

It needs to change. Like a shareholder of any other company, the Ministry's role should be

limited to contributing as shareholder in AGM/EGM of the companies, and providing it the requisite support. The role of Ministry in day-to-day management through correspondence should be avoided.

Non Commercial Activities

PSUs are expected to function on commercial consideration but are burdened with takeover of some sick/potentially sick units.

Investment in newer units is based on socio-political consideration. This results in non-flexibility of the company to reorganise its own business. Regularisation of contract labour under article 12 of the Constitution forces PSUs to absorb extra labour without any consideration to the existing manpower strength. PSUs are unable to spin-off loss making units or close operations in those units, which have become operationally unviable.

Ad-hoc Group of Experts (AGE) Report

Ad-hoc Group of Experts (AGE) on Empowerment of Central Public Sector Enterprises was set up in 2004. It was headed by Arjun Sengupta. It recommended in 2006-

- greater autonomy for Public Sector Units
- central PSUs should have truly independent boards. It recommended empowering the PSU boards to take decisions about mergers, joint ventures, pricing, exports, appointments, selection of dealers, promotion and transfer of employees, and so on. The ministry concerned should not review the PSU more than twice a year. Supervision should be done by sector specific supervisory boards.
- ministries should not interfere with the functioning of the PSUs under them. Their managements should be accountable to the board and not to the ministry
- supplementary audit by the Comptroller and Auditor General of India of the PSEs should be an exception rather than rule, as it delays the publishing of audited accounts as required by SEBI.
- reworking of the accountability of the PSEs to Parliament so that the questions raised on their functioning do not compromise sensitive trade data and work as an impediment in functioning as commercial enterprises.

The Government accepted some of the recommendations of AGE relating to enhancement of financial powers of Navratna, Miniratna and other profit-making CPSEs. The remaining recommendations relating to ownership issues, audit of Government companies, Article 12 of the Constitution, Parliamentary accountability, vigilance, management in CPSEs, etc. are under examination.

MOU

The beginning of the policy of Memorandum of Understanding can be traced to the report of the Arjun Sengupta Committee in mid eighties. One of the recommendations of this committee was for the introduction of the system of MOU for measurement of performance of public enterprises. The MOU system was introduced on an experimental basis in 1987-88. It means the unit accepts to achieve results for which it is given autonomy. It is ranked on its performance as per the obligations and commitments under the MOU. Good ranking brings more autonomy.

The MOU system has been adopted as it was felt that PSEs are unable to perform at efficient levels because of multi-point accountability. Also, there was no clarity of objectives. Absence of functional autonomy also hampered their performance.

The MOU covers both financial performance as well as non-financial performance. Under this system performance of the company is categorized into five categories namely: excellent, very good, good, fair, and poor.

The objectives of the MOU system are to improve the performance of public enterprises by increasing autonomy and accountability of the management through clearly laid down performance targets at the beginning of the year; enable the evaluation of managerial performance through objective criteria and provide a mechanism to reward good performance through performance incentives to stimulate improved performance.

Some recent initiatives in restructuring PSEs

- Maharatna status to 8 companies
- ETF
- Niti Aayog given the role to recommend strategic sale etc.

Purchase Preference Policy

Government gives purchase preference in supply of goods and services to the Government Departments, Autonomous bodies and other PSEs if the price quoted by the supplying CPSE is within 10% of the lowest valid bid price, other things being equal. It helps support the PSEs.



New Delhi

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Indian Agriculture

Agriculture plays a vital role in India's economy. Over 58 per cent of the rural households depend on agriculture as their principal means of livelihood. The share of primary sectors* (including agriculture, livestock, forestry and fishery) is estimated to be 20.4% of the GDP during 2016-17 at current prices.

Contrast it with the structural position after Independence. At the beginning of the First FYP, the share of agricultural Sector in GDP was 53% with industry at 17 % and service sector at 30%. Working population in agriculture was 72% and industrial sector had 10.6% and service sector 17.4%.

GDP from the sector is estimated to have grown at 3 per cent in FY18. Agriculture accounts for about 10% of the total export earnings and provides raw material to a large number of Industries (textiles, silk, sugar, rice, flour mills, milk products). Besides, the rural areas are the biggest markets for low-priced and middle-priced consumer goods, including consumer durables. It means, if agriculture performs, rural demand is high. Rural domestic savings are an important source of resource mobilisation. The agriculture sector is crucial in maintaining food security. The allied sectors like horticulture, animal husbandry, dairy and fisheries, have an important in improving the overall economic conditions and health and nutrition of the rural people. Thus, any change in this sector, positive or negative, has a multiplier effect on the entire economy.

India is the world's largest producer of milk, pulses and spices, and has the world's largest cattle herd (buffaloes), as well as the largest area under wheat, rice and cotton. It is the second largest producer of rice, wheat, cotton, sugarcane, farmed fish, sheep & goat meat, fruit, vegetables and tea.

Recognising the crucial role played by the agriculture sector in enabling the widest dispersal of economic benefits, Niti Aayog Action Agenda in 2017 has emphasised that agricultural development is central to equitable and fast economic development of country.

Foodgrain production 2017-18

India had produced record 284.83 million tonnes of foodgrains in 2017-18 crop year (July-June) which was 9.72 million tonnes (MT) higher than the country's previous record during 2016-17.

The year 2017-18 had witnessed record production of all major crops like Rice (112.91 MT), wheat (99.70 MT), coarse cereals (46.99 MT) and pulses (25.23 MT).

GOI attributed the record output to "near normal rainfall".

Food deficit to food surplus

After remaining a food deficit country for about two decades after Independence, India became self-sufficient in food grains.

From the mid 1960s, food security improved with the onset of resource-intensive green revolution: the introduction of high yielding varieties (HYVs) of crops, and the development of agriculture infrastructure for irrigation, input supply, storage and marketing. The HYVs motivated farmers to adopt improved production technologies with the use of water, fertilisers and agrochemicals. The extension support for production technology and the marketing support through procurement operations encouraged farmers to step up production.

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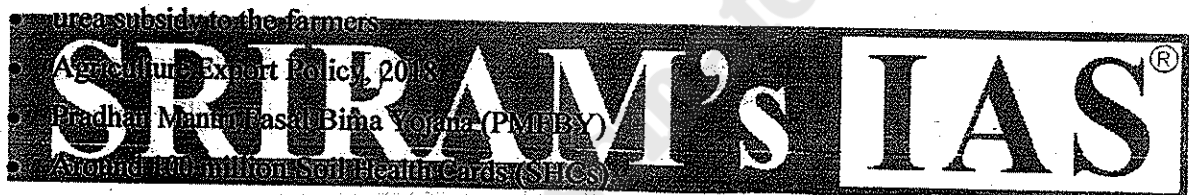
Accounting for Success in Agriculture

The main factors for the all-round success of agriculture have been

- increase in net sown area
- expansion of irrigation facilities
- land reforms, especially consolidation of holdings
- development and introduction of high yielding seeds
- fertilizers
- improved implements and farm machines
- technology for pest management
- price policy based on MSP and procurement operations
- infrastructure for storage/cold storage
- improvements in trade system
- increase in investments, etc.

Government Initiatives

Some of the recent major government initiatives in the sector are as follows:



- urea subsidy to the farmers
- Agriculture Export Policy, 2018
- Pradhan Mantri Fasal Bima Yojana (PMFBY)
- Arogya 100 million Soil Health Cards (SHCs)
- With an aim to boost innovation and entrepreneurship in agriculture, the Government of India launched a new AGRI-UDAAN programme to mentor start-ups and to enable them to connect with potential investors.
- Pradhan Mantri Krishi Sinchai Yojana (PMKSY) with an investment of Rs 50,000 crore aimed at development of irrigation sources for providing a permanent solution from drought.
- The Government of India plans to triple the capacity of food processing sector in India from the current 10 per cent of agriculture produce and has also committed Rs 6,000 crore as investments for mega food parks in the country, as a part of the Scheme for Agro-Marine Processing and Development of Agro-Processing Clusters (SAMPADA).
- The Government of India allowed 100 per cent FDI in marketing of food products and in food product e-commerce under the automatic route.
- A new platform for selling agricultural produce named e-RaKam has been launched by the Government of India and will operate as a joint initiative of Metal Scrap Trade Corporation Limited and Central Railside Warehouse Company Limited (CRWC).
- e-NAM
- PM-AASHA(Pradhan Mantri Annadata Aay Sanrakshhan Abhiyan)
- PM-KISAN

Crisis and Challenge in Agriculture

One of the major challenges is to reverse the deceleration in agricultural growth and achieve the targeted 4% growth rate. This deceleration is the root cause of the problem of rural distress that has surfaced in many parts of the country- unemployment, underemployment, declining incomes, distress migration etc.

Low farm incomes due to inadequate productivity growth, high prices of inputs and lack of credit at reasonable rates pushed many farmers into crippling debt. Uncertainties have increased- prices, quality of inputs, weather and pests which, coupled with unavailability of proper extension and risk insurance have led farmers to despair. This has also led to widespread distress migration, a rise in the number of female headed households in rural areas and a general increase in women's work burden and vulnerability (feminisation of agriculture).

To reverse this trend, corrective policies are being implemented. GOI is focused not only on the small and marginal farmers who continue to deserve special attention due to land fragmentation, negative terms of trade, marketing limitations, lack of extension services etc; but also on middle and large farmers who suffer from productivity stagnation arising from a variety of constraints like land degradation; export controls; inadequate public investment; lack of new varieties; deterrents to crop diversification; insufficient linkages with food processing industries etc.

It is vital to increase agricultural incomes for reasons of employment; equity; food security etc. A second green revolution is urgently needed to raise the growth rate of agricultural GDP to around 4% in an ever-green way (ecologically friendly).

Concerns

Initially, public sector investment played a crucial role in the development of infrastructure like irrigation, electricity, agriculture research, roads, markets and communications. Investment in agriculture declined in the last few years. This calls for a review of policies so that productive investment is made in capital formation. Diversion of scarce resources from creation of productive assets - rural electricity, irrigation, and other agricultural inputs to subsidies needs to be resisted. It is possible by better targeting of subsidies. Following are the concerns:

Firstly, the share of agriculture in GDP has declined from 61 per cent in 1950-51 to 15 per cent (2018), whereas the dependence of population on agriculture has declined only marginally from 3/4ths to 60% during the period. In all the developed countries, there has been a major shift of population from agriculture as an occupation to other sectors. However, this has not happened in India.

Secondly, the average size of holdings has reduced from 2.28 ha in 1970-71 to less than 1 ha in 2018 with the pressure on land increasing continuously. Small plots do not permit introduction of modern technology due to high costs. Thus productivity, incomes and living standards pose challenges.

Thirdly, foodgrains production growth rate and productivity growth rate declined: The per unit area productivity of our crop commodities is much lower as compared to that of the other major crop producing countries. There is also a wide gap in the yield levels among and within States.

Fourthly, the policy of various States has been to increase production through subsidies on inputs such as power, water and fertilisers, rather than by building new capital assets in irrigation and power. These problems are particularly severe in the poorer states. Lower public investment and deteriorating quality of public services in agriculture are the major problems. The poor base of rural productive assets and poorer technological base because of past public/private patterns of spending has been recognised as a serious constraint in increasing production and productivity.

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Boosting agricultural productivity by making available institutional credit adequately and affordably, support for investments in land development structures, farm mechanisation, biotechnology, cold storages, value adding enterprises and marketing to improve productivity and profitability in agriculture is the need of the hour.

As Niti Aayog(NA) observes-“ ...progress in agriculture has a bearing on the fate of the largest proportion of the low income population in India. NA identifies five important aspects of agriculture that need immediate attention to bring economic advantages to millions of farm families.

First, output per hectare, which is a common measure of agricultural productivity, remains low for many crops when compared to many other countries. There are also large regional variations within the country. Reasons include low and faulty input uses, poor access to modern technology and no real technological breakthrough in recent times.

Second, on average, farmers do not realize remunerative prices due to limited reach of the minimum support prices (MSP) and an agricultural marketing system that delivers only a small fraction of the final price to the actual farmer.

Third, the farm size of the majority of the household has declined to unviable levels inducing farmers to leave land and look for better job opportunities elsewhere. Because land leasing laws make it risky to lease land, increasingly, productive land is being left uncultivated. Changes in the land leasing laws may bring consolidation of land holding at operational level and attract better investment along with access to credit and relief to tenants.

Fourth, relief measures in the event of natural disasters are inadequate and suffer from procedural inefficiencies and delays. The risk adaptation measures are poorly executed and have not worked effectively. This situation needs to be rectified with at least minimum quick relief to farmers for crop loss in case of natural calamities.

Finally, the potential of the eastern region needs to be harnessed with suitable interventions. This region is unique for its suitability to the production of certain commodities. However, taking advantage of this potential would require institutional support and investment in technological innovations.”

Capital Formation in Indian Agriculture

Capital formation is one of the basic factors for increasing production. It means addition to the physical stock of dams, roads, power plants in rural areas, land reclamation and other infrastructure. This is all the more important in agriculture where we are faced with the need of increasing production against vagaries of weather to keep pace with the increase in population.

Capital formation helps in

- Judicious use of natural resources for sustainable production of agriculture
- adoption of advanced technology and development of infrastructure for facilitating all agricultural activities
- ensuring food security in the broader sense of making adequate nutritious food available and accessible to all and
- making agriculture a profitable commercial activity at par with other industries in the arena of global economy.

It is necessary to have a broader measure of agricultural capital formation which can be called **capital formation for agriculture** in comparison with **capital formation in agriculture**. That is, rural roads, powers-etc should also be considered capital formation for agricultural growth while they may not be directly related to agriculture.

Recent steps are showing positive results: gross capital formation in agriculture as a proportion of agriculture GDP improved. The Gross Capital Formation (GCF) in the agriculture and allied sectors in the country rose by 87 per cent to Rs 1,42,254 crore in the 2010-11 fiscal as compared to 2004-05. Capital investment in agriculture and allied sectors has witnessed a steady increasing trend in recent years. It has risen from 13.5 per cent of GDP in 2004-05 to 20.1 per cent in 2010-11.

This growth has been possible because of initiatives taken by the government to make agriculture a sustainable vocation.

Investment in public sector includes irrigation works, command area development, land reclamation, afforestation and development of state farms, it added. Private sector investment includes construction activities including improvement / reclamation of land, construction of non-residential buildings, farm houses, wells and other irrigation works, it said.

The share of public investment in gross investment increased. Efforts are being intensified to boost investment in agriculture. These programmes are likely to increase capital formation in agriculture by the public sector and induce the private sector to increase investment in agriculture. The improved availability of credit for agriculture and liberalized trade for agricultural products should enhance private investment in agriculture.

Government stepped up public investment significantly for rural roads and rural employment programmes. Major measures taken for agricultural development through enhanced capital formation include the following:

A roadmap for agricultural diversification has been prepared with focus on horticulture, floriculture, animal husbandry and fisheries.
Strengthening of agriculture marketing infrastructure.
National scheme for the repair, renovation and restoration of water bodies.

- Focus on micro irrigation, micro-finance, micro-insurance and rural credits.
- Setting up a Knowledge Centre in every village.
- Provision of urban amenities in rural areas through creation of new growth poles
- New fertilizer subsidy regime that is nutrient based so as to fortify soil
- Pradhan Mantri Gram Sadak Yojana
- Loan waiver also will enable fresh investment as farmers become eligible for loans again due to write off.

Historically, public sector has taken the lead in directing the growth and pattern of agriculture investment. Steps should be taken to improve capital formation for agriculture in both public and private Sectors as there will be gains by way of efficiency and capital infusion without straining government finances. Otherwise, it may be difficult to sustain the agriculture growth and rural purchasing power.

The new strategy of agriculture growth and diversification of agriculture from traditional crop cultivation to horticulture etc. would require more investments on cold storage, rural roads, communication, marketing network and facilities, warehouses etc. Simultaneously efforts should be made to revitalize agriculture through introduction of bio-technology and other innovations. This would require substantial increase in investment on research & development for agriculture.

(Read along with the schemes given above)

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Agricultural Price Policy in India

Prices of agricultural produce are important for farmers as these determine their incomes. Farming should become economically viable and profitable for agriculture to grow and country to have food security. Agricultural produce shows maximum price fluctuation. So farm sector needs a price policy for price stabilisation.

The main objective of the Government's price policy for agricultural produce is ensuring remunerative prices to the growers for their produce with a view to encouraging higher investment and adoption of modern farm technology for achieving higher levels of production as also to safeguard the interests of consumers by making available supplies at reasonable prices. Each season Government announces Minimum Support Price (MSP) for 24 major agricultural commodities and organises purchase operations through public and cooperative agencies. It operates effectively only for rice and wheat.

At the beginning of the sowing season for kharif and rabi crops, the Government announces Minimum Support Price (MSP) at which it is prepared to procure the produce that the farmer is willing to sell to the FCI for the PDS and buffer stock operations. When it actually procures when harvesting is done, the MSP is increased due to inflation and the procurement price is arrived at. The grain is sold at the PDS outlets at issue price. The FCI's economic cost is what it costs the FCI to procure, store, distribute etc.

The Government decides on the support price for various agricultural commodities based on the recommendations of the commission for agricultural costs and prices (CACP) which is a part of the Ministry of Agriculture & Farmers Welfare.

Commission for Agricultural Costs and Prices (CACP), while recommending prices takes into account all important factors, viz:

● Cost of Production

- Changes in Input Prices
- Input/Output Price Parity
- Trends in Market Prices
- Inter-crop Price Parity
- Demand and Supply Situation
- Effect on Industrial Cost Structure
- Effect on General Price Level
- Effect on Cost of Living
- International Market Price Situation
- Parity between Prices Paid and Prices Received by farmers (Terms of Trade).

CACP recommends MSPs for 24 important crops. Of all the factors, cost of production is the most tangible factor and it takes into account all operational and fixed demands. Government organises Price Support Scheme (PSS) of the commodities, through various public and cooperative agencies such as FCI, CCI, JCI, NAFED, Tobacco Board, etc., for which the MSPs are fixed. For commodities not covered under PSS, Government also arranges for market intervention on specific request from the States for specific quantity at a mutually agreed price. The losses, if any, are borne by the Centre and State on 50:50 basis. The price policy paid rich dividends. Production improved and food security is being realized.

However, the criticism of MSP is that it is promoting rice and wheat while the need is for diversification. Rice and wheat guzzle water. It helps the big farmer while the majority of farmers in India are subsistence farmers. Food subsidy burden is increasing and needs to be rationalized so as to spend on infrastructure; food habits are changing towards protein but rice and wheat cultivation does not diminish as MSP is available; it is a hurdle to crop diversification.

Bhavantar Bhugtan Yojana (BBY) and Telangana Model

Apart from the MSP model, there are others being debated across the country.

First is Bhavantar Bhugtan Yojana (BBY), a price deficiency payment (PDP) scheme, implemented by the government of state Madhya Pradesh. It covers eight notified kharif crops (soybean, maize, urad, tur, moong, groundnut, til and ramtil). Haryana adopted a similar scheme for four vegetables—potatoes, onions, tomatoes and cauliflower. Government sets the MSP. It also arrives at a market price from field surveys. The difference is paid to the farmer who sells his produce. Under the BBY, farmers have to register on a portal. Their sown area is to be verified by govt officials. They bring their produce to mandis during the specified period. Based on average productivity of a crop in the district and the area cultivated by the farmer, the quantity produce eligible for BBY determined. It is an alternative to the costly physical procurement of commodities at MSP in vogue for decades. But the scheme did not take off as the traders manipulated the prices and the farmers lost. Registration also posed problems for the digitally non-literate farmers.

Second is the Telangana model called Rythu bandhu. Telangana announced Rs 4,000 per acre per season to all farmers as investment support for their working capital needs. It has been raised to Rs 5,000 per season.

Under the Telangana model, there is no such need for farmer to register the area and crop cultivated by him. The farmer is free to grow any crop of his choice and he is free to sell it any time in any mandi of his choice. This model is crop-neutral, more equitable, more transparent and empowers farmers with freedom to choose. It does not distort the market as the MSP mechanism to which the WTO objected.

Krushak Assistance for Livelihood and Income Augmentation - KALIA

Financial assistance of Rs.25,000/- per farm family over five seasons will be provided to small and marginal farmers so that farmers can purchase inputs like seeds, fertilizers, pesticides and use assistance towards labour and other investments. This scheme is implemented from current Rabi Season 2018-19 onwards.

Financial Assistance of Rs.12,500/- will be provided to each landless Agricultural Household for Agricultural allied activities like for small goat rearing unit, mini-layer unit, duckery units, fishery kits for fisherman, mushroom cultivation and bee-keeping, etc.

Vulnerable cultivators/landless agricultural laborers will get financial assistance of Rs. 10,000/- per family per year to enable them to take care of their sustenance.

Vulnerable landless laborers, cultivators, share croppers and agricultural families identified by Gram Panchayats will be provided with cop loans up to Rs 50,000 made available at 0% interest.

Swaminathan formula

The National Commission on Farmers, chaired by Prof. M. S. Swaminathan, submitted five reports between 2004 – 2006 and recommended attractive ways of paying the farmer for his produce.

Paying the farmer for the purchase of his produce can be done by fixing the price in a variety of ways. It could be the A2 cost – actual paid out costs of the farmer calculated in a minimal

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manner; or the A2+FL cost (cost of inputs like fertilisers, seeds etc and the imputed value of family labour), or the C2 cost (which is the comprehensive cost plus imputed value of family labour, interest on the value of owned capital assets and the rental value of owned land). C2 plus 50% is recommended by Swaminathan Commission.

PM-AASHA

Pradhan Mantri Annadata Aay Sanraksha Abhiyan

The new Umbrella Scheme includes the mechanism of ensuring remunerative prices to the farmers and is comprised of

- Price Support Scheme (PSS),
- Price Deficiency Payment Scheme (PDPS)
- Pilot of Private Procurement & Stockist Scheme (PPPS).

The other existing schemes of Department of Food and Public Distribution (DFPD) for procurement of paddy, wheat and nutri-cereals/coarse grains and of Ministry of Textile for cotton and jute will be continued for providing MSP to farmers for these crops.

In Price Support Scheme (PSS), physical procurement of pulses, oilseeds and Copra will be done by Central Nodal Agencies with proactive role of State governments. It is also decided that in addition to NAFED, Food Corporation of India (FCI) will take up PSS operations in states/districts. The procurement expenditure and losses due to procurement will be borne by Central Government.

Under Price Deficiency Payment Scheme (PDPS), it is proposed to cover all oilseeds for which MSP is notified. In this direct payment of the difference between the MSP and the selling/modal price will be made to pre-registered farmers selling his produce in the notified market yard through a transparent auction process. All payment will be done directly into registered bank account of the farmer. This scheme does not involve any physical procurement of crops as farmers are paid the difference between the MSP price and Sale/modal price on disposal in notified market. The support of central government for PDPS will be given as per norms.

It has been decided that for oilseeds, states have the option to roll out Private Procurement Stockist Scheme (PPSS) on pilot basis in selected district/APMC(s) of district involving the participation of private stockist. The pilot district/selected APMC(s) of district will cover one or more crop of oilseeds for which MSP is notified. Since this is akin to PSS, in that it involves physical procurement of the notified commodity, it shall substitute PSS/PDPS in the pilot districts. The selected private agency shall procure the commodity at MSP in the notified markets during the notified period from the registered farmers in consonance with the PPSS Guidelines, whenever the prices in the market fall below the notified MSP and whenever authorized by the state/UT government to enter the market and maximum service charges up to 15% of the notified MSP will be payable.

The AASHA scheme tries to give better returns to farmers. If effectively implemented, the scheme will result in savings for the Centre. In the current physical procurement, government agencies end up stock-piling foodgrains, incurring storage costs and significant wastage and leakages as well.

Sustainable Agriculture: Water Management and Irrigation

Sustainable development of land and water resources becomes important for the nation like India, which shares about 16 per cent of the global population but has only 2.4 per cent of the total land and 4 per cent of the total water resource. Scarcity of water in rainfed areas is causing serious hardships. Ground water resources are dwindling fast due to poor water harvesting due to

excessive run off and poor recharging of ground water. This is accompanied by excessive drawal/ exploitation mainly to meet the household needs of growing population as also irrigation needs of new high yielding crops. The number of dark blocks/mandals where there is over exploitation of groundwater (over 85 per cent) is increasing in most of the States with large rainfed areas (Andhra Pradesh, Karnataka, Rajasthan, Madhya Pradesh, Chattisgarh etc.). If this continues, the number of over exploited blocks will double over a period of every twelve and a half years.

Water is a critical input for agriculture and this calls for more effective utilization of existing irrigation potential, expansion of irrigation where it is possible at an economic cost, flood forecasting and better water management in rainfed areas where assured irrigation is not possible.

Along with expansion of irrigation facilities, steps need to be taken to ensure that water is distributed equitably and that it is used efficiently. The pattern observed in the past where tail-enders are denied water because upper end-users appropriate it for highly water intensive crops must be avoided. Participatory Irrigation Management (PIM) by democratically organised water user associations empowered to set water charges, collect and retain substantial part of it, would help to maintain field channels, expand irrigated area, distribute water equitably and provide the tail enders their just share of water. Experience in Andhra Pradesh and Gujarat has shown the effectiveness of such PIM. Watershed management, rainwater harvesting and ground water recharge can help augment water availability in rainfed areas. Micro-irrigation is also important to improve water use efficiency.

Warabandi :- Warabandi means fixing of turns for irrigation water for each farmer so as to make it available for its potential users, i.e. farmers. It aims at use of water judiciously and equitably.

Drought

Drought is an extended period of unusually dry weather when there is not enough rain.

India Meteorological Department (IMD) defines a rainfall range between 96 and 104 per cent of the Long Period Average (LPA) as being "near normal", while 90 to 96 per cent is considered "below normal", 104 to 110 per cent "above normal", above 110 per cent "excess" and below 90 per cent "deficient". Droughts are of the following three types:

Meteorological drought is when the actual rainfall in an area is significantly less than the climatological mean of that area. The country as a whole may have a normal monsoon, but different meteorological districts and sub-divisions can have below normal rainfall.

Hydrological drought means marked depletion of surface water causing very low stream flow and drying of lakes, rivers and reservoirs.

Agricultural drought means inadequate soil moisture resulting in acute crop stress and fall in agricultural productivity.

Droughts can throw out of gear the rural and national economy. Cattle, human beings and crops suffer a water shortage.

With wide variations in agro-climatic zones, drought occurs somewhere in India each year. While parts of Rajasthan and Andhra's Anantpur and Chittoor districts see two droughts in five years, western UP and northern Gujarat face it once in three years. Maharashtra alone has about a quarter of India's drought-prone districts. About 50 million Indians are affected every year.

Climate change is accelerating drought attacks. There were six between 1900 and 1950 and 12 in the following 50 years. We have already faced three droughts between 2000 and 2009.

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There is an official checklist of symptoms to diagnose drought. The early warning signs include delay in onset of SW monsoon, long 'break' within a monsoon, less rain in July, rise in fodder prices, fall in water reservoir levels, dwindling water supply, slower crop sowing.

Drought occurs mainly due to failure of monsoon.

Initially, government advises farmers to grow less water-seeking crops, increase fodder supply, and keep the Centre's National Crisis Management Committee (NCMC) informed. It becomes an emergency when there is virtually no rain during the sowing period; monsoon withdraws mid-season; and a dry spell for more than a month. The deficit in rainfall by now grows and could be as much as 40% and crops start to wilt with no water and excessive heat.

The problem becomes acute and gets classified as a potential disaster when there is no rain for more than six weeks in a crop area, and the monsoon withdraws early, leaving behind parched land and people.

If 20%-40% of India's area is affected, it is called a drought year. If more than 40% of the country is reeling from rainfall shortage, the met department calls it an All India Severe Drought Year.

The primary responsibility of catching the early signs, offering relief and managing droughts lies with states.

The situation may warrant loan rescheduling, insurance premium waivers, and relief from the Centre. The state's budget can come under severe strain.

Once a drought is declared, Central government starts considering deferring/rescheduling farm loans, moving water and fodder by rail, linking food allocation to poor families, creating more jobs, importing foodgrains to meet likely demand-supply gap, and check inflation.

A ministerial task force is set up to take rapid decisions. Drought-declared states are monitored individually and more carefully by the Centre. The Essential Commodities Act is used to prevent hoarding, and states get money for relief programmes.

Landless labourers and marginal farmers move to cities in search of casual jobs. Families with loans from moneylenders get further entrapped in poverty. Health suffers and schooling is disrupted as money dwindles. The impact on cities is by way of migration stress; declining farm growth pulls down industry, urban goods and services.

Proper water management, drought-resistant agriculture, income diversification, smarter subsidies and technology can ensure no one is left devastated by it anymore.

Drought-resistant varieties of seeds should be made available sufficiently.

Remedies lie in the form of better water management; sprinkler irrigation; drought resistant varieties of seeds; creation of irrigation; better credit facilities; shifting to dairy and other animal husbandry activities.

Rainfed agriculture

Rainfed regions are those where crop production is exclusively dependent upon rainfall. The Union Ministry of Agriculture classifies areas, which receive less than 750 mm rainfall annually, and have less than 30 per cent land under irrigation (both surface and ground water) as drylands. In India rainfed regions cover 177 districts and exist in all agro-climatic zones. However, they are mostly concentrated in arid and semi-arid areas. Most of these districts are country's poorest. Rainfed regions account for 68 per cent of the total net sown area in the country, according to the Union Ministry of Agriculture.

Rainfed agriculture plays an important role in India's economy. Rainfed crops account for 48 per cent of the total area under food crops and 68 per cent of the area under non-food crops in the country.

Nearly 50 per cent of the total rural workforce and 60 per cent of the livestock in the country are concentrated in the dry districts.

As opportunities for further agricultural growth in irrigated regions get exhausted, food security and productivity growth in agriculture in India in the coming years will increasingly depend on improved utilisation of resources and productivity growth in rainfed regions.

Most agricultural lands in rainfed areas in Orissa, West Bengal, Bihar and Chhattisgarh suffer from sulphur and phosphorous deficiency. Thus soil has become acidic in nature. These areas need interventions from agriculture scientists in dealing with the crisis.

Promotion of appropriate cropping patterns and livestock development is necessary.

Development of suitable varieties and lab to land transfer is required.

Region specific watershed programmes need to be developed.

There is a need to divert a portion of the population dependent on agriculture to areas like fisheries, agro-processing and horticulture. Fisheries have a lot of potential in areas, which get good rainfall. It is quite clear that agriculture cannot sustain such a large mass of people in rainfed areas. The policy towards rainfed areas has to look beyond crop production and rainwater management.

National Rainfed Area Authority

National Rainfed Area Authority was set up in 2006 to coordinate the work of five ministries and improve productivity of the 85 million hectares of non-irrigated agricultural land. panchayat rural development, agriculture, water resources and environment and forests. NRAA works under the agriculture ministry

New Delhi

NRAA aims to build synergy among these ministries on their schemes, programmes and policies that are relevant to non-irrigated lands. It works for wholistic and integrated development of the rainfed areas.

The NRAA would prepare a national prospective plan, which would look at regional variations. The plan would be flexible and dynamic.

NDRF and SDRF

Government created State Disaster Response Fund (SDRF)/National Disaster Response Fund (NDRF) through Disaster Management Act, 2005 to mitigate hardships due to natural calamities including drought. There is ready availability of funds with State Governments under SDRF to take immediate relief measures. Government of India supplements efforts of State Governments with financial assistance and logistic support. All states will contribute 10% to the SDRF and rest 90 % will be contributed by the Union Government during 2018-19 and 2019-20 as per the recommended allocation by 14th FC.

Additional financial assistance, over and above SDRF, is considered from NDRF for natural calamities of severe nature. Allocation for SDRF/NDRF is made on the basis of recommendations of the 14th Finance Commission.

Micro Irrigation Fund (MIF)

The government in 2018 approved a dedicated Rs5,000 crore fund to bring more land area under micro-irrigation as part of its objective to boost agriculture production and farmers income. The

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fund has been set up under NABARD, which will provide this amount to states on concessional rate of interest to promote micro-irrigation, which currently has a coverage of only 10 million hectares as against the potential of 70 million hectares. Borrowings from NABARD shall be paid back in seven years including the grace period of two years. The lending rate under MIF has been proposed at 3% lower than the cost of raising the fund by NABARD.

Long Term Irrigation Fund (LTIF)

Union Budget 2016-17, announced creation of a dedicated Long Term Irrigation Fund (LTIF) in NABARD with an initial corpus of ₹20,000 crore for funding and fast tracking the implementation of incomplete major and medium irrigation projects. A Mission has been established in the Ministry of Water Resources, River Development and Ganga Rejuvenation (MoWR, RD & GR) for overall implementation of the scheme. The Long Term Irrigation Fund (LTIF) aims to bridge the resource gap and facilitate completion of these projects during 2016-2020.

WMO

The World Meteorological Organization (WMO) is an intergovernmental organization with a membership of 189 Member States and is a specialised agency of the United Nations for meteorology (weather and climate), operational hydrology and related geophysical sciences. It has its headquarters in Geneva, Switzerland, and is a member of the United Nations Development Group.

As weather, climate and the water cycle know no national boundaries, international cooperation at a global scale is essential for the development of meteorology and operational hydrology, as well as to reap the benefits from their application. WMO provides the framework for such international cooperation.

Since its establishment, WMO has played a unique and powerful role in contributing to the safety and welfare of humanity. Under WMO leadership and within the framework of WMO programs, National Meteorological and Hydrological Services contribute substantially to the protection of life and property against natural disasters, to safeguarding the environment and to enhancing the economic and social well-being of all sectors of society in areas such as food security, water resources and transport.

Soil Health

Soil health is a critical factor for agricultural productivity and human health. The following steps are being taken to improve it.

Government issues Soil Health Cards to all farmers in the country detailing the deficiencies in the soil and the amount of fertilizers needed, Soil Health Cards would give farmers information about the quality of the soil and what is the normal quantity of fertilizer to be used for a particular crop. For this, setting up of new soil testing laboratories and new mobile soil testing laboratories had been taken up.

Studies have found that over-dose and injudicious use of conventional chemical fertilizers and pesticides affect soil fertility, vegetation, human and animal health. The government is encouraging use of neem coated urea and organic fertilizer and vermicompost as overdose of conventional fertilizers has been found to affect fertility of the soil in many places. Land under organic farming has increased.

The introduction of nutrient based fertilizer subsidy will enhance soil health as it will be demand driven and not price driven. Earlier only urea was subsidised and so most farmers used it and this soil was spoilt. Now all nutrients are subsidised and farmers are purchasing the fertilisers according to the requirements of the soil and thus it is a step in sustainable agriculture.

Soil reclamation

It is necessary to offset the loss of agricultural land by bringing more land under cultivation. There is a large amount of degraded land that can be reclaimed through watershed development. There is also a considerable amount of saline and sodic land, which can be brought back to cultivation with treatment. Vast areas of cultivated land are acidic, where significant yield increases are possible through treatment using waste material from industry. There is sulphur deficiency in large parts of the country, but this can be treated effectively, particularly for pulses and oilseeds. More generally, Indian soils are relatively deficient in organic matter and are suffering inadequate manuring and composting, aggravated in many regions by unbalanced use of chemical fertilisers, especially excessive application of nitrogen. This raises prospects of large yield increases by applying nutrients, including micronutrients, that have been seriously depleted. Soil reclamation is being done by making many government programmes including MGNREGA.

The NBS based fertilizer subsidy can restore soil fertility.

Zero Budget Natural Farming in India

Zero Budget Natural Farming (ZBNF) is a set of farming methods which has spread to various states in India. It has attained wide success in southern India, especially the southern Indian states of Andhra Pradesh and Karnataka where it first evolved.

The agrarian crisis in India is making small scale farming unviable. Privatized seeds, inputs, and markets are inaccessible and expensive for peasants. Indian farmers increasingly find themselves in a vicious cycle of debt because of the high production costs, high interest rates for credit, the volatile market prices of crops, the rising costs of fossil fuel-based inputs, and private seeds. Debt is a problem for farmers of all sizes in India. Under such conditions, 'zero budget' farming promises to end a reliance on loans and drastically cut production costs, ending the debt cycle for desperate farmers. The word 'budget' refers to credit and expenses, thus the phrase 'Zero Budget' means without using any credit and without spending any money on purchased inputs. 'Natural farming' means farming *with Nature and without chemicals*.

Extension services

Agricultural extension services involve application of scientific research and new knowledge to agricultural practices through farmer education. It involves imparting awareness about the best practices; knowledge transfer; advisory services etc.

The National Commission on Farmers (NCF) has drawn attention to the knowledge deficit that exists at present and explains much of the difference between yields realised in experiments and what farmers actually get. One reason for this is the virtual collapse of extension services in most states. Farmers are not fully aware of the adverse consequences of unbalanced fertiliser use or of benefits of micronutrient application and soil testing to determine optimal nutrient requirements is hardly practised on a regular basis even by State Agriculture Departments. Similarly, although many new varieties of seeds and pesticides have entered the market during the last decade and farmers are using these, they do not appear to have significantly higher productivity and there are frequent complaints about quality. A problem is that input dealers, who have narrow commercial interests have emerged as the main vehicle for technology diffusion and farmers do not have access to reliable third-party advice which an effective and knowledgeable extension service should be able to provide. Lack of credit also pushes farmers to purchase inputs from local suppliers who often provide sub-standard inputs.

To overcome information gaps and for advice in contingencies such as pest-attacks, it is necessary to revitalise the extension system in a manner which links universities and best practices effectively to farmers. States need to take urgent steps in this area. Central initiatives on

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this also need to be strengthened. Krishi Vigyan Kendras set up by Indian Council of Agricultural Research (ICAR), can be better used. Agricultural Technology Management Agency (ATMA) model of extension being promoted by Department of Agriculture & Cooperation (DAC) will deliver results.

The Department of Agriculture and Cooperation, along with NABARD, has introduced a scheme for establishment of agri-clinics / agri-business centres / ventures by the agricultural graduates.

The ICAR is also associated in agriculture extension activities not only through KVKs but also Institute Village Linkage Programme (IVLP) and also its institutes / centres all over the country. The interaction of KVKs activities with the State / district extension machinery is being strengthened. It is planned to strengthen linkages between research and extension to improve quality and effectiveness of research and extension system. The extension system, thus, is being revitalised and broad based through KVKs, NGOs, farmers' organisations, cooperatives, the corporate sector and agri-clinics / agri-business centres. KVKs and ICAR/SAUs units are designated nodal agencies for quality certification including organic products, bio-fertilisers, and bio-pesticides. The supply of inputs, agro-processing and trade through such cooperatives / companies is encouraged through the availability of credit with the help of NABARD.

The NFC has suggested ways to synergise at the village level, for example through Farmer Knowledge Centres, and this is already being implemented in some places with PRI and NGO help. Since synergies across line departments and Centrally sponsored schemes can be derived best through district plans, the Planning Commission and Ministry of Panchayati Raj have begun strengthening the process of district planning. The recent MoA initiative to set up technical bodies such as the National Fisheries Board and the National Rainfed Areas Authority should help to improve synergy.

AgriClinic and agribusiness centre

The Ministry of Agriculture, Government of India, in association with NABARD, launched a unique programme to take better methods of farming to each and every farmer across the country. This programme aims to tap the expertise available in the large pool of Agriculture Graduates. AgriClinic offers professional extension services to innumerable farmers.

Government is now also providing start-up training to graduates in Agriculture, or any subject allied to Agriculture like Horticulture, Sericulture, Veterinary Sciences, Forestry, Dairy, Poultry Farming, and Fisheries, etc. Those completing the training can apply for special start-up loans for venture.

Agribusiness Centres would provide paid services for enhancement of agriculture production and income of farmers. Centres would need to advise farmers on crop selection, best farm practices, post-harvest value-added options, key agricultural information (including perhaps even Internet-based weather forecast), price trends, market news, risk mitigation and crop insurance, credit and input access, as well as critical sanitary and phyto-sanitary considerations, which the farmers have to keep in mind.

Farmers could make use of the clinic to undertake soil testing and get professional counsel. The programme was started in 2002 as a supplement to government's extension services.

SFAC

Small Farmers' Agribusiness Consortium (SFAC), a specialized agency of the Dept. of Agriculture & Cooperation, Govt. of India, supports entrepreneurs, farmer producer groups, cooperatives, companies and other entities to set up agribusiness enterprises which add value to agriculture produce by offering risk capital through its Venture Capital Assistance Scheme.

Rural credit

Nabard

The National Bank for Agricultural and Rural Development (Nabard) was set up in 1982, as the apex development bank for agriculture and rural development under an Act of Parliament. The bank began by taking over the agriculture credit functions of the Reserve Bank of India and the refinance functions of the then Agricultural Refinance and Development Corporation (ARDC).

Nabard's mission is to "promote sustainable and equitable prosperity in rural India through effective credit support, related services, institution development and other innovative initiatives." Its prime function continues to be that of refinancing, supplementing the resources of co-operative banks, regional rural banks (RRBs) and commercial banks against the amounts lent at the grassroots level for agriculture and rural development.

Apart from its developmental role, Nabard has also been entrusted with certain supervisory functions in respect of co-operative banks and RRBs under the Banking Regulation Act, 1949.

Promoting self-help groups reflects Nabard's capabilities in capacity-building and nurturing the rural credit delivery system.

Rural credit institutions

They comprise cooperative banks, RRBs and LABs.

Co-operative credit structure

Co-operative credit institutions continue to play a crucial role in dispensation of credit for agriculture and rural development.

The short-term credit structure is managed by State co-operative banks (SCBs) and district central co-operative banks (DCCBs). Primary agricultural credit societies (PACS) are short-term co-operative credit institutions dealing directly with individual borrowers.

The long-term co-operative credit structure is managed by State co-operative and agriculture rural development banks (SCARDBs) and primary co-operative agriculture and rural development banks (PCARDBs).

RRBs

Regional rural banks were set up in 1975 under an Act of Parliament to exclusively cater to the credit needs of the rural population, especially small and marginal farmers. The ownership structure of RRBs is, the Central Government (50 per cent), the State government concerned (15 per cent) and the sponsor commercial bank (35 per cent). The sponsor bank manages the RRB concerned.

Local area banks

LABs were started in 1996 with a view to providing institutional mechanisms for promoting rural savings as well as for the provision of credit for viable economic activities in the local areas. They are in the private sector. This is expected to bridge the gaps in credit availability and enhance the institutional credit framework in the rural and semi-urban area.

The bank shall be registered as a public limited company under the Companies Act, 1956. It will be licensed under the Banking Regulation Act, 1949 and will be eligible for including in the Second Schedule of the Reserve Bank of India Act, 1934.

The minimum paid up capital for such a bank shall be Rs.5 crore. The promoters' contribution for such a bank shall at least be Rs.2 crore.

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The area of operation of the proposed bank shall be a maximum of three geographically contiguous districts in one or more states. Backward and less developed districts are considered for area of operation of LABs.

Microfinance

Microfinance is defined as provision of credit and other financial services like insurance of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards. Micro finance Institutions are those which provide these facilities.

Microfinance covers not only consumption and production loans for various farm and non-farm activities of the poor but also include their other credit needs such as housing and shelter improvements.

A Self-Help Group (SHG) is a registered or unregistered group of micro entrepreneurs having homogenous social and economic background voluntarily coming together to save small amounts regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis.

While the SHG-bank linkage programme has surely emerged as the dominant micro finance dispensation model in India, other models too have evolved as significant micro finance channels.

Government allows 'Micro Credit/Rural Credit' (non-banking financial company, NBFC) activities for Foreign Direct Investment (FDI)/Overseas Corporate Bodies (OCB)/Non-Resident Indians (NRI) investment to encourage foreign participation in micro credit projects.

Types of micro credit providers in India

• Domestic Commercial Banks: Public Sector Banks: Private Sector Banks & Local Area Banks

- Regional Rural Banks
- Co-operative Banks
- Co-operative Societies
- Registered NBFCs
- Other providers like Societies, Trusts, etc.

New Delhi

In the area of microfinance, there are many areas of concern in India. They are:

- a) unjustified high rates of interest
- b) lack of transparency in interest rates and other charges.
- c) multiple lending
- d) upfront collection of security deposits
- e) over-borrowing
- f) ghost borrowers
- g) coercive methods of recovery

Malegam Committee

Aimed at reviving the crisis- ridden micro finance sector, Reserve Bank of India Committee suggested that micro finance institutions (MFIs) be allowed to charge a maximum interest of 24 per cent on small loans which cannot exceed Rs.25,000. The committee, headed by Reserve Bank's Central Board Director Y. H. Malegam, also recommended creation of a separate category of non-banking financial companies (NBFC-MFI) for the micro finance sector.

The panel also said small loans of up to Rs.25,000 could be given to families having an income up to Rs.50,000 per annum.

It further said at least 75 per cent of loans extended by MFIs should be for income generation purposes. It further recommended that a borrower cannot take loans from more than two MFIs.

These recommendations, the committee said, should be implemented from April 1, 2011. The RBI constituted the committee in October last in the wake of allegations of overcharging and using coercive recovery practices by MFIs that led to a spate of suicides in Andhra Pradesh.

About the regulations of MFIs, the Malegam Committee, suggested that it should be done by the National Bank for Agriculture and Rural Development (NABARD) in close coordination with the RBI.

With regard to NBFC-MFIs, the committee suggested that they should have a minimum net worth of Rs.15 crore.

It recommended that bank lending to NBFCs, which qualify as NBFC-MFIs, will be entitled to the 'priority lending' status. It has made a number of recommendations to mitigate the problems of multiple-lending, over borrowing, ghost borrowers and coercive methods of recovery.

These include: a borrower can be a member of only one self-help group or a joint liability group (where money is lent to the whole group, it is called JLG); not more than two MFIs can lend to a single borrower; there should be a minimum period of moratorium between the disbursement of loan and the commencement of recovery; the tenure of the loan must vary with its amount; a credit information bureau has to be established; the primary responsibility for avoidance of coercive methods of recovery must lie with the MFI and its management; and the RBI must prepare a draft customer protection code to be adopted by all MFIs.

NBFC-MFI (given elsewhere in the material)

NMFP

New Delhi

National Mission on Food Processing has been launched from 2012. The National Mission on Food Processing (NMFP) is a new Centrally Sponsored Scheme for giving of greater role to State/UTs; decentralized administration, better outreach and effective supervision and monitoring. The NMFP would also provide flexibility to States / UTs in the selection of beneficiaries, location of projects etc. for the development of food processing sector. This initiative of the Ministry would give an impetus to food processing industries in the country.

NMFP Scheme provides for sharing of the cost between Government of India (75%) and States (25%) for all States except North Eastern States, where, it is at 90:10 pattern. All Union Territories would be provided funds on 100% basis.

Kisan Credit Cards

The scheme of Kisan Credit Card (KCC) was introduced in 1998-99 for timely, easy and flexible availability of production credit to farmers. Commercial banks, cooperative banks and RRBs are implementing this scheme. Each farmer is provided with a Kisan Credit Card and a passbook for providing revolving cash credit facilities. The farmer is permitted any number of drawals and repayments within a stipulated date, which is fixed on the basis of land-holdings.

All categories of farmers including tenant farmers, share croppers, oral lessees are eligible for a Kisan Credit Card.

Precision agriculture

Precision agriculture (PA), satellite farming or site specific crop management (SSCM) is a farming management concept based on observing, measuring and responding to inter and intra-

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field variability in crops. It has the goal of optimizing returns on inputs while preserving resources. It is a key component of the third wave of modern agricultural revolutions. The first agricultural revolution came along during the advent of increased mechanization. The 1990s prompted the Green Revolution with new methods of genetic modification. It is expected that by 2050, the global population will reach about 9.6 billion, and food production must effectively double from current levels in order to feed every mouth with new technological advancements in the agricultural revolution of precision farming. The first wave of the precision agricultural revolution comes in the forms of satellite and aerial imagery, weather prediction, variable rate fertilizer application, and crop health indicators. The second wave will aggregate the machine data for even more precise planting.

Precision agriculture aims to optimize field-level management with regard to:

- crop science: by matching farming practices more closely to crop needs (e.g. fertilizer inputs);
- environmental protection: by reducing environmental risks and footprint of farming (e.g. limiting leaching of nitrogen);
- economics: by boosting competitiveness through more efficient practices (e.g. improved management of fertilizer usage and other inputs).

Research by members of our team found that the introduction of a low-cost, mobile phone-based agricultural extension system among 1,200 farmers in the state of Gujarat had positive and significant effects on agricultural yields and efficient input use in cotton cultivation. As a result of using this service, farmers' marginal net income increased and yields rose, all at a very low cost. We now have a wealth of data at our disposal, which, if harnessed appropriately, can help farmers make the most efficient use of vital inputs such as water and fertiliser by applying them in precise amounts. Mobile phone application is available as a part of Digital India to give site-specific recommendations to farmers on the correct fertiliser dose, based on data from the local department of agriculture. The right kind of nutrients for a specific soil area needs to be applied, at the right rate, at the right time and in the right place for optimal soil health.

Testing of samples of soil from agricultural fields is vital for achieving nutrient balance. India has a vast network of 661 soil testing laboratories including 120 mobile vans operating in 608 districts that can carry out 7.2 million tests annually.

Using satellite data for water use; micro irrigation; sprinkler irrigation; neem-coated urea; nutrient based fertilizer subsidy are all aimed at precision agriculture.

A key component of precision farm management approach is the use of information technology and a wide array of items such as GPS guidance, control systems, sensors, robotics, drones, autonomous vehicles, GPS-based soil sampling and software.

ECONOMIC INEQUALITY

Economic inequality is the unequal distribution of income and opportunity among different groups in society. That is disparities in the distribution of economic assets among individuals and groups. It has many dimensions: income, wealth, consumption and opportunities.

Income inequality is the extent to which income is distributed in an uneven manner among a population, includes income from all streams: wages, salaries, interest financial savings, dividends, rent and profits.

Wealth inequality is uneven distribution of financial assets, physical property, gold etc. Wealth is stock while income is flow.

Consumption inequality is essentially a result of increases in income and wealth inequality. It practically means rich consume more in quality and quantity of food, water, shelter, electricity, transport and other material and invisible goods and services. It is because of another inequality called inequality of opportunity.

Inequality of opportunity means the well off have access to good health, education, entertainment, communications etc while the same is either completely or partly denied to others.

Inequality does not necessarily mean poverty. It is possible that rich are getting richer faster than the poor becoming less poor. In that case, the poor are also improving their economic status with higher incomes relatively. It is only when inequality exceeds a certain level that the riches of the affluent start to hurt others.

Economic inequality may result from the operation of the economic system, access to assets, nature of laws, education and skills, social factors like caste and gender etc.

Effects of economic inequality

If it is excessive with disproportionate assets and incomes going to the affluent, poverty results inevitably associated by illiteracy, malnutrition, lack of sanitation etc for majority of the population. Human development suffers.

Rich may become so influential that crony capitalism results. When wealthy individuals and corporations influence the government policy to their advantage: low minimum wage, no or limited national health insurance, inadequate spending on health, safety or pollution regulations, access etc. Thus, rising inequality has the danger of it aggravating even more.

On the social side, the fault lines in society become reinforced: gender, caste, ethnic and other divides become even more polarized.

Environmental danger deepen as there is no bottom up inputs in policy making and growth at any cost prevails.

Poverty-Inequality Link

Poverty is deprivation of basic human needs. It can be relative (depending on the national income/per capita of the country) or absolute which is deprivation of basic needs.

Poverty and inequality generally go together but it need not necessarily be the case. Inequality is inevitable and universal. But inequality at the expense of basic minimum services to all is objectionable and needs to be remedied as it has unconscionable consequences mentioned above.

Measures of Inequality

Gini Coefficient

The Gini coefficient is a number that varies between 0 and 1. It measures inequality across the whole of society. If all the income/wealth goes to a single person (maximum inequality) and all others receive nothing, the Gini coefficient is equal to 1. If income is shared equally with everyone receiving the same amount, the Gini is equal to 0- perfect equality. The lower the Gini value, the more equal a society, in other words. Most OECD countries have a coefficient lower than 0.32 with the lowest being 0.24.

India's Gini

The most credible measure of inequality in the country is based on the consumption surveys of the NSSO. Based on these, the Gini of consumption expenditure as measured by the National Sample Survey (NSS) consumption expenditures surveys report a rise in consumption inequality to 0.38 in 2011-12 for urban areas. Corresponding estimates of Gini of consumption expenditure in rural areas is 0.29 in 2011-12.

On income inequality, the latest data on income inequality is available from the India Human Development Survey (IHDS) reports which show income inequality in India in 2011-12 at 0.55 which puts India among the high inequality countries.

According to the Credit Suisse Global Wealth Report (2017), top 10% of the households held 62.1% by 2012. The corresponding share of wealth held by the top 1% was 25.7% in 2012. The share of wealth held by the top 1% in India is only second to the United States among the major countries for which the data is available. The Gini of wealth in India in 2017 is at 0.83, which puts India among the countries with highest inequality.

Ahluwalia-Chenery Welfare Index

GDP may grow but the distribution of economic resources may in fact worsen making the rich richer and the poor poorer. Thus, inclusive growth and not merely growth is required. An index that measures how all social groups are impacted by growth is necessary. This problem is dealt by Ahluwalia-Chenery Welfare Index which measures how each social group is impacted from the prosperity and adjusts growth numbers accordingly. It is an alternative measure of income growth, one that gives equal weight to growth of all sections of society.

Kuznets Curve

Economist Simon Kuznets had hypothesised that, as an economy develops, inequality increases but later reduces. In other words, the shape of the Kuznets curve is like an inverted U.

Kuznets Curve and Thomas Piketty

The recent work of Thomas Piketty, "Capital in the Twenty-First Century", questions the Kuznets Curve. Piketty shows that since 1980, there has been a sharp rise in inequality in the US, Japan and Europe. His data shows a U-curve in the trends of inequality in the advanced nations - US, Japan, Germany, France and Great Britain - the exact opposite of the Kuznets Curve. Inequality grows sharply after having fallen initially for a few years.

Piketty shows that there is nothing natural or automatic about declining inequality under market system. It is the policies of a Keynesian welfare state and a strong labour movement that led to a decline in inequality in the 60-year period (1914-1974). The trend shifted towards greater market forces and so inequality rose again since the 1980's and the result is the rise in inequality.

The most important engine that drives inequality up, according to Piketty, is the higher rate of return on capital compared to the low overall growth rate of the economy. In slowly growing economies, past wealth takes on a disproportionately higher importance. Inherited wealth grows faster than overall output and income.

Piketty says that there are powerful forces that can mitigate inequality. He specifically identifies diffusion of knowledge and skill as a key factor. But these too depend on state policies on education, access to training and skill development.

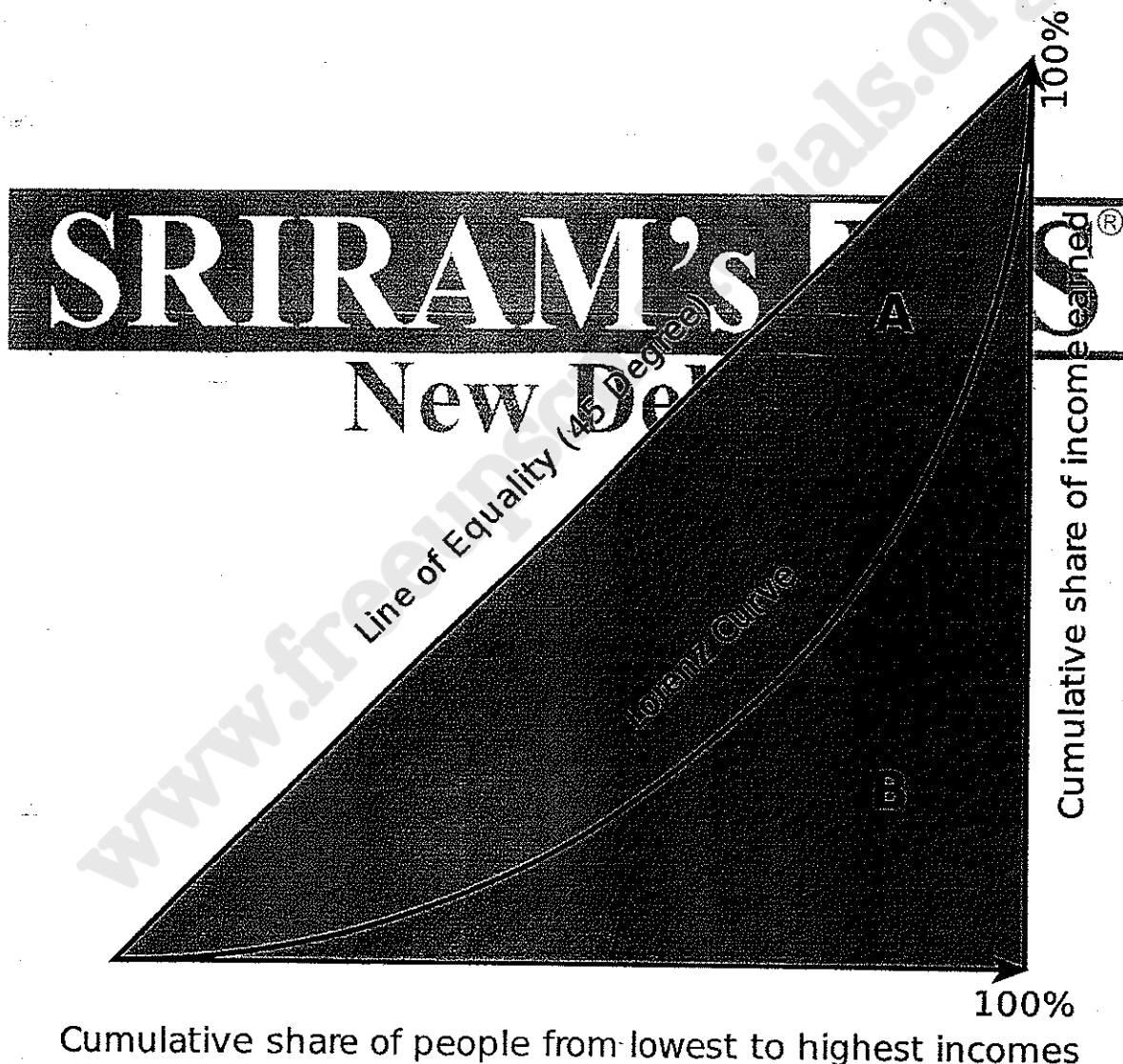
Palma Ratio

Unlike Gini index, Palma ratio used by Oxfam is the ratio of the income share of the top 10% to that of the bottom 40%.

Lorenz Curve

The Lorenz curve was developed by Max O. Lorenz as a graphical representation of income inequality measured by Gini data. It can be used to measure inequality of income or assets or any other facility. Gini coefficient is derived by taking the following two:

- area between the line of perfect equality and the Lorenz curve (a)
- area between the line of perfect equality and the line of perfect inequality (b)



Gini number is arrived when a is divided by b.

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Inter-Group Equality

There are deep disparities among groups based on a variety of identities: Scheduled Castes (SCs), Scheduled Tribes (STs), Other Backward Classes (OBCs), women, minorities, the differently abled and other marginalised groups. Inclusiveness from a group perspective goes beyond a poverty reduction perspective and includes consideration of the status of the group as a whole in relation to the general population. For example, narrowing the gap between the SCs or STs and the general population must be part of any reasonable definition of inclusiveness, and this is quite distinct from the concern with poverty, or inequality, though the two are related.

Balanced Regional Development (BRD) and Inclusive Growth

Another aspect of inclusiveness relates to whether all States, and indeed all regions, are seen to benefit from the growth process. The regional dimension has grown in importance in recent years. On the positive side, many of the erstwhile backward States have begun to show significant improvement in growth performance and the variation in growth rates across States has narrowed. However, both the better performing and other States are increasingly concerned about their backward regions, or districts, which may not share the general improvement in living standards experienced elsewhere. Many of these districts have unique characteristics including high concentration of tribal population in forested areas, or Minorities in urban areas. Some districts are also affected by left wing extremism, making the task of development much more difficult.

Government pays special attention to the scope for accelerating growth in the States that are lagging behind. This requires strengthening of States' own capacities to plan, to implement and to bring greater synergies within their own administration and with the Central Government. An important constraint on the growth of backward regions in the country is the poor state of infrastructure, especially road connectivity, schools and health facilities, and the availability of electricity, all of which combine to hold back development. Improvement in infrastructure must therefore be an important component of any regionally inclusive development strategy.

The efforts of the govt in this regard are

- special category states
- Green revolution in the eastern region
- North eastern region Vision 2020
- PMGSY
- Bharatmala
- Saubhagya
- DDY
- PMAY
- Aspirational districts

Economic growth and inequality

When economy grows, inequality is usually witnessed initially as the well off get most of the opportunities. It does not hurt growth also as there is an incentive for productivity, innovation and prosperity. Poor do not get poorer as they also benefit but very marginally. But the when inequality exceeds a certain threshold, it begins to harm growth. Empirical research shows that the effect of income inequality on economic growth can be either positive or negative, and that at a particular level of inequality—at a Gini of about .27—the direction of the relationship changes—that is, inequality begins to hurt economic development.

When income is concentrated in the hands of a narrow group of individuals, it can lead to reduced demand by the general population and lower investment in education and health, impairing long-term growth. When inequality is growing, economic growth does not lead to alleviation of poverty. Steep inequality damages the long-term prospects for economic growth by restricting the number of people who can participate in markets. Urban-dominated growth in India has caused social friction as a result of the high levels of migration to cities and a shortage of foreign investment in more isolated areas.

To examine why growth is not reducing inequality, we need to see the fact that income growth is concentrated in certain urban centers, and those whose incomes increase are usually already having high income and education, that is, those best positioned to gain from new economic opportunities are the educated urban-dwellers. On the other hand, the poor rely mainly on agriculture, and the agricultural sector has not been growing as fast as other sectors in most of Asia. They are not very high on human capital- education and skills and so can not enjoy the fruits of growth. Their education and health standards are low and thus can not be very productive and innovative which make the poverty cycle vicious for them.

Government should address inequalities by introducing policies that ensure education, health and skills; infrastructure, particularly rural; labour intensive growth; backward region development; social security; increased public investment in agriculture. Skills and training programs etc. For millions of children, inequality means not having access to adequate nutrition, health, and basic education. Therefore, public policy has huge challenges in providing these services.

Reasons for sharpening inequality

Main reasons for widening economic gaps in recent years are:
 • Cumulative inequality that was built over years
 • Globalization and greater opportunities for the corporates
 • Capital intensity of growth in a labour surplus country

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- Neglect of agriculture where 60% of people depend for their livelihood
- Financialization of economy where rich have far greater opportunities to generate even more
- Relatively low investment in education and health meant that the low income and poor remained so
- Skills received less attention
- Discrepancy in investment between urban and rural areas which favoured better- educated, better-off urban populations.
- Unevenness in growth in incomes across urban and rural areas, leading and lagging regions in the country, for example coastal and interior, and highly educated households and the less educated are important factors associated with increases in inequality.

Inclusive growth

There are many divides in the country that create and reinforce inequality- rural-urban; rich-poor; man-woman; social divisions based on caste and ethnicity; developed regions and underdeveloped regions; and digital divide. The efforts to alleviate these divides has been the crux of government's socio economic planning. Achieving inclusive growth has been one of the main priorities of the Government. For promoting inclusive growth, the Government is implementing various programmes/schemes for creating better employment opportunities, strengthening social infrastructure and providing basic amenities like water, electricity, roads, sanitation and housing for covering all sections of population. Various schemes such as Mahatma Gandhi National Rural Employment Guarantee Act Scheme (MGNREGA), Prime Minister's Employment Generation Programme (PMEGP), Pradhan Mantri Rojgar Protsahan Yojana, Pt. Deen Dayal Upadhyaya Grameen Kaushalya Yojana (DDU-GKY) and Deendayal

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Antyodaya Yojana- National Urban Livelihoods Mission (DAY- NULM) are being implemented by the Government in both rural and urban areas of the country which aim to create directly and indirectly additional employment opportunities to reap the benefits of the demographic dividend. The strategies include promoting labour-intensive sectors by encouraging agro-based industries, and Medium, Small and Micro Enterprises (MSMEs). Focus has also been given to growth of labour intensive textile sector. For social protection, under Ayushman Bharat, the National Health Protection Scheme, has been proposed in the Union budget 2018-19, which is expected to cover over 10 crore poor and vulnerable families (approximately 50 crore beneficiaries) providing coverage upto 5 lakh rupees per family per year for secondary and tertiary care hospitalization.

Inequality in India

The data on household consumption expenditure collected by National Sample Survey Office (NSSO) is among the prominent proxy measures used to capture economic inequality. As per the latest NSSO data available (2011-12) on Household Consumer Expenditure, the Gini coefficient (measuring the inequality between different expenditure classes of the population) in rural areas has remained almost the same in 2004-05 and 2011-12 at 0.27 and 0.28 respectively. In the urban areas, the Gini coefficient has increased marginally from 0.35 in 2004-05 to 0.37 in 2011-12.

Reducing inequalities is high on the agenda of the Government. Apart from economic growth which has a positive impact on incomes of the poor, several initiatives have been taken up by the Government of India to eliminate poverty, inequality and to empower the marginalized sections of the society by expanding the social security net through Pradhan Mantri Suraksha Bima Yojana (Accident Insurance), Atal Pension Yojana (Unorganized Sector) and Pradhan Mantri Jeevan Jyoti Yojana (Life Insurance) and institutional support to entrepreneurship with the help of MUDRA Bank to provide microfinance to entrepreneurs in rural hinterland of India and a National Hub for SC/ST entrepreneurs has been created to support the entrepreneurs belonging to the marginalized communities. Apart from providing the social security net and institutional credit support to the marginalized sections of the society, the Prime Mantri Jan Dhan Yojana is operational that strives to achieve financial inclusion by ensuring that the economically weaker sections have access to bank accounts. According to Economic Survey 2017-18, utmost priority to social infrastructure like education, health and social protection is being given by the Government to engineer an inclusive and sustainable growth in India.

Social Security

Certain social conditions need protection to prevent further distress - old age, poverty, unemployment, disability etc. Government provides social protection by way of wage employment, food grain either free or at affordable prices, old age pension etc. In some cases there is social insurance for disability etc. Public distribution system in India is a social security example. In social insurance, people receive benefits or services in return for contributions to an insurance scheme. These services include provision for retirement pensions, disability insurance, etc.

Social safety net is similar. It involves a collection of services provided by the state or other institutions including welfare, unemployment benefit, universal healthcare, homeless shelters etc to prevent individuals from falling into poverty beyond a certain level. For example, NREGA in India. Ayushman Bharat is another.

Recent examples:

- Maternity Benefit (Amendment) Act, 2017 that increased the duration of paid maternity leave available for women employees from the existing 12 weeks to 26 weeks.
- Pradhan Mantri Suraksha Bima Yojana (Accident Insurance), Atal Pension Yojana (Unorganized Sector) and Pradhan Mantri Jeevan Jyoti Yojana (Life Insurance).
- PM Jan Arogya Yojana (PMJAY) under Ayushman Bharat

Empowered Action Group (EAG)

The government had constituted an Empowered Action Group (EAG) under the Ministry of Health and Family Welfare following 2001 census to stabilise population in eight states (called EAG states) that were lagging in containing population. As per the latest census, EAG states Bihar, Jharkhand, Uttar Pradesh, Uttarakhand, Rajasthan, Madhya Pradesh, Chhattisgarh and Odisha have shown little improvement. They cover over 45 per cent of India's population.

Problems in the EAG States are less to do with the availability of funds than the issue of governance. Therefore, proposals for resolving the systemic issues relating to key areas such as human resource management, logistics management, integration of numerous health societies at State and district levels, regular release of funds to operational levels, joint planning/training for the field staff of the cognate departments, greater autonomy to the districts and within districts, to hospitals and PRIs, are integral parts of the plan. EAG needs to strengthen the systems of governance and monitoring. The need is to involve the community successfully through local empowerment and convergence. In a federal structure like India, there is need to strengthen the Centre-State coordination before direct interventions can be made at district levels.

Aspirational Districts initiative is remedying the problems and ensuring convergence of all schemes and rapid competitive development.

Globalisation And Inequality

The integration of the world economy through the progressive globalization of trade, investment and finance reached unprecedented levels and had dramatic impact on the economic well-being of citizens in all regions and among all income groups but different countries were impacted differently and within the countries, different groups had different levels of benefits. There are two schools of thought. One school of thought argues that globalization leads to a rising tide of income, which raises all boats. Hence, even low-income groups come out as winners from globalization in absolute terms. The opposing school argues that, although globalization may improve overall incomes, the benefits are not shared equally among the citizens of a country. The widening income disparities have not only raised welfare and social concerns, but also limited the drivers of growth because the opportunities created by the process of globalization may not be fully exploited. The sustainability of globalization also depends on maintaining broad support across the population, which could be adversely affected by rising inequality.

Different countries have felt different outcomes under globalization. China tapped its potential fully-even as inequality grew due to:

More talented sections having their pay gallop while others grew far less. There are disproportionate upper-income gains when compared with gains for middle- and lower-income groups.

There is a growing consensus that trade, driven in part by the integration of China into the world economy, has played a role in raising income. Rising import competition has adversely affected manufacturing employment, led firms to either shut down and become distribution agents for Chinese goods or upgrade their production and caused labor earnings to fall.

Also, the financial markets with speculative activity made rich richer with others having little or no scope for improving their lot.

Industrialists in some sectors saw their wealth grow as they found their market footprint expanded globally. That made little difference to poor and low income groups and much of it capital-intensive growth.

The blue collar and white collar grievances in USA led to populist isolationism and trade wars by Donald Trump.

Brexit and many nationalist movements in Europe also owe their origins to uneven globalisation and social unrest.

To bridge the inequality, there are redistributional interventions in India. There are: RTE, National Health Mission, PMGSY, Golden Quadrilateral; NHDP, Digital India, Skill Mission etc. But the progress is slow and the quality in some needs drastic improvement like in schools, hospitals, nutrition and skills. Till the interventions pay off, opportunities for the lower part of the pyramid are likely to stagnate and inequality will rise.

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Foreign Trade

No country is self-sufficient in all the goods and services that it requires. It has to depend on countries for what it lacks. For example, India depends on other countries for crude, edible oils, quality coal, electronic items, and so on. That is, we import them. Similarly, India has many surplus items- both goods and services that it can export to other countries. For example, agricultural goods, software services and so on. The exports and imports that a country makes together make foreign trade. If exports are more than imports, it is called trade surplus and if imports are more, is called trade deficit. India almost every year since Independence had a trade deficit.

Exports are foreign exchange earners. They stabilise and strengthen the exchange rate, if grow. They may be necessary for some imports- for example, gems and jewellery industry imports stones and carves them into jewelry in India. Exports make the domestic economy efficient international market requires high quality low price goods and services.

Imports are important for exports, domestic capital formation and consumption. They domestic producers competitive.

India's Exim policy: Its evolution and Content

India's external trade has evolved and witnessed many changes since Independence in 1947. Soon after Independence, the Government followed a policy of protectionism and so import substitution was the norm under the self-reliance model of planning.

The import substitution policy followed during the restrictive phase gave way to a new phase of reforms after mid 1980s aimed at easing trade restrictions to promote economic growth competitiveness. Till then India used to have an annual exim policy. For the first time, 13 year foreign trade policy was adopted to give it continuity for promotion of investment. The pace of change India's external trade policy and practices gathered real momentum in the 1990's. A slew of reforms were launched which included devaluation, convertibility of rupee, liberalization of imports etc. Today, except for a handful of goods disallowed on environmental, health and safety grounds and a few others that are canalized (bulk imports through designated agencies like STC) such fertiliser, cereals, edible oils and crude, all goods can be imported without a license or restrictions. Tariff reforms have also been addressed in a more systematic manner with across board reduction in peak rates rather than selective exemptions. The peak rate of customs duty been consistently brought down with the aim of converging it with the ASEAN levels. Today 10%. The reduction helps in making domestic economy competitive and helps imports for exports.

One of the instruments of shaping the country's trade dynamics is the Foreign Trade Policy. Foreign Trade Policies (FTP) of 2004-09, 2009-14 and 2015-20 recognised that trade is end in itself but its primary purpose is to stimulate greater economic activity and employment generation.

India's exports during 2017-18 were \$302.84 billion and imports were \$459.67 billion.

Initially, with restrictive trade policies India's share in world export declined continuously from in 1948 to 0.42% in 1980. After implementation of a series of trade reform measures India's in exports rose. **India's share in global merchandise exports has risen from 0.6 percent early 1990s to 1.7 percent in 2016**, and similarly the **share of imports has risen 0.6 percent to 2.4 percent** during the same period. In addition, diversification of exports high growth locations in Asia, CIS countries, Africa and Latin America through special trading arrangements has given an added fillip to export growth.

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Besides trade policy, another initiative of the government is to give a fillip to exports has been introduction of Special Economic Zones (SEZs) SEZ Act, 2005. The main objectives of the SEZ are

- generation of additional economic activity
- promotion of exports of goods and services
- promotion of investment from domestic and foreign sources
- creation of employment opportunities
- development of infrastructure facilities

India's trade reforms since 1991

One of the major dimensions of the economic reforms undertaken since 1991 was globalizing economy of which liberalization of foreign trade is a central aspect. The following reforms were made

- Devaluation of the currency in 1991 to boost exports
- Rupee convertibility on the trade account since 1992 to incentivize exporters
- Cutting down the peak customs duty that stood at above 300% in 1991 to 10% primarily facilitating exports
- Simplification of procedures
- SEZs
- FTAs/Cepa/Ceca
- WTO-led schedule for global trade integration
- Incentives for exporters like interest rate subsidy (subvention) etc
- Sector specific packages
- diversification

The effect is that exports have registered remarkable growth; created employment; given the country adequate forex; made the economy competitive; brought in FDI etc.

Foreign Trade Policy 2015-20

In order to boost India's exports, the Government has taken several measures through new Foreign Trade Policy 2015-20, its mid-term review released in 2017 and other policy measures taken time to time. The key measures include:

- FTP 2015-20 provides a framework for increasing exports of goods and services as well generation of employment and increasing value addition in the country, in line with the in India, Digital India, Skill India, Start-up India and Ease of doing business initiatives.
- The main policy objective is to enable India to respond to the challenges of the external environment keeping in view the rapidly evolving international trading architecture and trade a major contributor to the country's economic growth and development.
- The policy provides the framework for promotion of exports through schemes of incentives on exports and duty remission/exemption on inputs for export production. The policy introduces two new schemes, namely 'Merchandise Exports from India Scheme (MEIS)' for improving export of specified goods by merging five earlier schemes for better coherence and 'Services Exports from India Scheme (SEIS)' for increasing exports of notified services. Duty credit

scrips issued under MEIS and SEIS and the goods imported against these scrips are fully transferable. The MEIS scheme now covers 8057 tariff lines at 8-digit level to countries. (Exim/Duty Credit scrips are scrips given to exporters as "incentives" by the Government of India. While Merchandise Exports from India Scheme (MEIS) scrips are given for goods exports, Service Exports from India Scheme (SEIS) scrips are given services exports. The value of the scrips are a percentage of the FOB value of goods/services exported and are freely transferable. The scrips can be used to offset customs duty while importing.)

- The policy includes measures to nudge procurement of capital goods from indigenous manufacturers under the EPCG scheme by reducing specific export obligation from 90 percent to 75 percent of the normal export obligation.
- The policy provides issue of Advance Authorisation to allow duty free import of inputs, is physically incorporated in export product within a specified timeline.
- Interest Equalization Scheme on pre and post shipment rupee export credit has been introduced from 1.4.2015 to help exporters in accessing credit at reduced rates.
- Niryat Bandhu Scheme has been galvanised and repositioned to achieve the objectives of 'Skill India' and trade promotion and awareness. 'Niryat Bandhu' scheme was first introduced in 2011, by the Director General of Foreign Trade (DGFT), for first generation entrepreneurs in international business enterprises. Under this novel scheme the officer (Niryat Bandhu) would mentor those individuals who want to engage in foreign trade.
- Trade facilitation and enhancing the ease of doing business measures have been taken special focus on moving towards paperless working. India also ratified the WTO Agreement on Trade Facilitation (TFA) in April 2016 for enhancing trade facilitation.
- A new scheme called Trade Infrastructure for Export Scheme (TIES) has been launched 1st April 2017 to address the export infrastructure gaps in the country.
- The Mid-term Review of Foreign Trade Policy 2015-20 launched on 5th December provides more incentives for export promotion.

Agriexport Policy 2018

The Government has formulated a comprehensive Agriculture Export Policy to consolidate efforts for export of agricultural products.

The objectives of the Agriculture Export policy are:

- To diversify the export basket, destinations and boost high value and value added agricultural exports including focus on perishables.
- To promote novel, indigenous, organic, ethnic, traditional and non-traditional Agri products exports.
- To provide an institutional mechanism for pursuing market access, tackling barriers and with sanitary and phytosanitary issues.
- To strive to double India's share in world agri exports by integrating with global value • Enable farmers to get benefit of export opportunities in overseas market.

The Department of Commerce also has several schemes to promote exports, including exports agricultural products: Trade Infrastructure for Export Scheme (TIES), Market Access Initiatives (MAI) Scheme and Merchandise Exports from India Scheme (MEIS). In addition, assistance exporters of agricultural products is also available under the Export Promotion Schemes Agricultural & Processed Food Products Export Development Authority (APEDA), Marine Products Export Development Authority (MPEDA), Tobacco Board, Tea Board, Coffee Board,

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Rubber and Spices Board. These organisations also seek to promote exports through participation international fairs & exhibitions, taking initiatives to gain market access for different products different markets, dissemination of market intelligence and taking steps to ensure quality of exported products.

The exports of agricultural products depend on several factors such as international and domestic demand and supply situation, international and domestic prices, concerns of food security, diplomatic and humanitarian considerations. Agriculture imports are constantly monitored and appropriate decisions are taken as per the prevailing situation.

The year-wise details of export of agricultural products during the last three years are:

Year	2014-15	2015-16	2016-17	2017-18
Agricultural Exports (USD Billion)	38.71	32.43	33.28	38.43
Increase in Agricultural Exports (%)		-	2.64	15.45
		16.22		

India's exports and imports

Merchandise exports

Strategically located near highly populated trading partners including China, Pakistan and Bangladesh, India exported US\$323.1 billion worth of goods 2018. That dollar amount reflects a 1.7% improvement since 2014 and a 9.2% gain from 2017 to 2018.

India's exported goods plus services represent 19.1% of total Indian economic output or Gross Domestic Product.

From a continental perspective, almost half (49.3%) of Indian exports by value were delivered to fellow Asian countries. Another 19.3% was sold to European importers while 18% went to North America. Smaller percentages went to Africa (8.3%), Latin America (2.9%) excluding Mexico but including the Caribbean, then Oceania (1.3%) led by Australia.

Given India's population of 1.297 billion people, its total \$323.1 billion in 2018 exports translates to roughly \$250 for every resident in the vast South Asian country.

The following export product groups represent the highest dollar value in Indian global shipments during 2018. Also shown is the percentage share export category represents in terms of overall exports from India.

1. Mineral fuels including oil: US\$48.3 billion (14.9% of total exports)
2. Gems, precious metals: \$40.1 billion (12.4%)
3. Machinery including computers: \$20.4 billion (6.3%)
4. Vehicles: \$18.2 billion (5.6%)
5. Organic chemicals: \$17.7 billion (5.5%)
6. Pharmaceuticals: \$14.3 billion (4.4%)
7. Electrical machinery, equipment: \$11.8 billion (3.6%)
8. Iron, steel: \$10 billion (3.1%)
9. Cotton: \$8.1 billion (2.5%)
10. Clothing, accessories (not knit or crochet): \$8.1 billion (2.5%)

India's top 10 exports accounted for over three-fifths (61%) of the overall value of its global shipments.

Mineral fuels including oil was the fastest growing among the top 10 export categories. Close behind in second place for improving Indian export sales electrical machinery and equipment which gained 33.9%. India's shipments organic chemicals recorded the third-fastest gain in value up 30.7% year over year, ahead of the 22.5% sales expansion for the machinery.

There were three declining top categories for Indian exports: iron and steel its -14.7% drop, clothing and accessories (down -9.6%) and gems and precious metals (down -5.8%).

Merchandise imports

India imported US\$507.6 billion worth of goods from around the globe in 2018, up 14.3% from 2017 to 2018.

From a continental perspective, 60.3% of India's total imports by value in 2018 were purchased from fellow Asian countries. European trade partners supplied 15.8% of import purchased by India while 8.2% worth originated from Africa with another 8.1% coming from exporters in North America.

Smaller percentages arrived in India from Latin America (4.2%) excluding Mexico but including the Caribbean, and Oceania (2.9%) led by Australia.

Given India's population of 1.297 billion people, its total \$507.6 billion spent on 2018 imports translates to roughly \$400 in yearly product demand from every person living in the vast South Asian country.

The following product groups represent the highest dollar value in India's import purchases during 2018. Also shown is the percentage share each product category represents in terms of overall imports into India.

1. Mineral fuels including oil: US\$168.6 billion (33.2% of total imports)
2. Gems, precious metals: \$65 billion (12.8%)
3. Electrical machinery, equipment: \$52.4 billion (10.3%)
4. Machinery including computers: \$43.2 billion (8.5%)
5. Organic chemicals: \$22.6 billion (4.4%)
6. Plastics, plastic articles: \$15.2 billion (3%)
7. Iron, steel: \$12 billion (2.4%)
8. Animal/vegetable fats, oils, waxes: \$10.2 billion (2%)
9. Optical, technical, medical apparatus: \$9.5 billion (1.9%)
10. Inorganic chemicals: \$7.3 billion (1.4%)

India's top 10 imports accounted for four-fifths (80%) of the overall value its product purchases from other countries.

Imported mineral fuels including oil had the fastest-growing increase in value among India's top 10 import categories, up 37% year over year.

In second place for expanding import purchases was the inorganic chemicals category via a 29.8% improvement, trailed by the 25.6% increase for organic chemicals and the 20.1% gain for machinery including computers.

The two declining categories for India's imports were animal and vegetable fats, oils and waxes (down -14.4%) and gems and precious metals (down 12.6%).

Trading partners

Below is a list highlighting 15 of India's top trading partners in terms of countries that imported the most Indian shipments by dollar value during 2018. Also shown is each import country's percentage of total Indian exports.

1. United States: US\$51.6 billion (16% of total Indian exports)
2. United Arab Emirates: \$29 billion (9%)
3. China: \$16.4 billion (5.1%)
4. Hong Kong: \$13.2 billion (4.1%)
5. Singapore: \$10.4 billion (3.2%)
6. United Kingdom: \$9.8 billion (3%)
7. Germany: \$9 billion (2.8%)
8. Bangladesh: \$8.8 billion (2.7%)
9. Netherlands: \$8.7 billion (2.7%)
10. Nepal: \$7.3 billion (2.3%)
11. Belgium: \$6.8 billion (2.1%)
12. Vietnam: \$6.7 billion (2.1%)
13. Malaysia: \$6.5 billion (2%)
14. Italy: \$5.5 billion (1.7%)
15. Saudi Arabia: \$5.5 billion (1.7%)

About three-fifths (60.4%) of Indian exports in 2018 were delivered to the above 15 trade partners.

Merchandise Trade surpluses

India incurred the highest trade surpluses with the following countries:

1. United States: US\$19 billion (country-specific trade surplus in 2018)
2. Bangladesh: \$7.9 billion
3. Nepal: \$6.9 billion
4. Netherlands: \$5 billion
5. Sri Lanka: \$3.3 billion
6. Turkey: \$3.3 billion
7. United Kingdom: \$2.7 billion
8. Spain: \$2.4 billion
9. United Arab Emirates: \$2.2 billion
10. Kenya: \$2 billion

Among India's trading partners that generate the greatest positive trade balances, Indian surpluses with the Netherlands (up 60.5%), Nepal (up 35.1%) and Spain (up 26.6%) grew at the fastest pace from 2017 to 2018.

Merchandise Trade deficits

India incurred the highest trade deficits with the following countries:

1. China: -US\$57.3 billion (country-specific trade deficit in 2018)
2. Saudi Arabia: -\$22.9 billion
3. Iraq: -\$21.2 billion
4. Switzerland: -\$16.8 billion
5. Iran: -\$11.9 billion
6. South Korea: -\$11.6 billion
7. Indonesia: -\$11.2 billion
8. Australia: -\$10.4 billion
9. Qatar: -\$8.9 billion
10. Nigeria: -\$8.4 billion

Among India's trading partners that cause the greatest negative trade balances, Indian deficits with Iraq (up 50.9%), Saudi Arabia (up 44.3%) and Iran (up 40.9%) grew at the fastest pace from 2017 to 2018.

Services sector exports

India's services sector's contribution of 3.35% to the world services export is valued \$160 billion plus in 2016-17. It is twice that of its merchandise exports, which is 1.65% of the world's merchandise exports. India's services exports are dominated by the software sector followed by business, travel, transportation, and other services such financial, insurance and communication services.

More than 45% of India's services exports are on account of software services, followed by business (20%), travel (14%), transportation (10%).

With increasing demand for Indian services worldwide and sustained support from government, services exports have the potential to reach \$300 billion by 2022. For India should focus on services in global trade talks. The services sector was for long considered as non-tradable, non-transportable, and non-scalable and, therefore, has been ignored in trade negotiations worldwide. However, with the advent of various forms of connectivity, this is no longer true as services are digitised and much more should lay stress on establishing mutual recognition of services(MRA) regulations its trading partners.

Steps to boost services exports

Provide assistance in identifying export destinations: The government should assist services exporters in selecting export destination carefully. For this, government should ensure the dissemination of information about foreign markets and their technical standards, especially to small and medium entrepreneurs.

Assistance on creating brand India image: Emphasis should be on creating brand India image through participation in trade fairs abroad, marketing of projects, and information provision. The Centre provides limited financial assistance to display Indian products in foreign exhibitions under its Market Development Assistance Scheme. However, the lack of information on such exhibitions, especially by the MSME (Ministry of Micro, Small and Medium Enterprises) is also a concern.

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Resolve visa related issues: Indian services industry is facing several long-standing related-issues such as the H-1B visa issue in the United States. For long, we have argued that the labour mobility requires trade visas and not immigration visas. The govt. should pursue this line more vigorously and get a deal even if it requires some trade offs.

Ensuring timely delivery of quality services: Timely delivery of quality services should be a priority for exporters. Government of India and Services Export Promotion Council should ensure that detailed and accurate information related to various regulations standards of importing countries is provided to services exporters in reader friendly terms.

Indian embassies should take up commercial diplomacy. Our embassy staff needs be trained to identify and pursue potential for Indian business sectors in association with the export promotion councils.

Following WTO-based opportunities need to be explored:

WTO, GATS and India

We need measures to promote exports of Mode 2 service. The General Agreement Trade in Services (GATS) defines Mode 2 service as 'consumption abroad':

- **Formulating a long-term plan to attract more number of foreign tourists:** In 2016, India secured 1.18% and 1.88% of world's foreign tourists market in terms of foreign tourists' arrival and international tourism receipts respectively. This is very dismal considering India's potential. A total of 8.80 million foreign tourists visited India in 2016 and brought foreign exchange worth \$22.90 billion. Though the number of foreign tourists' arrival has increased, it is well below the tourism potential of the country. The ministry of tourism should formulate a long-term plan for attracting more foreign tourists. Some steps can be implemented such as extension in the list of countries eligible for visa on arrival, liberalising business immigration regulations etc.

- **Expansion of healthcare services to emerge as global health hub:** It is true India has emerged as a centre for low cost quality health care and Indian hospitals are serving a number of foreign patients. However, this healthcare network is limited to metro cities. There is huge scope for getting more number foreign patients if such hospitals are established in border areas such as in the Northeast, where the level of education attained is high.

- **Raise standards of Indian academic institutions:** Education has emerged as one of the largest services export sector in the world. There are many higher educational institutions in India but they are unable to attract a good number foreign students. This is mainly due to their low ranking in the world. With the FDI policies, we can attract larger number of foreign students and ensure that students are retained in the country.

WTO, GATS and Mode 3 service

GATS defines Mode 3 service as 'commercial presence'. It is true that many Indian companies are having global presence but it is mainly limited to few sectors such as (information and communication technology) and business services. There is a huge scope for Indian companies to expand their global operations in sectors such as finance, banking, insurance, legal, accounting, and education.

Considering the availability of skilled persons in the fields of tourism and health care; initiatives of the government such as Smart Cities, Digital India, Skill India; a robust health sector providing world class health treatment at an affordable price to many patients from abroad; vibrant tourism opportunities; global presence of Indian companies in areas of IT, telecom, oil & gas etc. – the target of \$300 billion services exports by 2022 is achievable. Meeting this target will establish India as a centre of services exports and also create millions of jobs.

Trading Across Borders of World bank

Trading Across Borders constitutes one of three most important components of the ten parameters which the World Bank measures. This parameter assesses the efficiency of time taken in clearing imported and export goods and the cost involved in these processes.

The rank in Trading Across Borders is a part of Doing Business report released by World Bank. Among the 11 parameters based on which the rankings are determined and which include indices like Starting a Business, Getting Electricity and Resolving Insolvency, the improvement in India's overall ranking can be mainly attributed to an exceptional performance in Trading across Borders. This positive jump is due to a series of reforms undertaken by Customs in conjunction with Ministry of Shipping and all stakeholders such as importers, exporters, Customs Brokers, CFS operators, Shipping lines and Terminal Operators.

Customs has undertaken several initiatives which included enhanced coordination with ministries and stakeholders, extensive use of digitization and new technologies and business process re-engineering to facilitate trade. Customs has come out with a National Trade Facilitation Action Plan which provides a road map for fulfilment of India's commitments under the Trade Facilitation Agreement. These initiatives by the government have also earned praise by the World Customs Organization (WCO). By introducing SWIFT, a Customs Single Window, Customs has unified entire clearance process on a single digital platform.

Challenges to boosting India's exports

There are both global as well as domestic issues.

Globally:

- Global trade is slowing down
- There are tariff wars that are threatening stability
- Multilateralism is in retreat
- Regional trading arrangements may not benefit India so much as is being debated with regard to the RCEP.

Domestically:

- Infrastructure like ports, roads, power etc.
- Transaction costs are still high due to procedural cumbersomeness
- Skill deficit
- Labour laws are rigid
- Tax stability after the introduction of GST

GST and exports

There is no GST charged for exports. The GST paid for any of goods or services for the purpose of exports is reimbursed. IGST will be levied on the import of goods and services into the country. Basic Customs Duty (BCD) will be levied on the import of goods in addition to IGST. Both are used for claiming credit.

The subsuming of major Central and State taxes in GST, complete and comprehensive setoff of input goods and services and replacement of Central Sales Tax (CST) is expected to reduce the cost of locally manufactured goods and services. This will increase the competitiveness of Indian goods and services in the international market and give boost to Indian exports. The uniformity in tax rates and procedures across the country will also go a long way in reducing the compliance cost.

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Important Schemes

Market Access Initiative (MAI)

MAI scheme is intended to provide financial assistance for medium term export promotion efforts with sharp focus on a country / product.

Financial assistance is available for Export Promotion Councils (EPCs), Industry and Trade Associations (ITAs), Agencies of State Governments, Indian Commercial Missions (ICMs) abroad and other eligible entities as may be notified.

A whole range of activities can be funded under MAI scheme. These include, amongst others,

- Market studies,
- Setting up of showroom / warehouse,
- Sales promotion campaigns,
- International departmental stores,
- Publicity campaigns,
- Participation in international trade fairs,
- Brand promotion,
- Registration charges for pharmaceuticals, and term export promotion efforts with sharp focus on a country / product,
- Testing charges for engineering products.

Marketing Development Assistance (MDA)

MDA Scheme is intended to provide financial assistance for a range of export promotion activities implemented by EPCs, ITAs on a regular basis every year.

Assistance includes participation in

- Trade Fairs and Buyer Seller meets abroad or in India, and
- Export promotion seminars.

Export and Trading Houses

Exporters are categorized depending on total FOB export performance during current plus previous three years (taken together) upon exceeding limit given below.

Status Category	Export Performance FOB (Rupees in Crores)
Export House (EH)	20
Star Export House (SEH)	100
Trading House (TH)	500
Star Trading House (STH)	2500
Premier Trading House (PTH)	7500

A Status Holder shall be eligible for facilities like authorisation and Customs clearances for both imports and exports on self-declaration basis; 100% retention of foreign exchange in EEFC account (Exchange Earners' Foreign Currency) etc. FOB - "free on board" value is value of goods excluding carriage, insurance and freight, i.e. approximately, the domestic price in the country of origin.

Served from India

Its objective is to accelerate growth in export of services so as to create a powerful and unique 'Served From India' brand, instantly recognized and respected world over. Eligibility is based on certain minimum forex earnings. They qualify for Duty Credit scrip it means that what they pay as duty on certain amount of their imports is credited to them for set off later when they import.

Focus market scheme (FMS)

Objective is to offset high freight cost and other externalities to select international markets with a view to enhance our export competitiveness in these countries. Duty Credit scrip benefits are one available. FOCUS (LAC), Focus (Africa), Focus (CIS) and Focus (ASEAN + 2) programmes are operating.

Helps the country diversify the geographical base and withstand any economic crisis.

Focus product scheme (FPS)

Objective is to incentivise export of such products, which have high employment intensity in rural and semi urban areas, so as to offset infrastructure inefficiencies and other associated costs involved in marketing of these products. Some Special Focus Initiatives are for Agriculture, Handicrafts, Handlooms, Gems & Jewellery and Leather & Footwear sectors.

Exports of notified products to all countries (including SEZ units) shall be entitled for Duty Credit scrip.

Hitech products export promotion scheme (HPEPS)

Objective is to incentivise export of High Technology products. Exports of High Technology products to all countries shall be entitled for Duty Credit Scrip.

100% Export oriented units

Introduced in the year 1981, the EOU Scheme's main thrust is to boost and attract sector specific exports from all parts of India having huge potential near to raw material source. The Scheme covers manufacturing/processing and services. The main objectives of the scheme is to increase exports, earn foreign exchange to the country, transfer of latest technologies stimulate direct foreign investment and to generate additional employment. 50% of physical exports can be sold in domestic market on payment of concessional duty.

GS1-India

GS1 (Global Standards) India is a not-for-profit standards body promoted by the Ministry of Commerce (GOI) and Indian Industry to spread awareness and provide guidance on adoption of global standards in Supply Chain Management by Indian Industry for the benefit of consumers, Industry, Govt. etc.

GS1 India is the only organisation in India authorised to issue company prefix numbers for use in barcodes, RFID tags etc. for unique, unambiguous and universal identification of products, cartons, containers etc. GS1 standards find wide application in Supply Chains across sectors. GS1 standards are the de-facto global standards in identification of consumer products in Retail. GS1 India is an affiliate of GS1 Global Office twin offices headquartered at Brussels (Belgium) and New Jersey (U.S.A.).

Institutional infrastructure

Board of Trade (BOT)

The Board of Trade was set up in 1989 with a view to providing an effective mechanism to maintain continuous dialogue with trade and industry in respect of major developments in the field of International Trade. The Board is chaired by the Union Commerce Minister. Its role is to, advise the Government on measures connected with the Foreign Trade Policy and how to achieve the desired objective of boosting India's exports. The Board is required to meet at least once every quarter and make recommendations to Government on issues pertaining to its terms of reference. It met in 2019 February. The representatives of industry expressed concerns about decreasing flow of credit to export sector, delays in refund of Input Tax Credit, withdrawal of GSP benefits by US, exports to Iran, availability of incentives for exports to neighbouring countries, etc.

Inter State Trade Council

The Inter State Trade Council was set up in 2005 with a view to ensure a continuous dialogue with State Governments and Union Territories. It advises the Government on measures for providing a healthy environment for international trade in the States with a view to boost India's exports. The

Council is represented by Chief Ministers of the States or State Cabinet Ministers nominated by Chief Ministers, Lt. Governors or Administrators of the Union Territories or their nominees etc.

Export Promotion Councils

Export Promotion Councils generally under the administrative control of the Department of Commerce and export promotion councils related to textile sector under the administrative control of Ministry of Textiles are set up.

These Councils are registered as non-profit organisations under the Companies Act/Societies Registration Act. The Export Promotion Councils perform both advisory and executive functions. These Councils are also the registering authorities.

Their relevance is greater to the national export effort in the context of globalisation and economic liberalization. Some Export Promotion Councils are Apparel Export Promotion Council, Chemicals Pharmaceuticals & Cosmetics Export Promotion Council, (CHEMEXCIL), Carpet Export Promotion Council, Cashew Export Promotion Council of India, Cotton Textile Export Promotion Council, Electronic & Computer Software Export Promotion Council, Engineering Export Promotion Council etc.

Commodity Boards

There are statutory Commodity Boards under the Department of Commerce. These Boards are responsible for production, development and export of tea, coffee, rubber, spices and tobacco.

Agricultural and processed Food Products Export Development Authority (APEDA)

The APEDA was set up by an Act of Parliament in 1986. The APEDA is a statutory body which is entrusted with the tasks of agricultural exports, including the export of processed foods in value added form.

Marine Products Export Development Authority

The MPEDA was set up under Section (4) of MPEDA Act, 1972. It is a statutory body functioning under the Department of Commerce. The MPEDA is responsible for development of the marine products industry with special reference to exports. It has its headquarters at Kochi.

Export-Import Bank

The Export-Import Bank of India (Exim Bank) is a public sector financial institution created by an Act of Parliament, the Export-import Bank of India Act, 1981. The business of Exim Bank is to finance Indian exports. Bank's primary objective is to help export-related companies by offering them a comprehensive range of products and services.

Export Credit Guarantee Corporation of India Ltd. (ECGC)

In order to promote the country's exports by covering the risk of export on credit, the ECGC provides a range of insurance covers to Indian exporters against the risk of non-realisation of export proceeds due to commercial or political causes.

Regional Free Trade Arrangements and India

Free Trade Agreements (FTAs) are arrangements between two or more countries or trading blocs that primarily agree to reduce or eliminate customs tariff and non tariff barriers on substantial trade between them. FTAs, normally cover trade in goods (such as agricultural or industrial products) or trade in services (such as banking, construction, trading etc.). However each maintains individual tariff structure for nonmembers.

FTAs can also cover other areas such as intellectual property rights (IPRs), investment, government procurement and competition policy, etc. The latter are generally referred to as CEPA or CECA.

Preferential Trade Agreement (PTA) is one in which two or more partners agree to reduce tariffs on agreed number of tariff lines. The list of products on which the partners agree to reduce duty is called positive list. India MERCOSUR PTA is such an example. Mercosur, officially Southern Common Market is a South American trade bloc. Its members are Argentina, Brazil, Paraguay and Uruguay. Venezuela was a member but was suspended in 2016.

The difference between an FTA and a PTA is that while in a PTA there is a positive list of products on which duty is to be reduced; in an FTA there is a negative list on which duty is not reduced or eliminated. Thus, compared to a PTA, FTAs are generally more ambitious.

India views Regional Trading Arrangements (RTAs) as 'building blocks' of trade liberalisation and as complementary to the multilateral trading system. About 50% of world trade is now conducted within

FTAs. Recognising the importance of RTAs, India has engaged with its trading partners/blocs to begin concluding, in-principle agreements to move towards Comprehensive Economic Cooperation Agreements (CECA) which cover FTA in goods, services, investment and identified areas of economic cooperation.

The India-Sri Lanka FTA, Agreement on SAFTA, India-Singapore CECA, CECA with Malaysia and CEPA with South Korea and Japan are important to note. India is negotiating Broad-based Trade & Investment Agreement (BTIA) with EU. India has an FTA in goods and services with ASEAN.

Comprehensive Economic Cooperation Agreement (CECA) and Comprehensive Economic Partnership Agreement (CEPA) describe agreements which consist of an integrated package on goods, services and investment along with other areas including IPR, competition etc. They cover a broad range of other areas like trade facilitation and customs cooperation, investment, competition, IPR etc.

CECA/CEPA are more comprehensive and ambitious than an FTA in terms of coverage of areas and the type of commitments. While a traditional FTA focuses mainly on goods; a CECA/CEPA is more ambitious in terms of a holistic coverage of many areas like services, investment, competition, government procurement, disputes etc.

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Secondly, CECA/CEPA looks deeper at the regulatory aspects of trade than an FTA. It is on account of this that it encompasses mutual recognition agreements (MRAs) that covers the regulatory regimes of the partners. An MRA recognises different regulatory regimes of partners on the presumption that they achieve the same end objectives.

Few terms need to be explained:

Custom Union: In a Customs union, partner countries may decide to trade at zero duty among themselves but have a common (unified) external tariff (CET) against non-members.

A common market is a Customs Union with provisions to facilitate free movements of labour and capital, harmonize technical standards across members etc. European Common Market is an example.

Economic Union: Economic Union is a Common Market extended through further harmonization of fiscal/monetary policies and shared executive, judicial & legislative institutions. European Union (EU) is an example.

Early harvest scheme is a precursor to a free trade-agreement (FTA) between two trading partners. This is to help the two trading countries to identify certain products for tariff liberalisation pending the conclusion of FTA negotiation. It is primarily a confidence building measure. A good example of an EHS is between India and Thailand signed in 2003, wherein 83 products were identified to be reduced to zero in a phased manner. The EHS has been used as a mechanism to build greater confidence amongst trading partners to prepare them for even bigger economic engagement.

Preference for FTAs: Countries negotiate Free trade Agreements for a number of reasons:
• By eliminating tariffs and some non-tariff barriers FTA partners get easier market access into one another's markets.

- Exporters prefer FTAs to multilateral trade liberalization because they get preferential treatment over non-FTA member country competitors. For example in the case of ASEAN, ASEAN has an FTA with India but not with Canada. ASEAN's custom duty on leather shoes is 20% but under the FTA with India it reduced duties to zero. Now assuming other costs being equal, an Indian exporter, because of this duty preference, will be more competitive than a Canadian exporter of shoes.
- Possibility of increased foreign investment from outside the FTA as it gets the MNC advantages as an exporter.
- Such occurrences are not limited to tariffs alone but it is also true in the case of non-tariff measures. Especially when a Mutual Recognition Agreement (MRA) is reached between countries.

(A mutual recognition agreement (MRA) is an international agreement by which two or more countries agree to recognize one another's conformity assessments. MRAs have become increasingly common since the formation of the World Trade Organization in 1995. MRAs are most commonly applied to goods, such as various quality control MRAs. However, the term is sometimes applied to agreements on the recognition of professional qualifications as well. India and France signed an MRA on educational standards in 2018)

Some experts are of the view that slow progress in multilateral negotiations(Doha Round) due to complexities arising from large number of countries to reach a consensus on polarising issues, may have provided the impetus for FTAs.

RCEP

Regional Comprehensive Economic Partnership (RCEP) is a proposed free trade agreement (FTA) between the ten member states of the Association of Southeast Asian Nations (ASEAN) (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam) and the six Asia-Pacific states with which ASEAN has existing free trade agreements (Australia, China, India, Japan, South Korea and New Zealand).

RCEP negotiations were formally launched in 2012.

In 2017, prospective RCEP member states accounted for a population of 3.4 billion people with a total Gross Domestic Product (GDP, PPP) of \$49.5 trillion, approximately 40 percent of the world's GDP.

India is negotiating for better terms for services trade and also multispeed RCEP where reduction of tariffs can be phased over a long period for countries like India while those economies that can withstand competition readily can have greater integration at the outset.

Exports and employment

One of the important objectives of trade policy has been to integrate it with the process of economic development and creation of more employment opportunities.

Government identified 12 export sectors as employment-intensive: textiles and garments, leather goods, gems and jewellery, cereals, horticulture, flowers, fruits and vegetables, dairy products, processed foods, toys and sports goods, pharmaceuticals, automobiles and auto-components, consumer electronics and electronic hardware. Special efforts are needed to promote exports from these labour-intensive sectors.

According to experts, if the cumbersome labour laws are made flexible, it should be possible to provide the much-needed boost to labour-intensive exports.

Also the small and medium enterprises (SMEs), which account for over 50 per cent of our total exports and which are also relatively more labour-intensive, deserve much greater financial and marketing support, testing facilities and better infrastructure, to enable them to increase their exports.

GST also made a erosive impact as there was a problem with registration and also refund which impacted working capital availability.

States and Export Efforts

To involve States and UTs in export efforts, the following initiatives are taken.

- ASIDE- assistance to states for the development of infrastructure for exports- for which Rs.330 crores are allocated
- SEZs can be set up by the States
- AEZs are set up in States for agroexports
- states are encouraged to set up export promotion councils and draw up export plans

Trade finance

Trade finance is related to international trade. Trade finance refers to financing international trading transactions. In this financing arrangement, the bank or other institution of the importer provides for paying for goods imported on behalf of the importer. Similarly exporter can take credit to make his exports. Collection of receivables for an exporter for a commission is forfaiting. Trade Finance is necessary to reduce the risks and uncertainties associated with commercial transactions, thus, facilitating trade.

While a seller (the exporter) can require the purchaser (an importer) to prepay for goods shipped, the purchaser (importer) may wish to reduce risk by approaching a bank. Banks may assist by providing various forms of support like LoU, LoC, LoC which are the following

Letter of Undertaking (LoU) is a bank guarantee under which a bank allows its customer to raise money from another, generally the foreign branch of another bank for which the LoU is a credible bankable instrument. It is a short-term credit used to make payment to the customer's offshore suppliers in foreign currency.

LoC is Letter of Credit which says that the person is creditworthy/bankable.

Letter of Comfort is a letter issued to a lending institution by a stakeholder of the company acknowledging support of the attempt for financing asked by that company. A letter of comfort does not imply that the parent company guarantees repayment of the loan being sought by the subsidiary company. It merely gives reassurance to the lending institution that the parent company is aware of the credit facility being sought by the subsidiary company, and supports its decision.

Bank guarantee is an undertaking by the Bank on behalf of its client to pay a certain sum of money to a beneficiary.

Other forms of trade finance can include trade credit insurance, export factoring (forfaiting). In many countries as in India, trade finance is often supported by quasi-government entities known as export credit agencies that work with commercial banks and other financial institutions.

In India, following are the few agencies who support for promotion of exports.

EXIM-Banks through its LoC provides a safe mode of non-recourse financing option to Indian exporters especially to SME sectors.

Reserve Bank of India monitors the flow of credits to exporters and extends interest subvention benefits as an incentive for promotion of exports.

Export Credit Guarantee Corporation of India Limited (ECGC) provides cost effective credit insurance to Indian Exporters to protect them against commercial and political risks. It also provides Insurance cover for Banks and financial institutions to facilitate adequate finance to the Indian Exporters. ECGC also assists exporters in recovering bad debts.

South-South Trade

When developing countries trade with one another, it is called south trade. The rising prominence of South-South trade and economic integration is borne out in the figures since the 1980s – these show that until the current decade the volume of exports from the developing world has risen nearly 5-fold, while the corresponding world growth figure amounted to a threefold rise. More than half of total exports from the South were accounted for by South-South trade flows. By 2014 the value of South-South trade reached nearly USD 5.5 trn, which is close to the scale of North-North trade. The higher potential residing in South-South trade rests on a number of factors:

- higher growth performance and future growth potential
- greater scope for trade liberalization, given that import tariffs remain elevated in the developing world
- greater scope for production-sharing given the similarity of levels of development and competitiveness
- strong complementarity in production and resource endowments between various segments of the developing world, including between the BRICs economies and low-income countries.

The higher growth potential of the developing countries that may in turn feed the higher growth in trade is reflected in the forecasts of the international organizations. According to the WTO GDP growth in the developing world is set to accelerate in 2019, while the corresponding figures for developed economies point to a deceleration in growth. With respect exports, developing countries are expected to exceed developed countries' growth trajectory by around 2 percentage points, with Asia being the main growth locomotive in terms of trade flows.

Most recently, South-South cooperation started to receive more of a boost from the BRICS economies.

Quantitative restrictions

There are four types of restrictions on imports

- tariffs
- quantitative restrictions
- banning and
- non-tariff barriers like quality norms etc.

In general QRs are measures, other than tariffs, to curb exports or imports. It can be in the form of quotas, licensing requirements and canalization (bulk imports/exports are allowed through a designated agency/agencies). Quantitative restrictions on the import of certain goods were placed by

India because of the difficult balance of payments situation. However, WTO rules do not allow them unless there are severe BOP pressures. Therefore, they had been lifted progressively.

Non-Tariff Barriers

Customs duties are the means through which the domestic economy is protected against competition from the foreign goods and services. However, WTO mandate requires that customs tariffs be reduced so as to promote globalization. However, the developed and other countries are still resorting to barriers though in the form of NTBs. For example, the social clause that is sought to be brought into the scope of the WTO to exclude imports from developing countries on grounds of weak labour laws ; child labour; human rights; weak green laws and so on are the prime examples . It is a form of back door protectionism. Restricting the number of H-1B visas in the USA and hiking the fees. Quantitative restrictions(QRs) are another form of NTB .

NTBs that are particularly allowed are the sanitary and phytosanitary measures (SPS) and technical barriers. SPS barriers relate to protection of animal , plant and human life within WTO members due to entry and spread of diseases –pests , toxins etc. Technical barriers relate to laying down product characteristics and related processes of production including packaging , labelling and marketing etc.

Glossary

DGFT Directorate General of Foreign Trade, which is headed by the Director General of Foreign Trade. The office of the DGFT is responsible for formulating and execution of Exim Policy, including licensing.

EPZs/EOUs EPZ means Export Processing Zones which are special enclaves, separated from the Domestic Tariff Area (DTA), to provide an internationally competitive duty-free environment for export production. EOU means Export Oriented Units. The EOU scheme is complementary to the EPZ scheme, except that it is widely dispersed in location, unlike EPZs, which are set up at specific locations.

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Forfaiting: In trade finance, forfaiting involves the purchasing of receivables from exporters. The forfaiter will take on all the risks involved with the receivables.

Deemed exports: They are inputs into exports and concessions are given to them for export promotion

EPCG: EPCG refers to the Export Promotion Capital Goods (EPCG) Scheme, which gives the manufacturer facility for import of capital goods for export production at concessional rate against certain level of export obligation.

Exchange Earners Foreign Currency (EEFC) Account Scheme: It was introduced in 1992, which enabled exporters and other exchange earners to retain a portion of their receipts in foreign exchange with an authorised dealer in India.

ITC (HS): It refers to Indian Trade Classification (Harmonised System). It is a system of classification of products for the purposes of export and import.

"Counter Trade" is international barter where goods are paid for in goods.

Assistance to States for Development of Export Infrastructure and other activities (ASIDE) Scheme

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