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ECONOMICS

UPDATED MATERIAL

INCLUSIVE GROWTH

Contents

1. What is Inclusive Growth?

Globally there is no uniform definition of Inclusive Growth. Different agencies define it differently.

According to OECD '***Inclusive growth is an economic growth that "creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society***".

The **UNDP** perspective on inclusive growth is based both on outcome and process. It implies that everyone should be able to participate in the growth process and the benefits should be shared equally. The UN Sustainable Development Goals (SDGs) do not directly mention inclusive growth, but some targets, if achieved, will help move towards inclusive growth. These include:

- **Goal 1**: Removal of poverty by half by 2030
- **Goal 2**: ending hunger by 2030
- **Goal 3**: reducing maternal mortality rates and infant mortality rates to fixed targets by 2030
- **Goal 4**: completely free, equitable and quality primary and secondary education to all girls and boys by 2030
- **Goal 4:** ensuring equal access for all women and men to affordable and quality technical, vocational and tertiary education, including university by 2030
- **Goal 8:** Sustained per capita economic growth and reduction of youth unemployment
- **Goal 9:** developing quality, reliable, sustainable and resilient infrastructure, promoting inclusive and sustainable industrialisation and, by 2030, significantly raise industry's share of employment and gross domestic product (GDP).

2. Dimensions of Inclusive Growth

3. Why is Inclusive Growth Needed?

- **Increasing Global Inequality:** Inequalities in the world has increased in the last three decades. Also there has been profound changes in the labor market due to technological changes, increased migration, ageing societies and shifting employment pattern. The direction of these changes have unfortunately often drifted the economies away from inclusiveness and social justice.
- **Changing labour market**: The new 'disruptive' technology and new global digital infrastructure has changed the face of 'work'. Many existing jobs are vanishing and new ones are emerging. According to a report by **Raghuram Rajan (2018),** there is need to move from routine and less productive work like agriculture and low productive industry and services and seize the opportunity in other spaces in areas of exports, tech start-ups in India.
- **Inequal Women Participation**: Inequality in participation of women in the workforce is another issue. According to McKinsey Report 2015 , if women play identical role in the labour market $28 trillion, or 26 per cent, could be added to global annual GDP by 2025. The report said that in Indian case, there would be 60 per cent increase in GDP by 2025.
- **Lack of inclusive growth**: Economic growth has not automatically resulted in inclusive growth. According to Joseph Stiglitz, despite long period of high growth, 14.5 percent of the population in the World in 2011 still faced poverty. It is a testimony that growth has not been all inclusive and policies have to go beyond just promoting growth.

Success of a future inclusive growth agenda would depend investment in employment intensive sectors and ensuring equal participation across various regions, gender and social groups. For India, investment on universal quality education and universal quality health care hold the key for inclusive growth.

4. What are the Challenges to Inclusive Growth?

1) **Slow economic growth:** Since the financial crisis of 2008-09, the global economy has not fully recovered from the recession. This is reflected in growing jobs deficits (both the quantity and quality of new jobs) in many countries, including India.
2) **Automation:** Robotics and automation will make worker's skill obsolete at much faster rate. It is estimated that between 400 millions to 800 millions individuals could be displaced by automation and need to find new jobs by 2030 around the world.
3) **Wealth concentration:** Studies by ILO and other organization have shown that declining share of total GDP that goes to working people through their pay checks.
4) **Corruption:** The country remains shackled in corruption, red tape, age old social barriers and a puzzling lack of transparency. Tackling corruption in high places, removing the ills of the electoral system, shunning politics of agitations and keeping national interest above petty politics should be the major goals of country's policy makers.
5) **Dependency on agriculture sector:** Most of the India's laborer are engaged in the agriculture sector. While the sector suffers from low growth and underemployment. This also furthers economic inequality.
6) **Extreme poverty:** One in five people in India live below the national poverty line of $1.90 per day, and more than half of the population lives on less than $3 a day.
7) **Informalization of labour:** More than 90% of the jobs are in the informal sectors. In the informal sector, workers are effectively excluded from accessing many of the resources they need to make themselves more productive and thereby improve their life chances.

5. Potential for Inclusive Growth in India

- **Service sector** is the major employer in India. this sector accounts for 68% of GDP and 30% of employment. Continued growth in domestic and export services is expected, and will be increasingly important in the face of uncertainty in the manufacturing sector.
- **Manufacturing Sector:** In face of **automation,** workers need to adapt to changing demand. India must develop an enhanced skills development framework. Such a framework should be accessible, driven by demand, linked to employment opportunities and enable individuals to quickly up-skill and re-skill.
- **MSMEs:** The adoption of digital technologies and emergence of digital platforms, such as in e-commerce and digital financial systems, are improving the business viability of microenterprises in India**.** In order to support inclusive growth among micro and small-sized firms, India must improve financial connectivity**.**
- **Digital Economy:** With increased digitization, new kinds of jobs will be created. It will create contract work and self-employment. Social benefits that are linked to employment should be accessible to individuals directly. Potential issues such as depressed wages, low productivity, and economic insecurity need to be managed through new policy frameworks.
- **Formal Labour:** It is imperative that India leverages digital technologies to bring workers into the formal labour force, connects individuals to social protection systems, and finds ways to effectively prepare people for a changing employment landscape.

6. Agriculture and Inclusive Growth

- The agriculture sector employs close to half the labour force in the country but generates the **lowest per capita output** (and hence is associated with the highest levels of poverty). It is clear that if there is to be **inclusive growth in India**, it has to begin in the agricultural sector.
- Statistics show that the smaller the landholding of a farmer is, slower is the income growth. As far as land ownership is concerned, the opposite of inclusive growth—a **regressive growth**—had taken place for agriculture.
- Given this state of affairs, the government has decided to set a target of '**doubling of farmers' income by the year 2022**'. Parallely, the Government is aiming to reorient agriculture sector by focusing on income centeredness. In order to realise net positive returns for the farmer, schemes as follows,
  - **Soil Health Card (SHC) scheme**
  - **Neem Coated Urea (NCU)**
  - **Pradhan Mantri Krishi Sinchayee Yojana (PMKSY)**
  - **Paramparagat Krishi Vikas Yojana (PKVY)**
  - **National Agriculture Market scheme (e-NAM)**
  - **Pradhan Mantri Fasal Bima Yojana (PMFBY)**
  - **National Food Security Mission (NFSM)**
  - **Mission for Integrated Development of Horticulture (MIDH)**
  - **National Mission on Oilseeds & Oilpalm (NMOOP)**
  - **National Mission for Sustainable Agriculture (NMSA)**
  - **National Mission on Agricultural Extension & Technology (NMAET)**
  - **Rashtriya Krishi Vikas Yojana (RKVY).**
- In addition, schemes relating to tree plantation (Har Medh Par Ped), Bee Keeping, Dairy and Fisheries are also implemented. All these schemes are implemented to enhance production and productivity of agriculture and thereby enhance income of farmers.

7. Measures for Inclusive Growth

- Various schemes 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. They include:
  - **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)**
  - **Deendayal Antyodaya Yojana- National Urban Livelihoods Mission (DAY-NULM)**
- Other budgetary (2081-19) announcements:
  - strategies for encouraging agro-based industries and Medium, Small and Micro Enterprises (MSMEs).
  - Focus has also been given to growth of labour intensive textile sector.
  - **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 providing coverage upto 5 lakh rupees per family per year for secondary and tertiary care hospitalization.
  - increase in the volume of **Institutional credit for Agriculture** to the tune of Rs. 11 lakh crore during 2018-19.
- 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)**
  - **Pradhan Mantri Jeevan Jyoti Yojana (Life Insurance)**
  - And institutional support for 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.**
- The biometric-based unique identification system, **Aadhaar**, now ensures that the poor are no longer invisible and, therefore, more empowered. A bank account for every adult now ensures **universal access to financial services**. When combined with Aadhaar, such access will accelerate financial inclusion.

At 70, what India needs to do next is clear: democratize productivity through inclusive growth to finally reach its full economic potential.

FINANCIAL INCLUSION

Contents

1. Global Overview of Financial Inclusion

According to World Bank, "Financial inclusion means that the individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way"

Few steps towards Financial Inclusion:

1. Being able to have **access to a transaction account** is a **first step** toward broader financial inclusion since a **transaction account allows people to store money**, and send and receive payments. A transaction account serves as a gateway to other financial services, which is why ensuring that people worldwide can have access to a transaction account is the focus of the World Bank Group's **Universal Financial Access 2020** initiative.
2. Moving from access to account **to account usage** is the next step for countries where 80% or more of the population have accounts (China, Kenya, India, Thailand). These countries relied on reforms, private sector innovation, and a push to open low-cost accounts, including mobile and digitally-enabled payments. However, close to one-third of adults – 1.7 billion – are still unbanked, according to the latest Findex data.

Global Financial Inclusion numbers:

- Globally great strides have been made toward financial inclusion and **1.2 billion adults** worldwide have gotten access to an account since 2011. Today, **69% of adults** have an account.
- However, close to **one-third of adults** – 1.7 billion – are still unbanked, according to the latest **Findex** data.
- About half of unbanked people **include women poor households in rural areas** or out of the workforce.
- The gender gap in account ownership remains stuck at **9 percentage points** in developing countries, hindering women from being able to effectively control their financial lives. Countries with high mobile money account ownership have **less gender inequality.**

Global commitment to financial inclusion:

- Financial inclusion has been identified as an enabler for 7 of the 17 **Sustainable Development Goals.**
- The **G20** committed to advance financial inclusion worldwide and reaffirmed its commitment to implement the G20 High-Level Principles for Digital Financial Inclusion.
- The World Bank Group considers financial inclusion a key enabler to reduce extreme poverty and boost shared prosperity, and has put forward an ambitious global goal to reach **Universal Financial Access (UFA) by 2020**.
- Since 2010, more than 55 countries have made commitments to financial inclusion, and more than 60 have either launched or are developing a national strategy.

Countries that have achieved the most progress toward financial inclusion have:

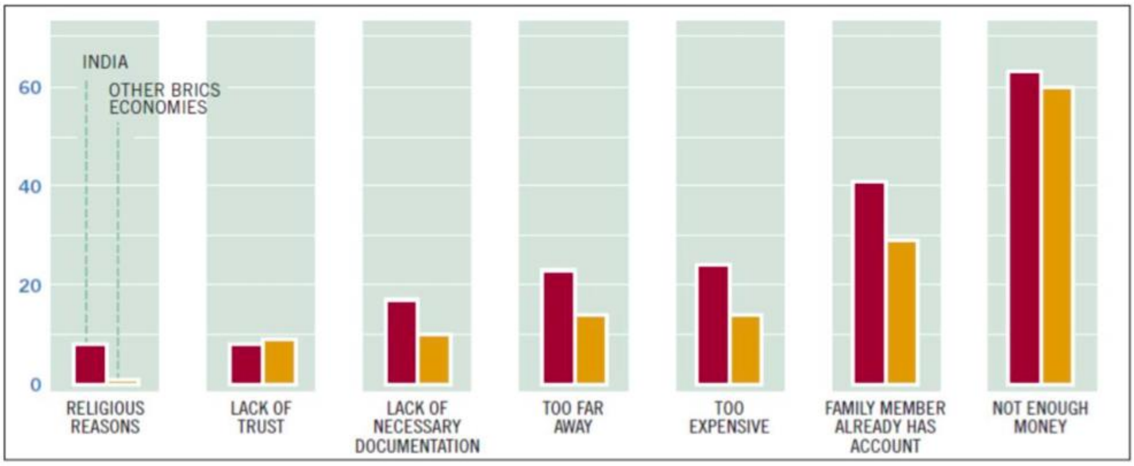
- **Policies delivered at scale**: such as universal digital ID - India and Aadhaar / JDY accounts - more than 1.2 billion residents covered.
- **Leveraged government payments**: For example, 35% of adults in low income countries receiving a government payment opened their first financial account for this purpose.
- **Allowed mobile financial services to thrive**: For example, in Sub-Saharan Africa, mobile money account ownership rose from 12% to 21%.
- **Welcomed new business models:** such as leveraging e-commerce data for financial inclusion

2. Financial Inclusion in India

Financial Exclusion

Before understanding the process of Financial Inclusion, there is need to understand the phenomena of 'Financial Exclusion'. According to the Census 2011, 65 % of Indian adult were excluded out of financial inclusion. There is one bank branch per 14,000 persons. Just 18 percent are debit card holders and less than 2 percent are credit cards holders. In India, the total branches of commercial banks including RRB‟s and SCB‟s has still stood only 48000 in a country to provide service to 6 lakh villages. (**one bank branch over the 12.5 villages**.) It was due to multiple factors: Refer to the chart given below:

Figure 1: Self - reported barriers to use of formal accounts
Non- account holder reporting barrier as a reason for not having an account (%)



The Global Findex Report: Financial Inclusion in India

3. Financial Inclusion

Definition

According to Reserve Bank of India(RBI), "*Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players*".

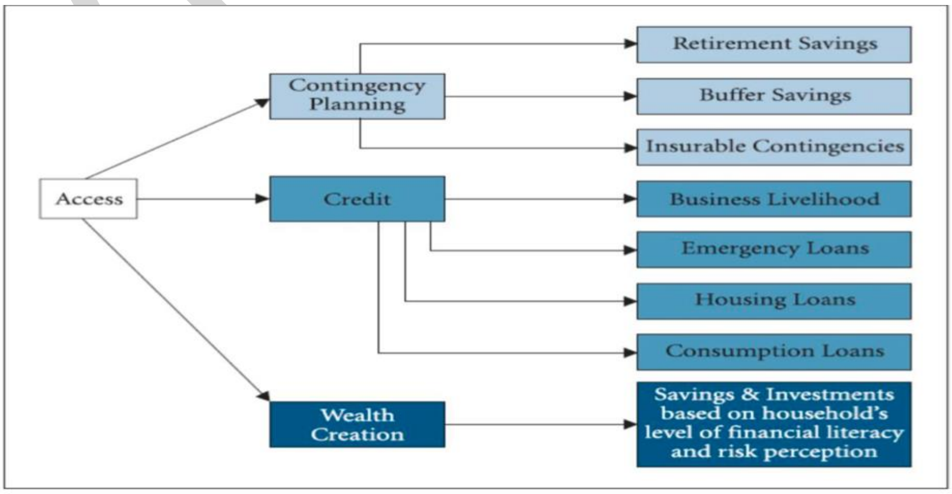
According to the **Committee on Financial inclusion** headed by Dr. C. Rangarajan defined financial inclusion as "*The process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost*".

Thus, Financial inclusion does not mean delivery of financial services for all at **all cost**, but delivery of financial services and products at **affordable costs.**

Significance of Financial Inclusion

- Financial inclusion is to provide equal opportunities to vast sections of population to access mainstream financial services for better life, living and better income. It provides path for inclusive growth.
- Easy access to financial services will allow the population leaving in lower strata, to save money safely and help in preventing concentration of economic power with a few individuals. It mitigates the risks that the poor could face as a result of economic shocks.
- In India, The single most frequently used source of loan for medium Indian household is still moneylender. Large parts of our financial system are still hampered by political intervention and bureaucratic constraints, limiting their potential contribution. India's poor, many of who work as agricultural and unskilled semi skilled wage laboures and low salaried workers are largely excluded from the formal financial system.
- Even micro and small enterprises, find it difficult to have an access to formal sources of finance and thus are largely excluded from financial system. Over 40% of India working population earn but have no saving. Financial inclusion provides protection to poor from the control of the spurious money lenders.
- Households need access to finance for several purposes like creating buffer, retirement, saving to hedge against unpredictable situations and take products for insurable contingencies. For details refer to the infographics given below:

Household Access to Financial Services



Source: A Hundred Small Steps a Report of the Committee on Financial sector reforms by **Raghuram G. Rajan**

History of Financial Inclusion in India

- Financial Inclusion (FI) as a policy initiative entered the banking lexicon only after the recommendations of the **Rangarajan Committee in 2008.** It began to attract the attention when banks realized the significance of connecting with more people for **business growth.**
- The span of financial services included provision of basic savings accounts, and access to adequate credit at affordable costs to vulnerable groups such as the excluded sections of the society and low-income households.
- The experience of microfinance units in India and abroad shows that vulnerable groups who pay usurious interest rates to local moneylenders, can also be **worthy borrowers of banks**.
- One of the broader objectives of FI is to **pull the poor community out of the net of exploitative moneylenders**. But despite such emphasis, the penetration of banking services was initially mostly confined to urban areas and major cities. Later to the hinterland.
- In 2010, RBI advised all the banks – private as well as public- to submit a broad based, three Financial Inclusion plan. This made FI critical to business domain of banks.
- These plans broadly included
    - **Self-set targets** in terms of bricks-and-mortar branches in rural areas,
    - Deployment of **Business Correspondents (BCs)**
    - Use of electronic/kiosk modes for provision of financial services.
    - Opening of no-frills accounts.
- For the dispensation of credit, Kisan Credit Cards (KCC), General Credit Cards (GCC), and other specific products designed to cater to the financially excluded segments, were introduced. Such accelerated microcredit was part of **priority sector lending schemes** of banks.
- Among associated developments, **RuPay – an Indian domestic debit card** – was introduced in 2012 by the National Payments Corporation of India (NPCI). It has been a **game changer** in creating better digital infrastructure and enabled faster penetration of debit card culture in India.

Progress of Financial Inclusion in India

- It was after 2010-11 that the process of FI accelerated. Commercial banks opened new rural branches, increased coverage of villages, set up ATMs and digital kiosks, deployed BCs, opened no-frills accounts, and provided credit through KCCs and GCCs.
- The introduction of **core banking technology** and proliferation of **alternate delivery channels (ATMs, Kisoks, Net banking)** aided the process of inclusion on a larger scale.
- Following graph depicts the accelerated growth of FI:

Parameter of financial inclusion	March 2010	March 2016	March 2017
Number of Bank branches in villages	33,378	51,830	50,860
Number of Business Correspondents (BCs)	34,174	531,229	543,472
Number of other forms of banking touch points	142	3,248	3,761
Total number of banking touch points	67,694	586,307	598,093
Number of BSBDA* (in millions)	73	469	533
Deposits in BSBDA (Amount in Rs. billions)	55	636	977

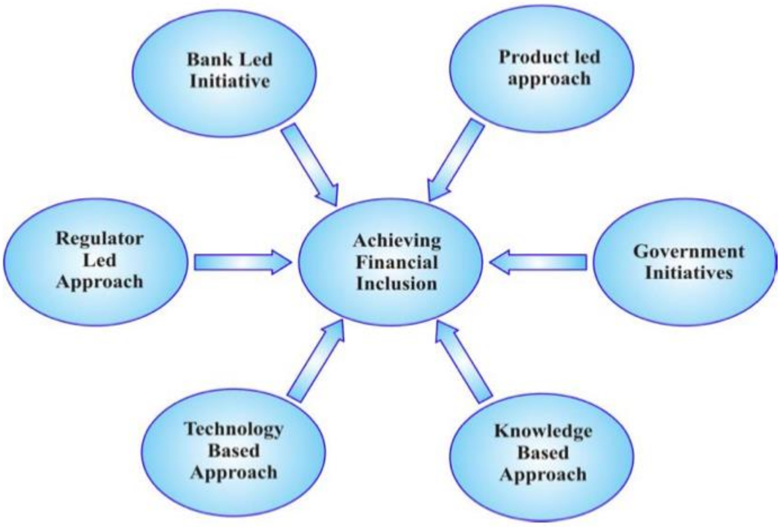
RBI Annual Report: 2016-17

BSBDA: Basic Savings Bank Deposit Account is a no-frill savings account without the need to maintain minimum balance and where no charges are levied.

- Over the last 7-8 years, banks have expanded their presence, and differentiated banks – payments banks and small finance banks – are set to take this further.
- However, It was **Pradhan Mantri Jan Dhan Yojna (PMJDY),** that brough tectonic shift in process of FI in India. It will be discussed in detail later.

Approaches to Financial Inclusion in India

In India, Government of India and Reserve of Bank of India (RBI) have taken various approaches for financial inclusion. Refer to the schematic diagram below:

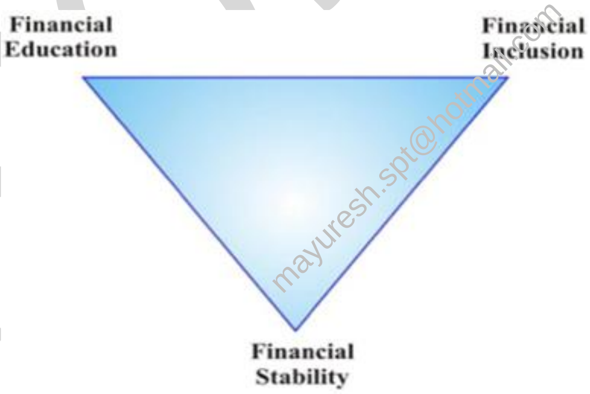


Approaches to Financial Inclusion in India

- **Product based approach:** This includes products like:
  - **No Frills Account:** Introduced in 2005, to provide access to basic baking services by financially excluded peoples. Under this approach banks open accounts with zero balance or very minimum balance requirement for the under-privileged.
  - **Basic Savings Bank Deposit Accounts (BSBDAs)** : A better version of No Frills Account, introduced in 2012. It is for all individuals with the facility of debit card, cheque book, internet banking, overdraft limits at minimal charges.
  - **Kisan Credit Cards (KCC)**: smart cards to the farmers for providing timely and adequate credit support from single window banking system for their farming needs
  - **General Purpose Credit Cards: (GCC):** facilitate credit up to Rs.25000/- without any collateral requirement for rural and semi urban people based on assessment of household cash flows.
  - **Saving account with Overdraft facility:** Banks have been advised to provide overdraft (OD) facility in saving account and also Small Overdrafts in No-frills accounts.
- **Bank led approach:**
  - **Self Help Group –** Bank Led Initiative (SLBP): major institutional based innovation in India for enabling access and covering the gap of reaching financially excluded population of the country in the last two decades.
  - In this model, the banks involve themselves with a group of local people with the idea of enabling them to pool up their savings. The same is deposited with the bank against which the bank also provides a certain amount of credit facility. The group takes a decision to whether to lend to any member of the group.

- The bank provides the framework, accounting services and support to the group to manage their deposits and lending. Thus the model has an approach of savings first, lending later.

- **Regulatory Approach:**
  - It includes simplified KYC norms, bank saving accounts opening and bank branch authorization.
- **Technology Based Approach:**
  - **Mobile Banking:** The banks have tied up with mobile operators to provide financial services like bill and utility payment, fund transfer, ticket booking, shopping etc. Some examples of this model are ***m-Pesa*** by Vodafone and Airtel Money
  - **Kisok/ATM based banking:** Banks have used the technology to enable their ATMs to virtually act like a 24x7 branches.
  - **Branchless baking:** Some of the leading banks have come up with this concept where there would be an online system with chat facility assisting the person to make use of various electronic machines for depositing and withdrawing cash and cheques
  - **Aadhar Enaabled Payment Systems (AEPS):** All accounts having aadhaar number updated are to be reported to RBI, which in turn reports it to various government departments. While making payments to people for working under initiatives like MGNREGA or various subsidy schemes, the departments use this information for directly crediting the money to the beneficiary's account.
- **Knowledge Based Approach:**
  - Financial education, financial inclusion and financial stability are three elements for effective use of the financial services network.
  - While financial inclusion works from supply side, financial education feeds the demand side by promoting awareness among the people regarding the needs and benefits of financial services offered by banks and other institutions.
  - These two strategies together promote greater financial stability.



Financial Tripod

- **Government Initiatives:** The government has come up with many schemes related to financial inclusion:
  - Pradhan Mantri Jan Dhan Yojana (PMJDY)
  - Atal Pension Yojana (APY)
  - Pradhan Mantri Vaya Vandana Yojana
  - Stand Up India Scheme
  - Pradhan Mantri Mudra Yojana
  - Pradhan Mantri Suraksha Bima Yojana (PMSBY)
  - Sukanya Samriddhi Yojana
  - Jeevan Suraksha Bandhan Yojana

- Credit Enhancement Guarantee Scheme (CEGS) for Scheduled Castes (SCs)
- Venture Capital Fund for Scheduled Castes under the Social Sector Initiatives
- Varishtha Pension Bima Yojana (VPBY)

4. Pradhan Mantri Jan Dhan Yojana (PMJDY)

What is this?

- It is a financial inclusion program of Government of India that aims to expand and make affordable access to financial services such as bank accounts, remittances, credit, insurance and pensions.
- It focuses on coverage of households as against the earlier plan, which focused on coverage of villages. It focuses on coverage of rural as well as urban areas.
- The plan also envisages channelling all Government benefits to the beneficiary's accounts and pushing the Direct Benefits Transfer (DBT) scheme of the Union Government.

Significance

- Poor households in India, in the absence of access to formal credit, have to deal with moneylenders who charge exorbitant rates of interest. Household Survey on India's Citizen Environment and Consumer Economy, 2016, shows that within the poorest section of the population two in three take credit from informal sources.
- Though access to formal financial institutions has improved over time but still thousands of villages not have a bank branch and less than 10 percent of all commercial bank credit goes to rural area.

Achievements

- **Helped in financial inclusion**- As per the Global Findex Database, almost 80% of adult Indians have bank accounts. Financial inclusion has taken place in three ways.
  - Financialization of savings- by giving lower income households access to a safe investment product.
  - Diversification of financial products- with 13.5 crore beneficiaries enrolling for the low-cost accident insurance cover and 5.5 crore for the life cover.
  - Transition to electronic payments- with 27.7 crore-account holders now having Rupay debit cards.
- **Helped in financial inclusion**- As per the Global Findex Database, almost 80% of adult Indians have bank accounts. Financial inclusion has taken place in three ways
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  - Transition to electronic payments- with 27.7 crore-account holders now having Rupay debit cards.
- **Helped banking sector**
  - Improved balance sheets of banks- even though they still make up less than 1 per cent of banks' deposit base, they sustained growth in a year when deposit flows were hard to come by.
  - Falling percentage of zero balance accounts- from 58% in 2015 to 15 % as on January 2019, with even the percentage of inoperative accounts declining from 19.8% in 2017 to 16.3% as on December 2018.
  - Servicing Cost is not an issue for the banks now- as the average deposit balance in these accounts has increased.

- **Helped in inclusive growth**
  - Focus on rural India- Of 35.70 crore account holders, those from rural & semi-urban regions are 21 crore.
  - Women empowerment- Around 18.88 crore account holders are women.
- **Direct benefit transfer**- data submitted by the government to Parliament shows that 23 per cent of these accounts received direct benefit transfers as on August 2018.
- **Plugging Leakages from Subsidy**: According to the Economic Survey for 2015-16 leakages in LPG subsidy transfers fell 24% and the exclusion of beneficiaries had been greatly reduced, due to banking infrastructure created by the combination named as JAM trinity.

Challenges

- Dependency on unsecured debt- Access to bank accounts seems to have had little effect on the dependence on private moneylenders.
- Internet connectivity issues: The inadequate infrastructure base for internet facilities basically in tribal and hilly areas make it difficult for Business Correspondents to deliver the required basic banking services.
- Funds for Overdraft Facility: Clarity has still not emerged on where the funds would be diverted from to finance the overdraft facility.
- Increasing Cost of Business Correspondents: If these accounts have to be functional and not remain dormant then the density of banking correspondent has to be increased, which will increase the cost of delivering the banking services.

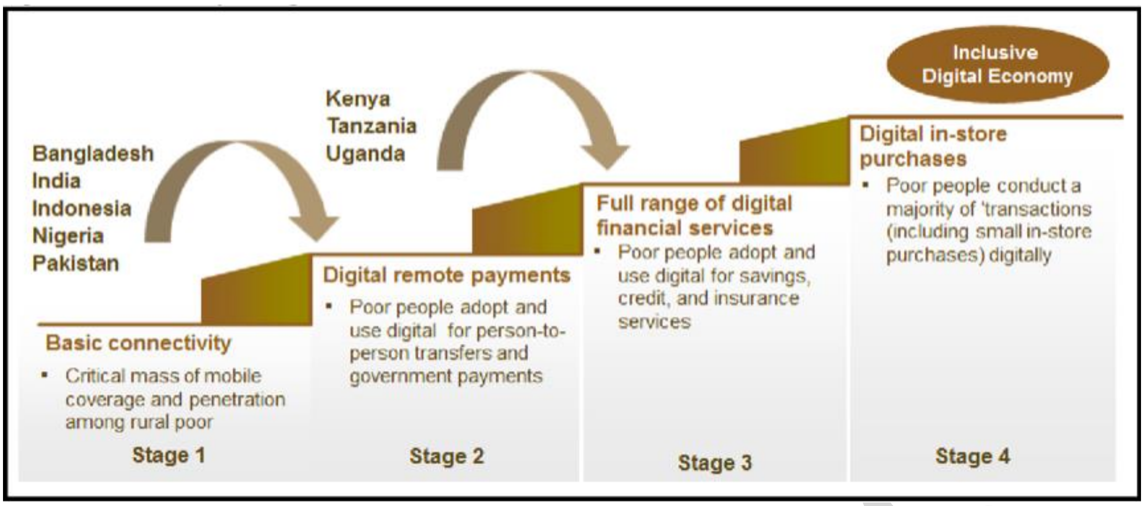
- Tackling Unaccounted Money Deposited During Demonetisation: After the announcement of
- Demonetization total deposits in 255 million Jan Dhan accounts have increased to Rs 642521 million by November 2016.

Way forward

- With the high deposits in the banks, the Government must nudge the banks to offer much-needed loan products to the account holders. Allowing them to build up a credit and transaction history in the banking system is critical to wean them away from the grip of informal money lenders.
- The Centre and the RBI also need to make sure that the first-time adopters are treated well at bank branches, know the grievance redressal mechanisms and are aware of, and protected from, the consequences of fraud or misuse of their accounts.
- The policy focus should shift from the quantity of inclusion to the quality of inclusion. The measure of success of the scheme should include clearly-defined targets for usage and transactions.
- Launching massive campaign programmes among the poor households focusing on improving the level of financial literacy and education can help them recognize the benefits they can avail under the scheme and the responsibilities associated with it.
- It is recommended that internet connectivity and speed should be increased in tribal and hilly areas so that the ease of doing banking transactions can be entertained.

5. Financial Inclusion through Digital Payment

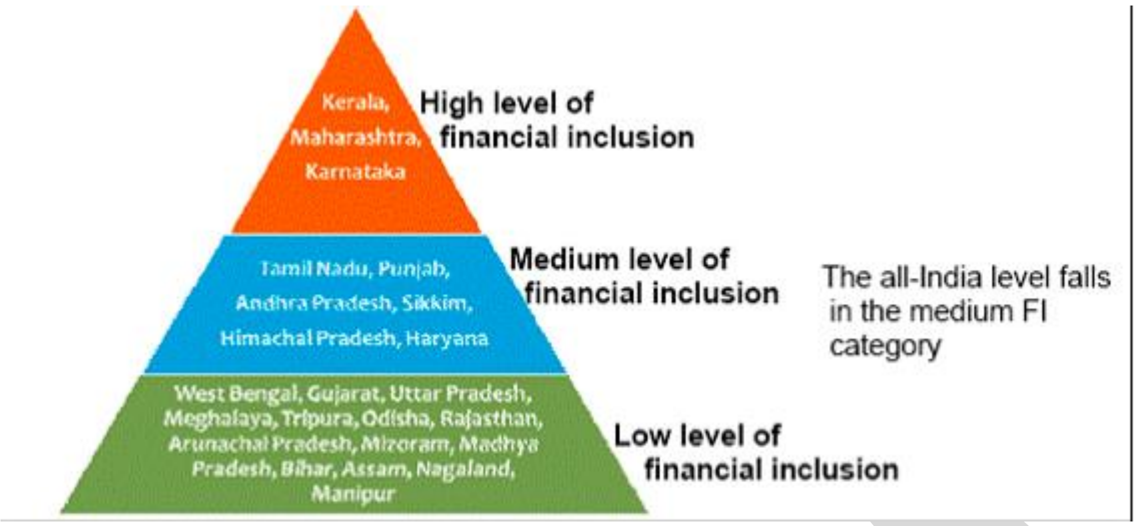
- Post demonetization, India has witnessed a significant increase in the usage of cards and digital wallets for low-value transactions. With growing smartphone ownership and internet usage in the country, non-cash, contactless payments have now become quite the norm across tier-I and tier-II cities.
- The shift to digital payments has also been fuelled by the unprecedented boom of the **Unified Payments Interface (UPI).** According to the data provided by the National Payments Corporation of India, which manages the platform, monthly UPI transactions crossed the **Rs 1 trillion-mark in December 2018**. The figure indicates the widespread adoption of digital payments in India, backed by both home-grown and global companies like Paytm, PhonePe, MobiKwik and Google Pay.
- **Niti Aayog** in its 'Strategy for New India @75' document also emphasised that digital payments will be instrumental in driving financial inclusion and creating financial opportunities for the poor and unbanked.
- Several initiatives have been launched by the RBI and the MeitY to promote the acceptance of digital payments, helping India become a predominantly cashless society. These include the launch of UPI-based BHIM app, the promotional scheme of BHIM Aadhaar, cashback scheme for merchants and referral bonus schemes for individuals on BHIM, Digital Financial Inclusion Awareness and Access (Digital Jagriti) programme, and the opening of a free Doordarshan DTH educational channel to create awareness around the digital payment.
- While the government put in a lot of efforts to mitigate financial exclusion, India still has a long way to go before it achieves the target set by the RBI.
- In urban centres, the increasing cost for merchants hinders the adoption of digital payments, whereas, in rural India, the limited availability of payments infrastructure is identified as the major challenge to financial inclusion



A Digital Pathway to Financial Inclusion

6. Measuring Financial Inclusion in India

- India's **first Financial Inclusion index** was launched in 2013 based on four critical dimensions:
  - Branch penetration
  - Deposit penetration
  - Credit penetration
  - Insurance penetration.
- CRISIL Inclusix measures progress on Financial Inclusion down to the level of each of the 717 districts in the country. The index is based on data provided by RBI, the Microfinance Institutions Network (MFIN), and the Insurance Information Bureau of India.
- The index readings for fiscal year 2015-16 show that FI has improved significantly, with the all-India score rising to 58 in FY 2015-16, compared with 50.1 in FY 2012-13. The PMJDY and RBI's steadfast focus on unbanked regions have made a big difference.
- As many as 600 million deposit accounts were opened between FY 2012-13 and FY 2015-16, which is twice the number between 2010 and 2013. Nearly a third of this was on account of PMJDY.
- There has also been a sharp incremental rise in number of people availing credit, to 31.7 million. This figure includes loans extended by banks and microfinance institutions together in the two years up to FY 2015-16, which is the highest since FY 2012-13.
- Notably, microfinance institutions contributed significantly to the financially under-penetrated regions. The **Digital India initiative, payment banks, and small finance banks** have all helped improve the outreach of formal financial services to economically disadvantaged sections of the populace and geographically remote regions.



Global Findex Report, 2018: India's performance in Financial Inclusion

- In the last seven years, India has taken massive strides towards financial inclusion. When the first **Global Findex Database** was released by the **World Bank** in 2011, it stated that 40% of adult Indians had a bank account.
- An overwhelming majority of Indians, especially in rural areas, were financially weak and were effectively excluded from the formal economy. Seven years later, almost **80% of adult Indians have bank accounts**.
- Today, 90% of India's 1.3 billion population have a unique Aadhar identity, which is vital for meeting anti-money laundering "know your customer" (KYC) requirements.
- In the last four years, **330 million new Jan Dhan bank accounts** have been opened.
- Mobile penetration is expected to **reach 90% by 2020.** Internet penetration has soared, and the use of digital payments is also rising significantly.

7. Way Forward: Achieving True Financial Inclusion

1) **Financial firms must understand the market and structure products accordingly:** For example, agricultural income is seasonal and lumpy. Therefore, loan given to farmer for a tractor should be structured where the repayment cycle is seasonal and not monthly.
   - In a country as vast and diverse as India, deeper understanding of the market can only come if firms have a widespread distribution and recruit locally.
   - For example: Today, Mahindra Finance is present in every Indian state, and its branch network covers 85% of districts nationwide. It has more than six million customers across more than 360,000 villages - **that's one in every two villages in the country.**
2) **Financial Literacy**: Unfortunately, this is one area where India still needs to do a great deal of work. According to a Standard and Poor's survey, basic financial literacy in India is sub-par.
3) **Partnership between the government and providers of various financial products**: It will ensure that the risks and rewards of working with marginal populations are shared.
   - A good example is rural housing. Powered by a government programme that provides financial support and participation from the private sector, 70 million new houses have been built in the last five years, up from about 400,000 previously.
   - The industry body Association of Mutual Funds of India has been running a successful campaign to raise awareness about the benefits of investing in mutual funds to create long-term wealth. The last decade's growth rate of investment in mutual funds in India is **now double that of the rest of the world**. Interestingly, digital flows into mutual funds have increased 12 times in the last two years.

Having developed a strong Financial Inclusion infrastructure and PMJDY accelerating the progress, the next milestone should be to bring about a **mindset and cultural shift** among newly connected beneficiaries to derive benefits from the formal financial system by borrowing from banks and repaying loans in time.

This can boost micro and small enterprises, and hence alleviate poverty and **raise the standard of living of the community** at the grass-roots level. The next phase of Financial Inclusion is therefore less to do with policy and more to do with educating people, disseminate financial and digital awareness in the society.

This campaign of literacy will need a multipronged, **bottoms-up approach**. RBI and banks should coordinate with institutions such as State Education Boards (SEBs), Central Board of Secondary Education (CBSE), University Grants Commission (UGC), and All India Council for Technical Education (AICTE), to include FI as a mandatory subject at different educational levels right from school to higher levels of education.

NGOs, corporate sector, banks, NBFCs (Non-Banking Financial Companies), and government departments currently engaged in FI should **be persuaded to increase thrust**.

UNEMPLOYMENT

Contents

1. Work and Employment

Work can be defined as the carrying out of tasks requiring the expenditure of mental and physical effort with the objective of production of goods and services that cater to human needs. While **Employment** is a contract between two parties, where the work is paid for.

Worker is a person who enters into employment out of his own will. On the nature of employment, work can be of two types:

1) **Formal Work:** It is the work where the worker is governed by the formal rules and regulations. These rules and regulations may be defined by legislations or statutes of the government. All the public sector establishments and those private sector establishments which employ 10 hired workers or more are called **formal sector**.
2) **Informal Work:** It is the work where the workers are not governed by the fixed rules, but by the directions of employers. Unfortunately, in India, more than 80% of the workforce is in the informal sector where they have low social security. It includes farmers, agricultural labourers, owners of small enterprises etc.

Since informal sector is not regulated by the laws and statutes of the government, they are more vulnerable to exploitation. Their wages and tenure are not regularized. They can't form trade union which minimizes their bargaining capacity with their employers.

Definition of 'formal' worker

In India, there exist various definitions of 'formal worker', such as:

- Those employed with enterprises registered under the Factories Act, 1948 (thus excludes those in services sector)
- Those in enterprises with 10 or more workers and all government workers
- Those who have a contract regardless of the size of the enterprise in which they work (Arjun Sengupta Committee Report)

A formal job is generally understood as regular salaried job in government establishments or private enterprises and one that comes with entitlement to one or more of the following social security benefits: provident fund, pension, gratuity, healthcare and maternity.

Organized versus Unorganized

In India, the term "organized enterprise" was originally used to refer to the enterprises registered under the Factories Act, 1948. Industrial enterprises with 20 or more workers if not using power and 10 or more workers if using power are required to register under this Act. But in some contexts, the term has been widened to include all enterprises with 10 or more workers in both industry and services. By implications, enterprises with less than 10 workers are called unorganized enterprises.

1.1. Nature of Employment in India

The nature of employment in India is multifaceted. Some get employment throughout the year while some others get employed for only a few months in a year. Therefore the economic planning in India aims to utilise the available resources in a manner which would maximise the rate of growth with optimal employment generation. Following are the key features of employment in India:

- **Ruralization:** During 2011-12, India had about 473 million strong workforce. About 3/4th of them are **rural workers.** About 70 per cent of the workers are men and the rest are women.
- **Informalisation:** According to the International Labour Organization, 81% of the labour is working in the informal sector, with only 6.5% in the formal sector and 0.8% in the household sector.

- **Casualization:** The phenomena of shift from regular salaried employment and self employment to casual wage work is called 'casualization of the workforce'. Statistics show that there has been a gradual increase in the casual workforce over the last few decades.
- **Masculinization:** India's female Labour Force Participation Rate (LFPR) has fallen to a historic low of **23.3%** in 2017-18. It means that over three out of four women in India are neither working nor seeking work. This would imply that they are most likely engaged in the household chores. This leads to under-valuation of women's contribution to the economy as a whole.

These issues arise mainly because India's economy is highly informalized. There is need to a formal economy.

1.2. Formalization of Indian Economy

Formalization means creation and expansion of formal jobs, essentially, that come with social security, financial inclusion and legal empowerment of the workforce.

Advantages of formalization

- Increased tax revenues for the government due to better reporting under taxation laws
- Coverage of population under social protection plans, saving from financial distress during difficult times
- Increase workers' welfare and the opportunities for decent jobs
- Reduce unfair competition between formal and informal enterprises arising from tax or regulatory arbitrage

Downsides of formalization

- Exclusion of population, if knee-jerk steps are taken e.g. demonetization
- Poverty and destitution as rapid formalization imposes additional costs on informal economy.

How should we go about it?

- Stress on creation of high-productivity high- paying jobs (more under 'job creation')
- Build synergies between different sectors of economy, by inter-Ministries' coordination.
- Ensure employability by addressing skill- mismatch, formal skill training and re-training.
- Improve women's participation in the economy, in line with SDG 5 on Gender Equality.
- Slow transition of informal sector into the formal economy, to avoid downsides of formalization process.

Devising a **National Employment Policy** would go a long way in ensuring coherent and converging actions for formalization of Indian economy.

1.3. Sector Wise Employment in India

As per Employment-Unemployment Survey (by NSSO) of 2011-12 (latest available), total workforce employed stands at 47.36 crore; with 23.16 crore in agriculture and 24.2 crore in industry and services.

SECTOR-WISE EMPLOYMENT: NSSO

(in crore persons)

Workforce by Major Sector (in usual status)	2004-05	2009-10	2011-12
Agriculture & Allied	26.85	24.48	23.17
Industry	8.31	9.90	11.49
Services	10.74	11.64	12.73
Total Workforce*	45.90	46.02	47.38

* Figures may not be additive due to rounding

2. Unemployment

Unemployment is a situation in which individuals are ready and willing to work at the prevailing rate of wages but cannot get the work. According to the NSSO, unemployment is a situation in which all those who, owing to lack of work, are not working but either seek work through employment exchanges, intermediaries, friends or relatives or by making applications to prospective employers or express their willingness or availability for work under the prevailing conditions of work and remunerations

Number of unemployed = Labour Force - Work force

Where, workforce = working or being engaged in economic activity and labour force = work force + not engaged in economic activity and either making tangible efforts to seek work or being available for 'work' if the work is available.

2.1. Types of Unemployment

a) **Cyclical unemployment:** This kind of unemployment occurs when all those who want to work cannot be employed because there is not enough demand in the market for their work. It is called as cyclical unemployment because it varies with the trade cycle. For example, when the economy is doing well there would be greater demand for the goods, but the opposite is true for the years when the economy slows down. For example: In the aftermath of the US subprime crisis, many people lost their jobs.

b) **Frictional Unemployment:** This kind of unemployment occurs when a person leaves/loses a job and starts looking for another one. This search for a job may take a considerable amount of time resulting in frictional unemployment. Frictional unemployment tends to be on a high when an economy is not doing so well. This kind of unemployment may also be high in an economy if people change jobs frequently due to high level of dissatisfaction with the working conditions in the economy.

c) **Seasonal Unemployment:** This kind of unemployment is expected to occur during certain parts of the year. For example, tourism related jobs at a hill station may experience seasonal unemployment during the winter months . Another example could be the seasonal unemployment in agriculture depending upon the success of monsoon. Similarly if irrigation facilities are missing, only one crop may be produced in a year, rendering the farmer unemployed for the rest of the year.

d) **Structural Unemployment:** This kind of unemployment happens when the structure of an industry changes. For example, as the country is tending to move from use of bicycles to motorcycles, the demand for labor in the cycle industry continuously falls. Therefore, structural unemployment essentially occurs when there exists a mismatch between the skills of the unemployed and the skills needed for the job. **Changes in technology and changes in tastes** are two big reasons for the occurring of structural unemployment in the economy. One of the reasons why NITI Ayog focuses on skill development is to address the problem of structural unemployment in the country.

e) **Underemployment:** This term can be used in multiple connotations but one of the primary usage is to showcase a situation where a person with high skills works in low wage and low skill jobs.

f) **Disguised Unemployment:** Such type of unemployment is quite common in the agricultural sector in India. It occurs when people are employed in a job where their presence or absence does not make any difference to the output of the economy. Because of large families in the rural areas several people work on farms and at times the work of 2-3 people is done by 4-5 people.

g) **Open unemployment –** this refers to a situation where there are some workers who have absolutely no work to do. They are willing to work at the prevailing wage rate, but they are forced to remain unemployed in the absence of work. These workers are completely idle. Such unemployment is clearly visible as the number of such person can be clearly counted and therefore it is known as open unemployment. It is found largely in cities and to a limited extent in rural areas. Frictional, structural and cyclical are different types of open unemployment.

h) **Natural unemployment** – Unemployment ranging between 2 to 3% in the country is considered natural and inevitable. This minimal percentage of unemployment cannot be eliminated at all. It is called natural unemployment.

Full Employment: It is a situation when every able-bodied adult works the number of hours considered normal for a fully employed person.

The case of Jobless growth

It is an economic phenomenon in which a macro economy experiences growth while maintaining or decreasing its level of employment. India faced jobless growth from period 2004-05 to 2009-10. The robust growth witnessed by India, has been mostly associated with a rapid rise in labour productivity, rather than an expansion in employment. The total employment grew by only 0.1 per cent during five years till 2009-10 (from 457.9 million in 2004-05 to 458.4 million in 2009-10), while labour productivity grew by more than 34 per cent in total during this period

Over-emphasis on services and neglect of the manufacturing were mainly responsible for this phenomenon. The number of people seeking jobs are growing in India and they need to be constructively engaged to avoid socio-economic conflict and arrest the increasing Informalisation in the economy.

Experts argue that the growth of manufacturing will be the key for growth in income and employment for multiple reasons. For every job created in the manufacturing sector, three additional jobs are created in related activities. The other is that manufacturing in India is scalable and has higher labour absorption in comparison to services.

2.2. Nature of Unemployment in India

- Since India is a developing country, the nature of unemployment is starkly different from the developed countries. In developed countries unemployment is primarily driven by a **fall in demand.** As the demand for goods and services fall, the industries have to stop the production thus rendering the workers jobless.
- But in India under-employment or disguised unemployment is a major concern. This is not due to the lack of demand for goods but due to the shortage of capital equipment for setting up new industries. This creates **supply side constraints** in the economy. Because of the lack of capital, India has not been able to commensurately meet the needs of the growing labour force in the country. This manifests itself in two ways- **firstly,** the prevalence of large scale unemployment in the urban areas; **secondly**, in the growing numbers engaging themselves in the agricultural sector resulting in disguised unemployment.
- The basic solution to the entire problem is **faster rate of capital formation** so as to enlarge employment opportunities. For this the government needs to **encourage savings and their productive utilization in increasing the rate of investment**.
- The state itself can participate in the process of capital formation by undertaking such development activities since the private entrepreneurs do not find it profitable to undertake. There is also a need for the government to increase and attract more foreign investment.

2.3. Measuring Unemployment

Currently, the National Sample Survey Office (NSSO) is the principal source of data on employment. Comparable survey rounds of sample populations are done once in five years. Ministry of Statistics and Programme Implementation (MOSPI) has decided to conduct quarterly and annual surveys of employment.

In measuring employment/unemployment in a country like India, certain specific features of the workforce need to be taken into account. The structure of workforce with dominance of self-employment and primary sector tends to depress unemployment rates in general. Inadequacy of the measure of unemployment in terms of open unemployment has, therefore, been well recognised by the method adopted by NSSO.

Therefore, National Sample Survey Organisation (NSSO) uses three different concepts.

- **Usual Principal Status** - A person is considered unemployed on Usual Status (US) basis, if he/she was not working, but was either seeking or available for work for the major part of the reference year. It is generally regarded as the measure of **chronic open unemployment**. Projections of labour force and employment have been made on the usual status concept, and qualified, where necessary, on the basis of the other two concepts below.
- **Current Weekly Status** - On the basis of a week as the reference period, a person is considered unemployed by Current Weekly Status (CWS), if he/she had not worked even for one hour during the week, but was seeking or available for work. The CWS unemployment rates also measure chronic unemployment, but with the reduced reference period of a week.
- **Current Daily Status** - The third concept of unemployment is the Current Daily Status (CDS), which is in terms of total person days of unemployment, and is the aggregate of all the unemployment days of all persons in the labour force during the reference week. The CDS is considered to be a comprehensive measure of unemployment, including both chronic and invisible unemployment.

Improving Employment Data

Report of the NITI Aayog's Task Force (released in 2017) made recommendations to create a 21st century statistical system in India for the generation of comprehensive employment, unemployment and wage estimates on a sustained basis. These include:

- Conduct of household surveys on an annual basis.
- Introduction of time-use survey, that be conducted every three years (such surveys also help in measuring women's participation in unpaid work).
- Use of technology for faster and better data collection, processing and assimilation.
- Introduction of annual enterprise survey using enterprises registered with the GSTN as the sample frame.
- Separate annual survey of enterprises excluded from the GSTN database (i.e. those in health and education sectors, and those with turnover < INR 20 Lakh in other sectors).
- Adoption of inclusive and wider definition of 'formal workers'.
- Adoption of GSTN across all legislations, ministries and departments as the universal establishment number.

<table>
<tr><th colspan="3">CLASSIFICATION OF SURVEYS AND STUDIES TO STUDY EMPLOYMENT AND ITS COMPOSITION IN INDIA</th></tr>
<tr><th>Type and Names</th><th>Description</th><th>Limitations</th></tr>
<tr><td colspan="3">Household Surveys:
• (+) Comprehensively cover the entire labour force
• (-) These are conducted every five years
• (-) Time lag between data collection and availability of the results
• E.g. - Employment-Unemployment Survey (NSSO), Annual Labour Force Survey (Labour Bureau)</td></tr>
<tr><td colspan="3">Enterprise Surveys:
• (+) Better accuracy than Household surveys, in accessing industry structure, wages and other employment characteristics
• (-) Available sample frames may not cover small, unorganized enterprises
• (-) Self-employed and farm workers are excluded
• E.g. - Economic Census (by MOSPI), Annual Survey of Industries (MoSPI), Unorganized Sector Surveys of Industries and Services (NSSO), Quarterly Employment Survey (QES) (Labour Bureau)</td></tr>
<tr><td colspan="3">Social Security Schemes:
• (+) Wide coverage of new job additions
• (-) Highly partial coverage and potential double-counting of jobs
• (-) Substantial overlap across the government schemes
• E.g. - Employees' Provident Fund Organization (EPFO), Employees' State Insurance Corporation (ESIC)</td></tr>
<tr><td colspan="3">Other Sources:
• Administrative data: it includes tax returns and filings, pension and medical insurance programs etc.
   ○ (+) Good measure of formal employment
   ○ (-) Partial coverage
   ○ (-) Difficult to gauge addition of jobs
• Data from government schemes: it includes estimates via MGNREGA, MUDRA, job creations under programs such as ICDS, PMKVY, DDUGKY etc.
• Emerging sources: GSTN, Big Data analytics</td></tr>
</table>

2.4. Unemployment Rate

Unemployment rate is defined as the number of people who were unable to find a job (though they were looking for jobs), as a ratio of total number of people who were looking for jobs.

Unemployment in India

- ILO report "World Employment and Social Outlook Trends - 2018": The number of unemployed persons in India is expected to rise from 18.3 million in 2017 to 18.6 million in 2018 and 18.9 million by 2019. At the same time, the unemployment rate is expected to remain static at 3.5 per cent.
- The World Bank in its comprehensive report on India's economy opines that India needs to create a lot of salaried jobs (formal jobs) to meet the working population demands and step up its growth to a middle-income country.
- About 65 percent of the population in the country has an average age of less than 35 years. A large section of unemployed within this can become a demographic burden for India.

NSSO 68th Round Survey: Key facts

- The unemployment rate in urban areas reduced from 4.5% in 2004-05 to 3.4% in 2011-12. While in urban areas it reduced from 4.5% in 2004-05 to 3.4% in 2011-12.
- Unemployment rate across all the religious groups in rural areas was on the lower side compared to urban areas for both males and females.
- The **most astonishing finding** was that Christians have the highest rate of unemployment in both rural (4.5%) and urban (5.9%) areas in 2011-12.
- While the unemployment rate in rural areas has decreased for Sikhs **(lowest among all religious groups)** it has slightly increased for Muslims. At 3.3%, Hindus have the lowest unemployment rate in urban areas.
- **Self-employment** is the major source of income for almost half the households, across all religious groups, in rural areas, followed by casual labour.

2.5. Labour Force Participation Rate

- The labour force participation rate measures the proportion of people in the working-age (16 - 64years) group who are actually available for work.
- Following are few findings from the latest report by the NSSO:
    - The labour force participation rate (LFPR) stood at 49.8 per cent in 2017-18, falling sharply from 55.9 % in 2011-12.
    - The proportion of the active labour force declined twice for females between 2011-12 and 2017-18.
    - The fall in LFPR was far more in rural areas, from 67.7% to 58.7%, than in urban areas, from 49.3% to 47.6%. The gap in LFPR has narrowed between urban and rural areas due to a decline in the active labour force in villages.
- There is a small decline in labour force participation among men in the working-age group, attributable to their **increasing preference for higher education**. The decline in labour force participation among children and, especially, women is attributable to **declining poverty.**

2.6. Women's Participation in the Labour Force

- The relatively low proportion of working women in India is one of the most significant obstacles to economic progress. The difference in the labour participation rate of the two main genders in India is over 50 percentage points, one of the highest among G-20 nations, according to World Bank data.
- The labour force participation rate of women in urban areas is less than the participation of women in rural areas.

Reasons for low participation

- lower wages for women
- the inability to provide flexibility, childcare benefits and maternity leaves creates disincentives for women to seek work outside the home
- gender discrimination in Indian society - low social status of women compared to men
- security issues also hinder labour mobility among women

Economic Consequence of Low participation of Women-

- A new study by the McKinsey Global Institute estimated that India's gross domestic product (GDP) in 2025 can be higher by as much as 60% if women's participation in the economy were on par with that of men.
- A study by Asian Development Bank (ADB) also points to the similar fact. It says that if women's participation in India increases to the level prevailing in the advanced countries, annual GDP will be higher by 4.2%.
- No country can attain its full potential if half of its human capital is unable to contribute fully to its growth and development. India is no exception.

NITI Ayog's 3 Year Action Agenda (2017-2020)

- Job creation in Industry and Services
- Create Coastal Employment Zones to boost exports and generate high-productivity jobs.
- Enhance labour-market flexibility through reforming key laws
- Address the high and rising share of Non-Performing Assets (NPAs) in India's banks through supporting the auction of larger assets to private asset reconstruction companies (ARCs), and strengthening the State Bank of India-led ARC.
- Action points for specific sectors- Apparel, Leather and footwear, Electronics, Food processing, Gems and jewelry, Tourism, Finance, Real estate.

2.7. Reasons for Unemployment

India has comparative advantage in terms of cheaper and more abundant labour. But this is nullified by other factors that render them less competitive than their peers in competitor countries.

- **Defective education system** - Failing education system that creates thousands of 'unemployable graduates'. National Employability Report for Engineers (Aspiring MInds) reveals that over 80 per cent of Indian engineers are unemployable
- **Slow economic growth** - Inadequate job creation (therefore non-farm sector (such as manufacturing) needs to be encouraged as farm land is limited)
- **Lack of infrastructural development**- India is behind its competitors when it comes to infrastructure such road and logistics. The costs and time involved in getting goods from factory to destination are greater than those for other countries.
- **Poor ranking in Global Competitiveness Index**-reflected in the high average tariff that India is maintaining on its imports, low level of factor accumulation, and relatively high incremental capital-output ratio. India has slipped 10 ranks in the latest Global Competitive Index.
- **Rapid population growth** - Skilling and job creation is hard to catch up with a rapid growing population especially when the population base is large and the institutions and policies are not effective in creating quality jobs.
- **Inadequate employment planning** by government in comparison to the population growth.
- **Lack of entrepreneurship culture-** India needs to develop a culture of job-providers than being a job-seeker among its youth.

2.8. Consequences of Unemployment

- **Unrest in population – especially the youth**- The Jaat reservation stir in Haryana is a visible manifestation of violent form of the problem of unemployment. Similarly other locally dominant caste and communities like Patels in Gujarat, Kapu community in Andhra Pradesh, Gujjar in Rajasthan are also demanding reservation in employment.
- **Low economic growth –** The human capital of a nation is not fully utilized if the unemployment rate is high. It turns the people who are an asset into a liability. Increase in unemployment is an indicator of a depressed economy.
- **Vicious cycles of Poverty –** Unemployment and poverty feed are the two sides of the same coin with one leading to the other. It also reduces demand which in turn affect other sectors of the economy**.**
- **Lower social indicators & burden on government –** Unemployment leads to reduced spending on health and education by people. This affects social indicators of the population.
- **Source of exploitation -** People cannot remain completely unemployed for very long because of their desperate economic condition. Thus, they are forced to accept jobs that may be unpleasant or exploitative.
- **Loss of labour efficiency –** When a person is out of work for long, his/her efficiency decreases as a result of loss of skills and work habits.
- **Adverse effects on savings –** As the employed person have to take care of the unemployed ones in the family, their capacity to save falls.
- **Leads to inequalities of income –** Unemployment pushes people to poverty. During the period of mass unemployment, the extent of poverty and inequality of income tends to increase.

2.9. Steps Taken by the Government to Tackle Unemployment

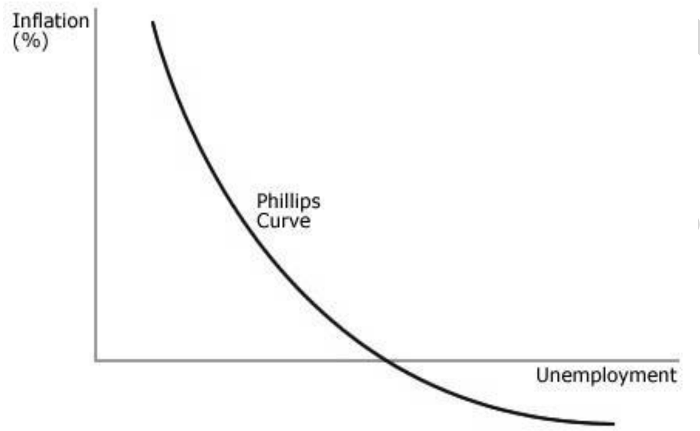
India is midway through its demographic dividend – a period of time when demography gives economic growth a boost by expanding the working-age share of the population. To exploit the dividend and meeting the aspirations of people entering the labour force, India's economy needs to create enough "good jobs". Many steps have been taken for increasing employment in recent times.

- **National Rural LIvelihood Mission:** Two initiatives for skill development are undertaken under this scheme:
  - **Pandit Deen Dayal Upadhyaya Grameen Kaushalya Yojana:** It is a placement linked skill development program which allows skilling in a PPP mode and assured placements in regular jobs in an organization not owned by the skilled person.
  - **Rural Self Employment and Training Institutes (RSETI)**: It enables the trainee to take Bank credit and start his/her own Micro-enterprise
- **Make in India:** It aims at promoting India as an important investment destination and a global hub for manufacturing, design and innovation.
- **Startup India Programme**: It aims to build a strong eco-system for nurturing innovation and startups in the country which will drive economic growth and generate large scale employment opportunities.
- **Mudra Scheme:** It provides access to institutional finance to unfunded micro / small business units by extending loans upto Rs.10 lakh for manufacturing, processing, trading, services and activities allied to agriculture, which help in creating income generating activities and employment.
- **Stand Up India:** It provides access to institutional finance to unfunded micro / small business units by extending loans upto Rs.10 lakh for manufacturing, processing, trading,

services and activities allied to agriculture, which help in creating income generating activities and employment.
- **National Manufacturing Policy** to engage in job creation numbering 10 crore work opportunities by 2022.
- **National Urban Livelihoods Mission:** It focuses on organizing urban poor in self help groups, creating opportunities for skill development leading to market-based employment and helping them to set up self-employment ventures by ensuring easy access to credit.

3. Relationship between Unemployment and Inflation Rate

- Professor Phillips, emphasized that there exists a close relationship between the level of unemployment and the rate of wage increase in an economy. This relationship between the two is depicted in the form of **Phillips curve.**
- It is a graphic curve, which advocates a relationship between inflation and unemployment in an economy. As per the curve there is a 'trade off' between inflation and unemployment i.e. an inverse relationship between them. The curve suggests that lower inflation, higher unemployment and higher inflation, lower unemployment.



4. Potential Sectors for Employment Generation

At present almost half of India's population is concentrated in the agricultural sector. In fact the agricultural sector shows signs of **disguised employment** and **low productivity**. There is an urgent need to take workforce out of this sector towards manufacturing and services. Creating jobs in the latter sectors is India's central challenge. India needs to generate jobs that are formal and productive, provide bang-for-buck in terms of jobs created relative to investment, have the potential for broader social transformation, and can generate exports and growth.

Moreover, India's growth has to be led by manufacturing, not services because, among other reasons, employment elasticity is higher in manufacturing. Also, a large section of the labour force has little or no education, and cannot be employed in skilled jobs in the services sector. Nor can they be easily skilled, given their lack of basic education. Outside agriculture, they can only be employed in low-skill jobs in the manufacturing sector.

Top 10 job-generators

The construction sector has accounted for more than a third of new jobs in post-liberalization India

Sectors	Share of new non-farm jobs created between 1980-81 and 1990-91 (in %)	Share of new non-farm jobs created between 1990-1991 and 2015-16 (in %)	Share in total workforce in 2015-16 (in %)	Productivity per worker (Rs1,000/ worker, in 2015-16)
Construction	20.13	**35.74**	14.40	126.56
Trade	24.84	**14.56**	10.04	235.78
Miscellaneous services (includes real estate brokerage)	7.38	**8.43**	5.02	415.53
Transport and storage	9.78	**7.44**	4.29	255.39
Education	3.13	**6.26**	3.22	222.13
Business services	1.47	**5.99**	2.18	811.68
Hotels and restaurants	2.49	**3.75**	1.89	123.53
Gems, jewellery and misc. manufacturing	3.02	**2.46**	1.43	87.19
Food products, beverages and tobacco	4.92	**2.28**	2.42	158.72
Financial services	2.42	**2.26**	1.11	1259.52
Health and social work	0.81	**2.07**	1.08	290.04

Note: only sectors which account for at least 1% of the total workforce have been considered here

Source: KLEMS India Database, RBI, Mint calculations

Meeting the challenge of jobs may require paying attention to labour-intensive sectors. The apparel and leather sectors meet many desirable attributes for policy attention: bang- for buck for creating jobs, especially for women, opportunities for exports and growth. Nearly every successful economic growth take-off in post-war history in East Asia has been associated with rapid expansion in clothing and footwear exports in the early stages. Apparels and Leather sectors offer tremendous opportunities for creation of jobs, especially for women.

Rising labor costs means that China is gradually vacating its dominant position in these sectors, affording India an opportunity. To not cede this space to competitors such as Vietnam and Bangladesh will require easing restrictions on labor regulations, negotiating FTAs with major partners such as the EU and UK, and ensuring that the GST rationalizes current tax policy that can discriminate against dynamic sectors.

25 focus sectors under MSME

'Make in India' aims at projecting India as an investment destination and develop it as a global hub for manufacturing, design and innovation. The 'Make in India' initiative does not target manufacturing sector alone, but also aims at promoting entrepreneurship in the country. Under the initiative various components have been identified which will lead to creation of a positive investment climate. These components involve improvement in Ease of Doing Business, creation of modern infrastructure, opening of new Sectors for FDI and change in the mindset of government agencies from being regulators to facilitators.

As part of Make in India initiative, 25 focus sectors have been identified in which there is an Action Plan which has been approved to encourage and promote investments in those sectors. These sectors include Textiles, Tourism and Hospitality, Leather, Pharmaceuticals, Electronic System Design and Manufacturing, Food processing, construction, Aviation etc.

Employment prospects in India's IT Sector: Robust Outlook

Indian IT sector employment prospects, both in the near and long-term are expected to be broadly positive and encouraging for the future. India IT companies currently serve two thirds of the fortune 500 companies and have created 40 lakhs direct jobs in India.

India's total software product market grew at 9.5% in FY2017 to reach USD 7 billion. In comparison, the domestic market grew much faster, at 10.4%, reaching USD 4.8 billion.

The emerging and promising digital economy in the country is going create a very powerful potential for job creation. The Government is encouraging greater stress on cyber security and this will lead to greater focus on innovation, research and thus significant potential for job creation.

POVERTY & INEQUALITY

Contents

1. Poverty

"Poverty is the worst form of violence."

This quote by Mahatma Gandhi precisely sums up the overall impact of poverty on the lives of the poor. It places many disabilities hampering the development of the poor by restricting their freedoms and trapping generations in poverty if adequate level of support is not provided to them.

The natural questions that rise are- What is poverty? What are its causes? How is poverty measured? What steps have been taken to mitigate poverty? What more needs to be done? We will find answers to these in subsequent sections of this document.

1.1. What is Poverty?

Poverty, in simplest terms, is a condition where people are **unable to fulfil basic needs** of life such as- food, clothes, shelter etc. **for want of money**. Over the time, poor access to healthcare services, education and poor standard of living have also come to be attributed to poverty.

1.2. Types of Poverty

Poverty is defined in either relative or absolute terms. **Absolute poverty** measures poverty in relation to the amount of money necessary to meet basic needs such as food, clothing, and shelter. **United Nations** defines it 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 access to service. The **World Bank** has defined the absolute poverty line as the percentage of population of country living on **less than $1.90 a day** (PPP) at constant prices at 2011 price levels.

However, the concept of absolute poverty is not concerned with broader quality of life issues or with the overall *level of inequality* in society. The concept therefore fails to recognize that individuals have important social and cultural needs. This, and similar criticisms, led to the development of the **concept of relative poverty**.

Relative poverty defines poverty in relation to the economic status of other members of the society: people are poor if they fall below prevailing standards of living in a given societal context. One of its criticisms is that it is merely a *measure of inequality*, using the term 'poverty' for it is misleading. For example, if everyone in a country's income doubled, it would not reduce the amount of 'relative poverty' at all. However, others have pointed out that **the problem of poverty in the industrialized nations today is mostly a problem of relative poverty**. That after a certain minimum level of economic development the effects of poverty is not seen in any absolute form but the effects of the contrast, daily perceived, between the lives of the poor and the lives of those around them. Nonetheless, poverty is not equal to inequality and both are two distinct concepts affecting each other which we will deal with later in this document.

Other Ways of Categorizing the Poor-

Chronic Poor- People who are always poor and those who are usually poor but who may sometimes have a little more money (example: casual workers) are grouped together as the chronic poor.

Churning Poor- Another group are the churning poor who regularly move in and out of poverty (example: small farmers and seasonal workers).

Occasionally Poor- Those who are rich most of the time but may sometimes have a patch of bad luck. They are called the transient poor.

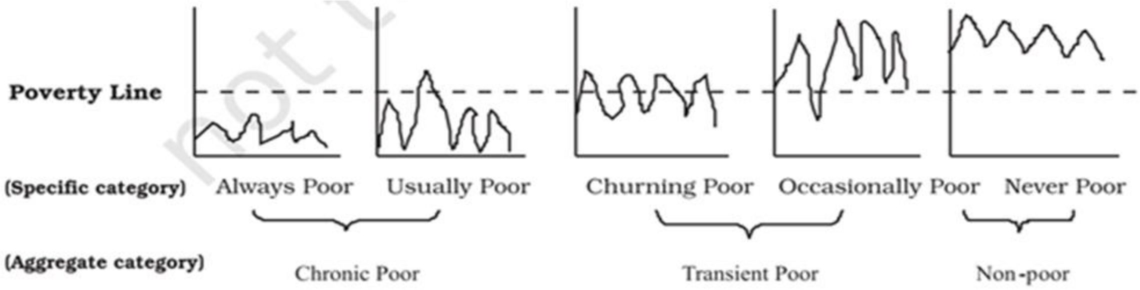


Chart: The Chronic Poor, Transient Poor and Non-poor

1.3. Measuring Poverty

For the purpose of defining poverty, we divide people into two categories; the poor and the non-poor and the poverty line separates the two. However, there are many kinds of poor; the absolutely poor, the very poor and the poor. Similarly, there are various kinds of non-poor; the middle class, the upper middle class, the rich, the very rich and the absolutely rich. Think of this as a line or continuum from the very poor to the absolutely rich with the poverty line dividing the poor from the non-poor.

The Poverty Line: Poverty Line is a monetary threshold under which an individual is considered to be living in poverty. National Sample Survey Organization is the institution which collects data regarding estimation of poverty in India. There are many ways of measuring poverty. One way is to determine it by the monetary value (per capita expenditure) of the minimum calorie intake that was estimated at 2,400 calories for a rural person and 2,100 calories for a person in the urban area. Based on this, in 2011-12, the poverty line was defined for rural areas as consumption worth Rs 816 per person a month and for urban areas it was Rs 1,000. Thus the government uses Monthly Per Capita Expenditure (MPCE) as proxy for income of households to identify the poor.

Poverty Estimation in Pre-independent India

In pre-independent India, Dadabhai Naoroji was the first to discuss the concept of a Poverty Line. He used the menu for a prisoner and used appropriate prevailing prices to arrive at what may be called 'jail cost of living'. However, only adults stay in jail whereas, in an actual society, there are children too. He, therefore, appropriately adjusted this cost of living to arrive at the poverty line.

Poverty Estimation in Independent India

In 1962, the Planning Commission constituted a working group to estimate poverty nationally, and it formulated separate poverty lines for rural and urban areas – of Rs 20 and Rs 25 per capita per year respectively. VM Dandekar and N Rath made the first systematic assessment of poverty in India in 1971, based on National Sample Survey (NSS) data from 1960-61. They argued that the poverty line must be derived from the expenditure that was adequate to provide 2250 calories per day in both rural and urban areas. This generated debate on minimum calorie consumption norms while estimating poverty and variations in these norms based on age and sex.

Alagh Committee (1979): In 1979, a task force constituted by the Planning Commission for the purpose of poverty estimation, chaired by YK Alagh, constructed a poverty line for rural and urban areas on the basis of nutritional requirements.

Lakdawala Committee (1993): In 1993, an expert group constituted to review methodology for poverty estimation, chaired by DT Lakdawala, made the following suggestions:

1. Consumption expenditure should be calculated based on calorie consumption as earlier;
2. State specific poverty lines should be constructed and these should be updated using the Consumer Price Index of Industrial Workers (CPI-IW) in urban areas and Consumer Price Index of Agricultural Labour (CPI-AL) in rural areas;
3. Discontinuation of 'scaling' of poverty estimates based on National Accounts Statistics. This assumes that the basket of goods and services used to calculate CPI-IW and CPI-AL reflect the consumption patterns of the poor.

Tendulkar Committee (2009): In 2005, another expert group to review methodology for poverty estimation, chaired by Suresh Tendulkar, was constituted by the Planning Commission to address the following three shortcomings of the previous methods: (i) consumption patterns were linked to the 1973-74 poverty line baskets (PLBs) of goods and services, whereas there were significant changes in the consumption patterns of the poor since that time, which were not reflected in the poverty estimates; (ii) there were issues with the adjustment of prices for inflation, both spatially (across regions) and temporally (across time); and (iii) earlier poverty lines assumed that health and education would be provided by the State and formulated poverty lines accordingly.

It recommended four major changes:

1. Using *Mixed Reference Period* (MRP) based estimates, as opposed to Uniform Reference Period (URP) based estimates that were used in earlier methods for estimating poverty.
2. A uniform poverty line basket (PLB) across rural and urban India;
3. A change in the price adjustment procedure to correct spatial and temporal issues with price adjustment; and
4. Incorporation of private expenditure on health and education while estimating poverty.

It based its calculations on the consumption of the following items: cereal, pulses, milk, edible oil, non-vegetarian items, vegetables, fresh fruits, dry fruits, sugar, salt & spices, other food, intoxicants, fuel, clothing, footwear, education, medical (non-institutional and institutional), entertainment, personal & toilet goods, other goods, other services and durables. The Committee computed new poverty lines for rural and urban areas of each state. To do this, it used data on value and quantity consumed of the items mentioned above by the population that was classified as poor by the previous urban poverty line. It concluded that the all India poverty line was Rs 446.68 per capita per month in rural areas and Rs 578.80 per capita per month in urban areas in 2004-05.

The following table outlines the manner in which the percentage of population below the poverty line changed after the application of the Tendulkar Committee's methodology.

Committee	Rural	Urban	Total
Lakdawala Committee	28.3	25.7	27.5
Tendulkar Committee	41.8	27.5	37.2

Table: Percentage of population below poverty line calculated by the Lakadwala Committee and the Tendulkar Committee for the Year 2004-05

The Committee also recommended a new method of updating poverty lines, adjusting for changes in prices and patterns of consumption, using the consumption basket of people close to the poverty line. Thus, the estimates released in 2009-10 and 2011-12 use this method instead of using indices derived from the CPI-AL for rural areas and CPI-IW for urban areas as was done earlier. Table below outlines the **poverty lines computed using the Tendulkar Committee methodology** for the years 2004-05, 2009-10 and 2011-12.

Year	Rural	Urban
2004-05	446.7	578.8
2009-10	672.8	859.6
2011-12	816.0	1000.0

Table: National poverty lines (in Rs per capita per month) for the years 2004-05, 2009-10 and 2011-12

Rangarajan Committee: In 2012, the Planning Commission constituted a new expert panel on poverty estimation, chaired by C Rangarajan. The Rangarajan committee estimation is based on an independent large survey of households by Center for Monitoring Indian Economy (CMIE). It has also used different methodology wherein a household is considered poor if it is unable to save.

The methods also include certain normative levels of adequate nourishment, clothing, house rent, conveyance, education and also behavioral determination of non-food expenses. It also considered average requirements of calories, protein and fats based on ICMR norms differentiated by age and gender.

According to the report of the committee, the new poverty line was set **at Rs 32 in rural areas and Rs 47 in urban areas**. The earlier poverty line figure was Rs 27 for rural India and Rs 33 for Urban India (see following table).

	No. of Rural poor	**No. of urban poor**	**Total**	**Percent of poor in the year 2011-12**
Rangarajan Committee	260.5 million	102.5 million	363 million	**29.5%**
Tendulkar committee	216.5 million	52.8 million	269 million	**21.9%**

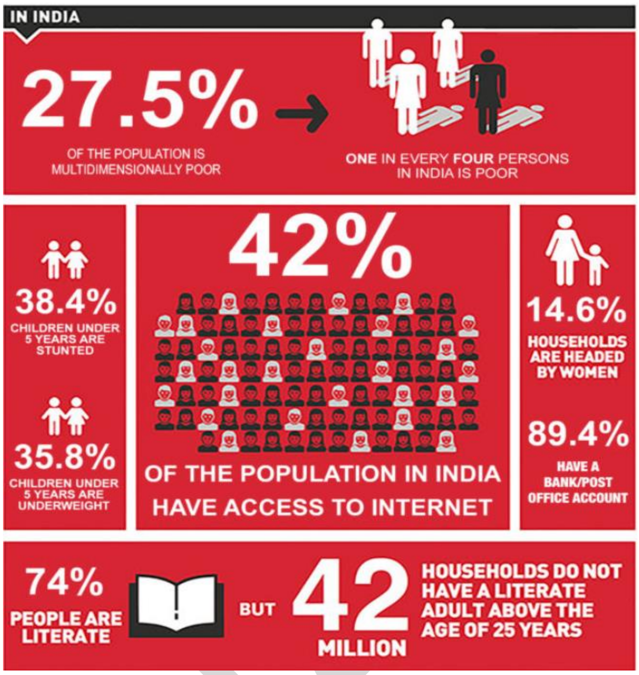
Hashim Committee- The Hashim Committee in its 2012 report recommended three stage identification process to identify the families living Below Poverty Line in **urban areas** which include automatic exclusion, automatic inclusion and scoring index of the remaining urban families in this order. The methodology recommended mainly emphasizes on capturing residential, social and occupational vulnerabilities.

Saxena Committee- Dr. N.C. Saxena Committee was set up by the Ministry of Rural Development to advise it on the **suitable methodology for BPL Census and not for estimation of poverty**. However, in the Report submitted by the Expert Group on 21st August 2009 it was mentioned that the percentage of people entitled to BPL status should be revised upwards to at least 50%.

1.4. Multidimensional Poverty

"*What use is equality before law if there is no equality in fact? Freedoms guaranteed by Article 19 will become empty slogans for a person who has no food to eat, no roof under which he can take shelter and no clothes to wear; and what is the use of vote to a person who is hungry and kept illiterate and denied the knowledge required to participate in the affairs of the State?*" - Justice K. S. Hedge.

The above quote drives home the point that poverty is not only economic hardship but it affects other aspects of life hampering overall growth of poor. The United Nations in the Sustainable Development Goal 1, also, calls **to eradicate poverty in all its forms everywhere**. In this context, traditional poverty measures – often calculated by numbers of people who earn less than a certain income level – shed light on how little people earn but not on whether or how they experience poverty in their day-to-day lives.



The **Multidimensional Poverty Index** helps answer that call, providing immensely valuable information for all those seeking to understand what poverty looks like for a particular place or group of people, and for those working on the policies to help people escape poverty now and into the future.

About Multidimensional Poverty Index

- It was developed in 2010 by the **Oxford Poverty and Human Development Initiative (OPHI) and the United Nations Development Programme (UNDP).**
- The global Multidimensional Poverty Index (MPI) is an **international measure of acute multidimensional poverty** covering over 100 developing countries.
- The MPI goes **beyond income as the sole indicator for poverty**, by exploring the ways in which people experience poverty in their **health, education, and standard of living.** It captures **both the incidence and intensity of poverty**.
    - The MPI assesses **poverty at the individual level**.
    - If someone is deprived in three or more of ten (weighted) indicators, the global index identifies them as 'MPI poor', and the extent – or intensity – of their poverty is measured by the percentage of deprivations they are experiencing.

Dimensions of Poverty	Indicator	Deprived if living in the household where...	Weight
Health	Nutrition	An adult under 70 years of age or a child is undernourished.	1/6
	Child mortality	Any child under the age of 18 years has died in the five years preceding the survey.	1/6
Education	Years of Schooling	No household member aged 10 years or older has completed six years of schooling.	1/6
	School Attendance	Any school-aged child is not attending school up to the age at which he/she would complete class 8.	1/6
Standard of living	Cooking Fuel	The household cooks with dung, wood, charcoal or coal.	1/18
	Sanitation	The household's sanitation facility is not improved (according to SDG guidelines) or it is improved but shared with other households.	1/18
	Drinking Water	The household does not have access to improved drinking water (according to SDG guidelines) or safe drinking water is at least a 30-minute walk form home, round trip.	1/18
	Electricity	The household has no electricity.	1/18
	Housing	Housing materials for at least one of roof, walls and floor are inadequate: the floor is of natural materials and/or the roof and/or walls are of natural or rudimentary materials.	1/18
	Assets	The household does not own more than one of these assets: radio, TV, telephone, computer, animal cart, bicycle, motorbike or refrigerator, and does not own a car or truck.	1/18

- The global MPI can be used to create a **comprehensive picture of people living in poverty, and permits comparisons both across countries and world regions,** and within countries by ethnic group, urban/rural area, subnational region, and age group, as well as other key household and community characteristics.
- It **complements the international $1.90 a day poverty rate** by showing the nature and extent of overlapping deprivations for each person.
- The **2019 update of the global MPI** covers 101 countries—31 low income, 68 middle income and 2 high income.

India specific Findings

- **Improvement**
  - India lifted **271 million people out of poverty (down to 27.5 per cent from 54.7 per cent) between 2006 and 2016**, recording the fastest reductions in the multidimensional poverty index values during the period with strong improvements in areas such as "assets, cooking fuel, sanitation and nutrition.
  - **India's MPI value reduced from 0.283 in 2005-06 to 0.123 in 2015-16.**
  - Among the four Indian states with the most acute MPI — Bihar, Jharkhand, Uttar Pradesh and Madhya Pradesh — **Jharkhand has made the most progress.**
  - India **reduced:**
    - ✓ **deprivation in nutrition** from 44.3% in 2005-06 to 21.2% in 2015-16,
    - ✓ **child mortality** from 4.5% to 2.2%,
    - ✓ **people deprived of cooking fuel** from 52.9% to 26.2%,
    - ✓ **deprivation in sanitation** from 50.4% to 24.6%,
    - ✓ **deprivation of drinking water** from 16.6% to 6.2 %,
    - ✓ **access to electricity** as deprivation from 29.1% to 8.6%,
    - ✓ **housing** from 44.9% to 23.6%
  - Overall, India was among three countries where **poverty reduction in rural areas outpaced that in urban areas** is an indicator of pro-poor development.

Limitations of MPI

- The indicators **may not reflect capabilities** but instead reflect outputs (such as years of schooling) or inputs (such as cooking fuel).
- The health data are **relatively weak and overlook some groups' deprivations**, especially for nutrition.
- In some cases **careful judgments were needed to address missing data**.
- **Intra-household inequalities may be severe**, but these could not be reflected.
- MPI goes well beyond a headcount ratio to include the intensity of poverty, it **does not measure inequality among the poor**, although decompositions by groups can be used to reveal group-based inequalities.
- Estimates presented are based on publicly available data and cover various years between 2007 and 2018, which limits direct cross-country comparability.

1.5. What Causes Poverty

Economic Reasons

- Widespread unemployment and lack of gainful employment
- Lack of resources and wealth and inequality in wealth distribution
- Relatively lower rate of growth of income as compared to inflation
- Lack of capital and skill leading to a vicious circle of poverty
- Lower Per Capital Income
- Lack of professional and technical education and inadequate growth of industries

- Lower productivity in agriculture and industries
- Low level of wage rates
- Agriculture being over-burdened due to lack of alternative employment

Historical Reasons

- Exploitative colonial rule destroyed local industries i.e. de-industrialization and turned India into exporter of raw materials and imported of finished goods
- Destruction of rural and urban handicrafts and small scale industries
- Drain of Wealth by colonial government

Social Reasons

- High rate of population growth
- Social discrimination – caste system and gender gap
- Regional disparity among different states
- High out of pocket expenditure on healthcare services
- Illiteracy and lack of skill labour

Government Policies

- Giving more importance to heavy and capital industry after independence while majority of the population was engaged in agriculture
- Adopting the policies followed in western developed country without adapting them to suit Indian needs

Miscellaneous Reasons

- Frequent destruction of wealth due to natural disasters in some regions like floods etc.
- Corruption in implementing poverty alleviation schemes

1.6. Policies and Programmes Aimed At Poverty Alleviation

The Indian Constitution and five year plans state social justice as the primary objective of the developmental strategies of the government.

The government's approach to poverty reduction is of three dimensions. The *first one* is ***growth oriented approach***. It is based on the expectation that the effects of economic growth — rapid increase in gross domestic product and per capita income — would spread to all sections of society and will trickle down to the poor sections also. This was the major focus of planning in the 1950s and early 1960s. However, this approach could not produce desired outcome. Economists state that the benefits of economic growth have not trickled down to the poor.

The *second approach* is based on the ***creation of additional assets by means of work generation***. This approach has been initiated from the Third Five Year Plan (1961-66) and progressively enlarged since then. One of the noted programmes initiated in the 1970s was *Food for Work.*

Examples of self-employment programmes are

- Rural Employment Generation Programme (REGP)
- Prime Minister's Rozgar Yojana (PMRY)
- Swarna Jayanti Shahari Rozgar Yojana (SJSRY)

These programs aim at providing financial help to create self-employment opportunities for unemployed. Additionally, SJSRY also aims at creating wage employment.

- Swarnajayanti Gram Swarozgar Yojana (SGSY) - Earlier, under self-employment programmes, financial assistance was given to families or individuals. Since the 1990s, this approach has been changed. Now those who wish to benefit from these programmes are encouraged to form *self-help groups (SHGs)*. Initially they are encouraged to save some money and lend among themselves as small loans. Later, through banks, the government provides partial financial assistance to SHGs which then decide whom the loan is to be given to for self-employment activities. This has now been restructured as **Deendayal Antyodaya Yojana- National Rural Livelihoods Mission (DAY-NRLM)**. A similar programme called **Deendayal Antyodaya Yojana- National Urban Livelihoods Mission (DAY-NULM)** has also been in place for urban poor.

- **Mahatma Gandhi National Rural Employment Guarantee Act**- This has been termed as the biggest scheme for poverty alleviation. In August 2005, the Parliament passed this Act to provide guaranteed wage employment to every rural household whose adult volunteer is to do unskilled manual work for a minimum of 100 days in a year.
- **PM Kisan NIdhi Scheme**- As it uses direct income support (DIS), it marks the beginning of a new policy direction. It can reach about 86 per cent of farm families compared to loan waivers that can benefit a maximum of 30 per cent of the peasantry and higher MSP policy which can benefit a maximum of 10-15 per cent of peasantry.

The *third approach* to addressing poverty is to ***provide minimum basic amenities to the people***. This has been sought to achieve through provision of food grains at subsidised rates, education, health, water supply and sanitation. Programmes under this approach are expected to supplement the consumption of the poor, create employment opportunities and bring about improvements in health and education. One can trace this approach from the **Fifth Five Year Plan**- "even with expanded employment opportunities, the poor will not be able to buy for themselves all the essential goods and services. They have to be supplemented up to at least certain minimum standards by social consumption and investment in the form of essential food grains, education, health, nutrition, drinking water, housing, communications and electricity."

Three major programmes that aim at improving the food and nutritional status of the poor are Public Distribution System, Integrated Child Development Scheme and Midday Meal Scheme. Pradhan Mantri Gram Sadak Yojana, Pradhan Mantri Gramodaya Yojana, Valmiki Ambedkar Awas Yojana, Pradhan Mantri Awas Yojana are also attempts in developing infrastructure and housing conditions.

The government also has a variety of other social security programmes to help a few specific groups. National Social Assistance Programme is one such programme initiated by the central government. Under this programme, elderly people who do not have anyone to take care of them are given pension to sustain themselves. Poor women who are destitute and widows are also covered under this scheme. The government has also introduced a few schemes to provide health insurance to poor people. From 2014, a scheme called Pradhan Mantri Jan-Dhan Yojana is available in which are encouraged to open bank accounts. Besides promoting savings habit, this scheme intends to transfer all the benefits of government schemes and subsidies to account holders directly. Each bank account holder is also entitled to Rs. 1 lakh accident insurance and Rs. 30,000 life insurance cover.

1.7. Poverty Alleviation Programmes- A Critical Assessment

Identifying the multidimensional nature of poverty, various schemes are being implemented to address various facets of poverty. These schemes have given some good results as can be seen from following figures-

- The number of poor facing multidimensional poverty in India has nearly halved from 54.7% in 2005-06 to 27.5% in 2015-16.
- The ratio of poverty in India as per Tendulkar Committee stood at 21.9 % in 2011-12.
- The percentage of absolute poor in some states is well below the national average.

- There is improvement in terms of per capita income and average standard of living
- Housing has been provided to a sizeable population under various housing schemes.

However, despite various strategies to alleviate poverty, hunger, malnourishment, illiteracy and lack of basic amenities continue to be a common feature in many parts of India. Though the poverty alleviation programs have evolved progressively since independence but no radical change is observed in their character. None resulted in any radical change in the ownership of assets, process of production and improvement of basic amenities to the needy.

Major areas of concern which prevent successful implementation of these programs are-

- Unequal distribution of land and other assets, due to which the benefits from direct poverty alleviation programmes are appropriated by the non-poor.
- Compared to the magnitude of poverty, the amount of resources allocated for these programmes is not sufficient.
- These programmes depend mainly on government and bank officials for their implementation. Since such officials are ill motivated, inadequately trained, corruption prone and vulnerable to pressure from a variety of local elites, the resources are inefficiently used and wasted.
- There is also non-participation of local level institutions in programme implementation.
- High growth alone is not sufficient to reduce poverty. Without the active participation of the poor, successful implementation of any programme is not possible.
- Government policies also have proved inadequate to address the vast majority of vulnerable people who are living on or just above the poverty line.

1.8. Way Forward

The government should work towards effective implementation of various ongoing programs by-

- Sufficient allocation of resources
- Providing adequate training and incentives to government and bank officials implementing these programs
- Ensuring participation of local government and institutions
- Ensuring active participation of poor in these programs
- Effective distribution of wealth and benefits of economic growth

It has also been realized that poverty can effectively be eradicated only when the poor start contributing to growth by their active involvement in the growth process. This is possible through a process of social mobilisation, encouraging poor people to participate and get them empowered. This will also help create employment opportunities which may lead to increase in levels of income, skill development, health and literacy. Moreover, it is necessary to identify poverty stricken areas and provide infrastructure such as schools, roads, power, telecom, IT services, training institutions etc.

1.9. Poverty: Last One Decade

One of the great achievements in recent decades has been the huge reduction in the numbers of people living in extreme poverty, defined by the World Bank as $1.90 per person per day. India has been able to lift 270 million people out of poverty facing multidimensional poverty, thus reducing its poor population by nearly half. Yet new evidence from the World Bank shows that the rate of poverty reduction has halved since 2013. Extreme poverty is actually increasing in sub-Saharan Africa. This new evidence also shows that much of humanity has barely escaped poverty, with just under half the world's population – 3.4 billion people – subsisting on less than $5.50 a day, which is the World Bank's new poverty line for extreme poverty in upper-middle-income countries. The Bank finds that women are more often among the poorest people, particularly during their reproductive years, because of the level of unpaid care work they are expected to do. This is a direct result of inequality, and of prosperity accruing disproportionately to those at the top for decades.

1.9.1. Nobel Prize in Economics

Indian-American economist **Abhijit Banerjee** has won the **2019 Nobel Prize in Economics**, along with **Esther Duflo** of the Massachusetts Institute of Technology and **Michael Kremer** of Harvard University **"for their experimental approach to alleviating global poverty."** Their new experiment-based approach- called **Randomised Control Trials (RCTs)** has transformed development economics.

What are Randomised Control Trials?

- RCTs break larger questions about policy interventions into smaller, easier to test studies.
- For example, the big questions like 'poverty' are broken down into its various dimensions like- poor health, inadequate education, etc.
- Within poor health, they look at nutrition, provisioning of medicines, and vaccination, etc. Within vaccinations, they try to conduct various experiments and, based on such "evidence", decide what needs to be done.
- This is extremely relevant when it comes to framing policy in low- and middle-income countries, where state capacity is quite limited and it is particularly necessary to be able to prioritise more effective policies over less.

How RCTs Work?

- For instance, if one wanted to understand whether providing a mobile vaccination van and/or a sack of grains would incentivise villagers to vaccinate their kids, then under an RCT, village households would be divided into four groups A, B, C and D.
  - Group A would be provided with a mobile vaccination van facility,
  - Group B would be given a sack of food grains,
  - Group C would get both, and
  - Group D would get neither.
- Households would be chosen at **random** to ensure there was no bias, the groups are equal, and that any difference in vaccination levels was essentially because of the "intervention".
- Group D is called the "**control**" group while others are called "**treatment**" groups.
- Such an experiment would not only **show whether a policy initiative works**, but would also provide **a measure of the difference it brings about.**
- It would also show what happens when more than one initiatives are combined. This would help policymakers to have the evidence before they choose a policy.

Is there a flip side to RCTs?

- Randomly assigning people or households makes it likely that the groups are equivalent, but randomisation **"cannot guarantee" it.**
- So, one group may perform differently from the other, not because of the "treatment" that it has been given, but because it has more women or more educated people in it.
- Also, RCTs do not guarantee if something that worked in Kerala will work in Bihar, or if something that worked for a small group will also work at large scale.

Some studies using RCTs

- **On vaccination:**
  - **Problem**: Low service quality one reason why poor families invest so little in preventive measures. For example, the staff at the health centres that are responsible for vaccinations are often absent from work.
  - **Solution**: Mobile vaccination clinics, where the care staff were always on site – could fix this problem. Vaccination rates tripled in the villages that were randomly selected to have access to

these clinics, at 18 per cent compared to 6 per cent.
    - This increased further, to 39 per cent, if families received a bag of lentils as a bonus when they vaccinated their children.
    - Because the mobile clinic had a low level of fixed costs, the **total cost per vaccination actually halved, despite the additional expense of the lentils.**
- **On education:**
    - **Problem:** In many poor country's schools, curricula and teaching do not correspond to pupils' needs. There is a high level of absenteeism among teachers and educational institutions are generally weak.
    - **Solutions:** Reason for high level of absenteeism **was lack of clear incentives and accountability for teachers.** One way of boosting the teachers' motivation was **to employ them on short-term contracts that could be extended if they had good results**.
    - Experiments found that pupils who had teachers on short-term contracts had significantly better test results, but that having fewer pupils per permanently employed teacher had no significant effects.
    - Studies suggested that additional resources are, of limited value whereas, **targeted support for weak pupils had strong positive effects**, even in the medium term.
- **On health subsidy:**
    - **Question:** Whether medicine and healthcare should be charged for and, if so, what they should cost?
    - **Experiment:** A field experiment showed how the demand for deworming pills for parasitic infections was affected by price. They found that 75 per cent of parents gave their children these pills when the medicine was free, compared to 18 per cent when they cost less than a US dollar, which is still heavily subsidised.
    - **Inference:** Poor people are extremely price-sensitive regarding investments in preventive healthcare.

2. Inequality

"You need some inequality to grow... but extreme inequality is not only useless but can be harmful to growth because it reduces mobility and can lead to political capture of our democratic institutions." – Thomas Piketty.

The above quote points towards the perils of rising inequality which as per various reports is on an upward trajectory worldwide. There is widespread concern that economic growth has not been fairly shared, and that the economic crisis has only widened the gap between rich and poor. Similar concerns were voiced by former US President Barack Obama in 2013 when he termed **inequality as 'the defining challenge of our time'.**

2.1. What is inequality?

The Cambridge dictionary describes inequality as "the unfair situation in society when some people have more opportunities, etc. than other people". The United Nations describes it as "the state of not being equal, especially in status, rights and opportunities". While the term itself is quite vast and has various interpretations, **here, we are concerned with "economic inequality" and its relationship with poverty**. Economic inequality generally refers to the disparity of wealth or income between different groups or within a society. Often characterized by the aphorism "**the rich get richer while the poor get poorer**," the phrase often refers more specifically to **the gap in income or assets between the poorest and richest** segments of an individual nation.

Income inequality is the inequality in and disparity in the incomes commanded by the top percentile of the population in comparison to the bottom percentiles, while **wealth inequality** measures look to do the same but by calculating disparities in wealth instead of income.

Economic inequality is used to measure relative poverty with the help of **Lorenz curve**.

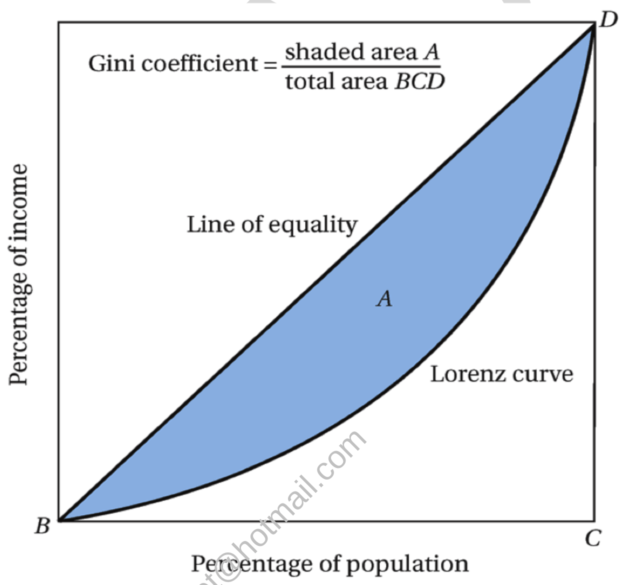
2.2. Significance of Economic Inequality

Even though the basic concept of inequality has entered the public consciousness, the effects of highly concentrated wealth are hotly debated and poorly understood by observers. Research attributes advantages and disadvantages to pronounced levels of economic inequality. Global trends have led to an increasing concentration of wealth in an increasingly small number of hands. Some economists conclude inequality is beneficial overall for stimulating growth, improves the quality of life for all members of a society, or is merely a necessary part of social progress. Other economists claim wealth concentrations create perpetually oppressed minorities, exploit disadvantaged populations, hinder economic growth, and lead to numerous social problems.

2.3. Measuring Economic Inequality

- **Indices**

A. Gini Coefficient/ Gini Index



Gini coefficient is the most widely used measure of inequality. It is based on Lorenz curve. The Lorenz curve plots percentiles of the population on the horizontal axis and corresponding cumulative income or wealth on the vertical axis.

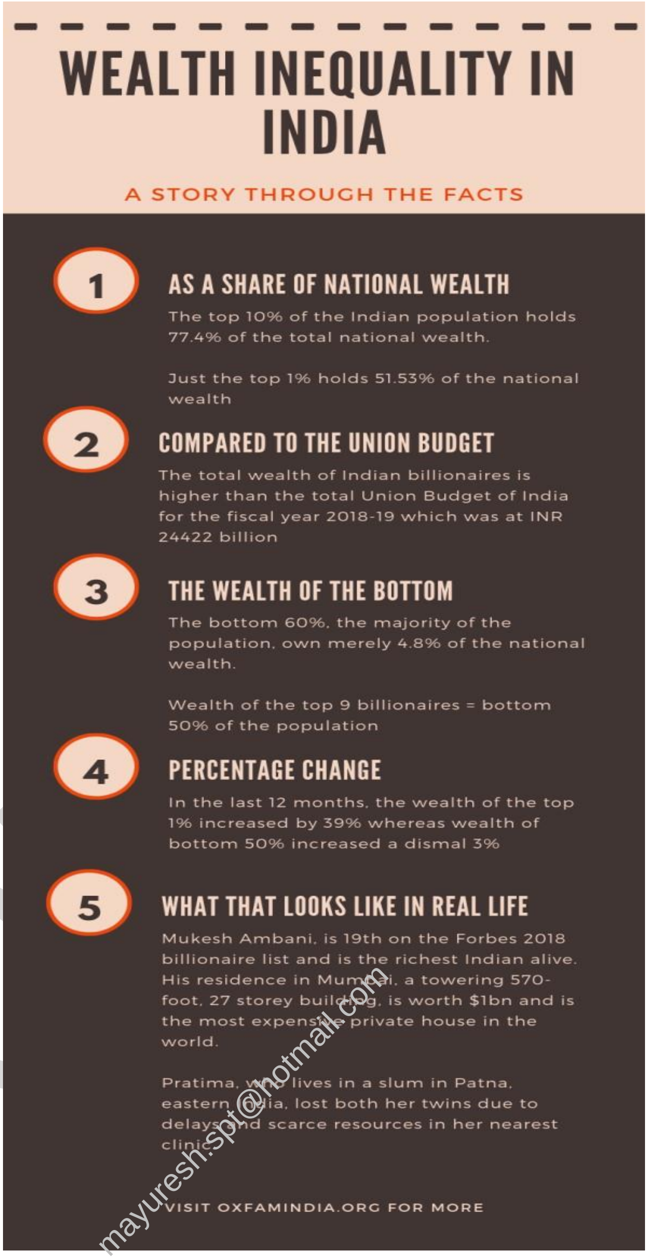
The Lorenz curve is often accompanied by a straight diagonal line with a slope of 1, which represents perfect equality in income or wealth distribution; the Lorenz curve lies beneath it, showing the actual distribution. **Gini coefficient is the area between the straight line and the curved line which is expressed as a ratio of the area under the straight line.** A coefficient of 1 means that one person earns all of the income or holds all of the wealth, while zero represents that everyone has the same income, i.e. perfect equality.

World Bank data reveals that inequality in India is on the rise with all-India Gini coefficient increasing from 0.30 in 1983 to 0.36 in 2011-12. As per United Nations, the Gini coefficient of income inequality for India fell from 0.36 in 2010 to 0.33 in 2015.

Shortcomings of Gini Coefficients

Though useful for analyzing economic inequality, the Gini coefficient has some shortcomings. Its main limitation is that it **is not easily decomposable or additive**. Also, it **does not respond** in the same way to income transfers between people in opposite tails of the income distribution as it does to transfers in the middle of the distribution. Furthermore, very **different income distributions** can present the same Gini coefficient. It also **does not show demographic variations** among subgroups within the distribution, such as the distribution of incomes across age, race, or social groups. In that vein, **understanding demographics** can be important for understanding what a given Gini coefficient represents. For example, a large retired population pushes the Gini higher.

Also, the metric's accuracy is dependent on **reliable GDP and income data**. Shadow economies and informal economic activity are present in every country. **Informal economic activity** tends to represent a larger portion of true economic production in developing countries and at the lower end of the income distribution within countries. In both cases this means that the Gini index of measured incomes will overstate true income inequality. Accurate wealth data is even more difficult to come by due to the popularity of tax havens.



B. Atkinson's inequality measure (or Atkinson's index)

This is the most popular **welfare-based measure of inequality**. It presents the percentage of **total income that a given society would have to forego** in order to have more equal shares of income between its citizens. This measure depends on the degree of society aversion to inequality (a theoretical parameter decided by the researcher), where a higher value entails greater social utility or willingness by individuals to accept smaller incomes in exchange for a more equal distribution. An important feature of the Atkinson index is that it can be decomposed into within and between-group inequality. Moreover, unlike other indices, it can provide welfare implications of alternative policies and allows the researcher to include some normative content to the analysis

C. Hoover index (also known as the Robin Hood index, Schutz index or Pietra ratio)

It shows the proportion of all income which would have to be redistributed to achieve a state of perfect equality. In other words, the value of the index approximates the share of total income that has to be transferred from households above the mean to those below the mean to achieve equality in the distribution of incomes. Higher values indicate more inequality and that more redistribution is needed to achieve income equality. It can be graphically represented as the maximum vertical distance between the Lorenz curve and the 45-degree line that represents perfect equality of incomes.

D. Theil index and General Entropy (GE) measures

The values of the GE class of measures vary between zero (perfect equality) and infinity (or one, if normalized). A key feature of these measures is that they are fully decomposable, i.e. inequality may be broken down by population groups or income sources or using other dimensions, which can prove useful to policy makers. Another key feature is that researchers can choose a parameter α that assigns a weight to distances between incomes in different parts of the income distribution. For lower values of α, the measure is more sensitive to changes in the lower tail of the distribution and, for higher values, it is more sensitive to changes that affect the upper tail. The most common values for α are 0, 1, and 2. When α=0, the index is called “Theil’s L” or the “mean log deviation” measure. When α=1, the index is called “Theil’s T” index or, more commonly, “Theil index”. When α=2, the index is called “coefficient of variation”. Similarly to the Gini coefficient, when income redistribution happens, change in the indices depends on the level of individual incomes involved in the redistribution and the population size.

- **Ratios**

Ratios constitute the most basic inequality measures available. They are simple, direct, easy to understand, and they offer few data and computation challenges. Accordingly, they do not provide as much information as the complex measures described above.

A. Decile dispersion ratio (or inter-decile ratio)

It is the ratio of **the average income of the richest x per cent of the population to the average income of the poorest x per cent**. It expresses the income (or income share) of the rich as a multiple of that of the poor. However, it is vulnerable to extreme values and outliers. Common decile ratios include: D9/D1: ratio of the income of the 10 per cent richest to that of the 10 per cent poorest; D9/D5: ratio of the income of the 10 per cent richest to the income of those at the median of the earnings distribution; D5/ D1: ratio of the income of those at the median of the earnings distribution to the 10 per cent poorest. The Palma ratio and the 20/20 ratio are other examples of decile dispersion ratios.

B. Palma Ratio

The Gini coefficient doesn't capture very explicitly changes in the top 10% - which has become the focus of much inequality research in the past 10 years - or the bottom 40%, where most poverty lies. Palma ratio is the ratio of national income shares of the top 10 per cent of households to the bottom 40 per cent. If the richest 10% of the population has five times the income of the bottom 40%, a country's Palma ratio is 5. The Palma ratio has been listed in the OECD rankings of countries' inequality, and in annual UN Human Development reports, alongside the Gini.

C. 20/20 Ratio

It compares the ratio of the average income of the richest 20 per cent of the population to the average income of the poorest 20 per cent of the population. Used by the United Nations Development Programme Human Development Report (called “income quintile ratio”).

2.4. Rising Inequality?

Oxfam 2019 report titled- “Public Good or Private Wealth?” provides following data about the **inequality existing in India**-

- **1%-** The top 10% of the Indian population holds 77% of the total national wealth. **73% of the wealth generated in 2017 went to the richest 1%**, while 67 million Indians who comprise the poorest half of the population saw only a 1% increase in their wealth.
- **70-** There are 119 billionaires in India. Their number has increased from only 9 in 2000 to 101 in 2017. Between 2018 and 2022, India is estimated to produce **70 new millionaires every day**.
- **10x-** Billionaires' fortunes **increased by almost 10 times over a decade** and their total wealth is higher than the entire Union budget of India for the fiscal year 2018-19, which was at INR 24422 billion.
- **63 M-** Many ordinary Indians are not able to access the health care they need. 63 million of them are **pushed into poverty because of healthcare costs every year** - **almost two people every second**.
- **941 years-** It would take 941 years for a **minimum wage worker** in rural India **to earn what the top paid executive** at a leading Indian garment company **earns in a year**.

Inequality in World

- According to Oxfam's report-
  - In 2018, world's 26 people owned the same wealth as the poorest 50% i.e. 3.8 billion people.
  - In the 10 years since the financial crisis, the number of billionaires has nearly doubled.
  - Between 2017 and 2018 a new billionaire was created every two days.
  - The world's richest man, Jeff Bezos, the owner of Amazon, saw his fortune increase to $112bn. Just 1% of his fortune is equivalent to the whole health budget for Ethiopia, a country of 105 million people.
- The World Inequality Report 2018 showed that between 1980 and 2016 the poorest 50% of humanity only captured 12 cents in every dollar of global income growth. By contrast, the top 1% captured 27 cents of every dollar.

Thus the inequality is on an increasing trend in the world as well as in India.

2.5. Causes of Inequality

Some economists suggest following reasons for the widening inequality in India-

A. Inequitable and Uneven Distribution of Economic Growth
- India's economy continues to grow with its GDP rising faster than most nations but people living at the bottom 10% are characterized by low wages; long working hours; lack of basic services such as first aid, drinking water and sanitation.
- Phenomenon of billionaire boom is a symptom of failing economic system where those who are working hard, growing food for the country, building infrastructure, working in factories are struggling to fund their child's education, buy medicines for family members and manage two meals a day.

B. Oxfam report 2019 puts the blame for increasing inequality on biased economic framework towards rich, where
- Top rates of tax on the wealthiest people and corporations are lower than they have been for decades.
- Unprecedented levels of tax avoidance and evasion ensure that the super-rich pay even less.

C. Urban- Rural Inequality
- India's badly shaped agricultural and rural safety nets. Per capita food production is going down. Rural infrastructure such as power, road transport facilities are in a poor state.

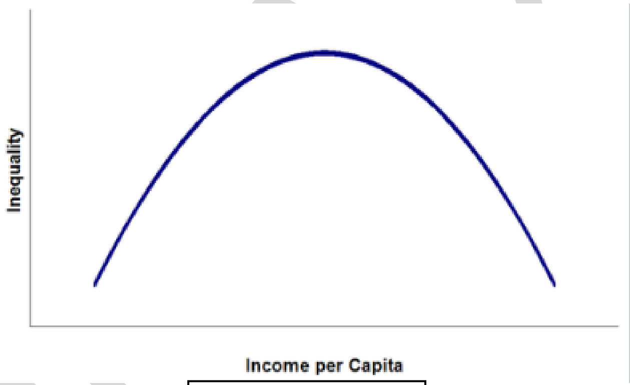
- Rural job scheme and public distribution system performing far below their potential. This has added to the suffering of rural India while market forces are acting in favour of urban India, which is why it is progressing at a faster rate."

2.6. Inequality, Poverty and Economic Growth

Economic growth and inequality play a major role in generating changes in poverty. High and sustained growth is essential for poverty reduction if the distribution of income remains more or less constant. Likewise, greater inequality tends to increase relative poverty. For these reasons, rise in growth has not led to commensurate reduction in poverty in countries where income inequality has been rising.

2.6.1. Inequality and Economic Growth

The relationship between growth and inequality has long been an important question for economists, and a number of influential theories have emerged over the years. But for most people, the issue boils down to this: is rising inequality good or bad for growth? Those who believe it's good, or at least necessary, argue that it provides incentives to entrepreneurs and a source of overall investment for the economy. Those who believe it's bad argue that it can prevent poorer people from investing in their education and encourage the rich to grab a bigger slice of the economic pie without making the pie any bigger.



Kuznets Curve

Kuznets curve provides a way to study the relationship between inequality and economic growth. It says that **as the economy grows, inequality increases in the beginning and then it decreases** with further growth in economy.

As per **Kuznets hypothesis**, as economic growth comes from the creation of better products, it usually boosts the income of workers and investors who participate in the first wave of innovation. The industrialisation of an agrarian economy is a common example. This inequality, however, tends to be temporary as workers and investors who were initially left behind soon catch up by helping offer either the same or better products. This improves their incomes.

Inequality is good for the Growth

- Drives growth by allowing entrepreneurs – like Apple's Steve Jobs or HTC's Cher Wang – to enjoy the rewards of their risk-taking.
- Light tax and relatively little distribution allow people to accumulate wealth becoming sources for investment for the economy.

Inequality is bad for Growth

- A widening wealth gap leads low-earning families to invest less in education and skills. This probably hurts growth by reducing the number of skilled – and more highly productive – workers available for hire in the economy
- In OECD countries, the average increase in inequality of 3 Gini points over the past couple of decades is estimated to have cut GDP by around 8.5%.

2.6.2. Inequality and Poverty

The continued accumulation of wealth by the very richest in our societies, while most of humanity subsists on barely anything, is extremely detrimental. **Relative poverty** has in present times been recognized as **growing inequality** and the main form of poverty in industrialized countries. Also, inequality affects the rate of economic growth which is very important for poverty reduction.

Even, the United Nations Sustainable Development Goals recognizes the role of inequality in making the fight to end poverty much harder. Goal 10 of SDG talks about "**Reduced Inequalities**" which can be achieved by equitable and just distribution of benefits of economic growth to the poorest people. **As per the World Bank, unless growth benefits the poorest people more between now and 2030, the first Sustainable Development Goal (SDG) – to eliminate extreme poverty – will be missed.** Thus, inequality affects poverty both- directly and indirectly.

Other Impacts of Inequality

- The growing income inequality in India has negatively impacted poor citizens' access to education and healthcare.
- Rising income inequality makes it difficult for the poor to climb up the economic ladder and increases their risk of being victims to poverty trap.
- Worldwide, the human cost of inequality is devastating. Today:
    - 262 million children will not be allowed to go to school.
    - Almost 10,000 people will die because they cannot access healthcare.
    - 4 billion hours of unpaid care work will be done, the majority by women in poverty.
- Inequality is destabilizing. For instance, in recent years we have seen a rise in authoritarianism by governments worldwide, with crackdowns on freedom of speech and democracy. We have also seen a rise in popularity for right-wing, racist, sexist views and authoritarian politicians who support them. Many have pointed to the link between this global trend and high levels of inequality.
- Inequality undermines our societies. It is bad for everyone, not just the poorest people. In more unequal countries, trust is lower and crime higher. Unequal societies are more stressed, less happy and have poorer mental health.
- Inequality makes the fight to save our planet from climate breakdown even harder. Oxfam has shown that the average carbon footprint of the richest 1% globally could be as much as 175 times higher than that of the bottom 10%.

2.7. Role of Government in Reducing Inequality

Current crisis of inequality is the direct result of the moral failure of present governance and market system which allows few persons to accumulate extreme wealth while masses languish in poverty. Such exclusive, highly unequal society may seem sturdy and inevitable in short term, but eventually it will collapse. Eventually the pitchforks will come out, and the ensuing chaos will not benefit anyone – not the wealthy people, and not the poorest people who have already been left behind. To avert this existential crisis, steps must be taken to not reward greed at the expense of future. The present system must be replaced with a new economic framework – what Oxfam has called a **more 'Human Economy'**, which recognizes that justice and inclusion are not the result of economic prosperity, but rather the cause of economic prosperity.

Governments face a stark choice today – a choice between a life of dignity for all their citizens or continued extreme wealth for a tiny few. The lesson is clear: to beat poverty, we must fight inequality.

2.8. Steps Taken to Tackle Income Inequality

- Government of India has taken various steps to reduce income inequality-
  - Progressive taxation policy which taxes the rich more.
  - Land reforms and redistribution of surplus land after independence.
  - Various social security measures such as pensions, subsidized foodgrains through PDS etc.
  - Introduction of the three pronged Jan Dhan-Aadhaar-Mobile programmes aimed at a comprehensive strategy of inclusion, financial empowerment and social security.
  - Minimum wage rates have been revised upwards from time to time.
  - Provision of free of cost education and health services, however, these services need significant improvement.
- **Beyond extreme poverty: A focus on the bottom 40:** Sustainable Development Goal 10 presents to the international community the following task: ensure that the income growth of the bottom 40% of their population is higher than the national average by the year 2030.
- The World Bank in 2013 introduced **shared prosperity**, defined as the growth in the average income or consumption of the poorest 40 percent of the distribution in the population, as one of the twin goals, along with ending extreme poverty.

2.9. Way Forward

Specifically, **policy measures in three areas** will be critical:

- Inclusive growth and the expansion of productive employment.
- Redistribution of incomes and assets.
- Pro-poor macro-economic policies.

Oxfam has given following recommendations to reduce Income Inequality in India-

- Address the needs of the **underfunded social sector in India**. More public resources should be mobilised for providing basic essential services like health and education, social protection, etc. to reach out to the poor and excluded. The affirmative policy interventions like Gender Budgeting, Scheduled Caste Sub Plan, Tribal Sub Plan, etc. must be implemented properly.
- **Promote inclusive growth** by encouraging labour-intensive sectors that will create more jobs; investing in agriculture; and effectively implementing the social protection schemes that exist.
- In taxation, the focus should be more on **generating revenue from direct taxes**. Ensure proper mobilisation of property & wealth taxes. Rationalize corporate tax exemptions/incentives.
- **Scrutinise the new Goods and Services Tax (GST) regime** from the perspective of the poor. The rates for different commodities should be such that they do not place an unfair burden of taxes on the poor households.
- It also sought **sealing of the "leaking wealth bucket"** by taking stringent measures against tax evasion and avoidance, imposing higher tax on super-rich and removing corporate tax breaks.

3. Previous Years UPSC Mains Questions

1. Explain various types of revolutions, took place in Agriculture after Independence in India. How these revolutions have helped in poverty alleviation and food security in India?
2. Establish the relationship between land reform, agriculture productivity and elimination of poverty in Indian Economy. Discussion the difficulty in designing and implementation of the agriculture friendly land reforms in India.

3. Pradhan Mantri Jan-Dhan Yojana (PMJDY) is necessary for bringing unbanked to the institutional finance fold. Do you agree with this for financial inclusion of the poorer section of the Indian society? Give arguments to justify your opinion.
4. Capitalism has guided the world economy to unprecedented prosperity. However, it often encourages shortsightedness and contributes to wide disparities between the rich and the poor. In this light, would it be correct to believe and adopt capitalism driving inclusive growth in India? Discuss.

4. Previous Years Vision IAS GS Mains Questions

1. ***The idea of Universal Basic income has gained appeal in recent months. Enumerating the challenges in its implementation, discuss whether it can be a potent tool to reduce leakages in the system and address inequality in the economy.***

Approach:

- Briefly explain the idea of Universal Basic Income (UBI).
- Discuss UBI as tool for reducing leakages and inequality.
- List the challenges in its implementation.
- Conclude about its desirability in India.

Answer:

Universal Basic Income is a radical and compelling paradigm shift to ensure social justice along with a productive economy. It is premised on the idea that a just society needs to guarantee to each individual a minimum income which provides the necessary material foundation for a life with access to basic goods and a life of dignity.

Potent tool to reduce leakages and reduce inequality

- **Direct transfer**: UBI reduces out of system leakage because transfers are directed straight to the beneficiaries' bank accounts.
- **Reduced opportunities**: The scope for diversion is reduced considerably, since discretionary powers of authorities are eliminated almost wholly.
- **Increased accountability**: Furthermore, UBI's expanded coverage will likely impact out of system leakage since the state is answerable to a larger section of its citizens.
- **Better monitoring**: Finally, given the fewer avenues for leakages, monitoring a UBI would be easier than many other schemes.

UBI has immense potential to reduce inequality by way of direct and indirect effects.

- **Direct effects** include: redistribution of wealth, creating flexibility in labour market, enhancing productivity, positively affecting education.
- **Indirect longer-term effects** include: increased entrepreneurship and large multiplier effects, increased number choices for education and enhanced participation in democracy. All these will lead to even greater reduction in inequality than might be immediately apparent.

Challenges in its implementation

- Given the current status of financial access among the poor, a UBI may put too much **stress on the banking system**
- **Gender disparity induced by cash**- Gender norms may regulate the sharing of UBI within a household – men are likely to exercise control over spending of the UBI. This may not always be the case with other in-kind transfers.

- **Fiscal cost given political economy of exit** -Once introduced, it may become difficult for the government to wind up a UBI in case of failure.
- Opposition may arise from the provision of the **transfer to rich individuals** as it might seem to trump the idea of equity and state welfare for the poor.
- **Exposure to market risks (cash vs. food)-** Unlike food subsidies that are not subject to fluctuating market prices, a cash transfer's purchasing power may severely be curtailed by market fluctuations
- **Moral Hazard**- A minimum guaranteed income might make people lazy and opt out of the labour market.

In spite of various challenges, implementing UBI in India is desirable due to high inequality, weaknesses in existing welfare schemes (which are riddled with misallocation, exclusions and leakages) and fast progress in JAM scheme. Moreover UBI stands greater chance in a developing country like India, where it can be pegged at relatively low levels of income but still yield immense welfare gains.

2. *Briefly highlight the parameters used by the government to determine the extent of poverty in India. Examine the relationship of economic growth and poverty alleviation in the post-reforms era.*

Approach:

- The answer should begin with a very brief definition of poverty, and how it is measured.
- Mention the different figures arrived at by Rangarajan and Tendulkar methodology.
- Then the answer should discuss the lack of consensus among scholars as to the efficacy of various methods and criteria to measure poverty estimates.
- The second part has to discuss the rise or fall of poverty with economic growth since the dawn of economic reforms. This part should end with an assessment with supportive argument.

Answer:

Poverty is a state of deprivation, in which some people are not able to meet their basic needs. For evaluating the effectiveness of poverty alleviation programs, we need to measure the extent of poverty, which is done using a poverty line. In India, Poverty line was determined by erstwhile Planning Commission based on consumption data provided by NSSO. However, what constitutes the representative basket of consumption is debatable and is decided differently by different committees. The two most common parameters are income and energy requirement for meeting basic demands.

Rangarajan Methodology: the latest It used the following parameters:

- 'Monthly expenditure of a Household of five', such as house rent, electricity etc.
- Certain normative levels of 'adequate nourishment' plus clothing, house rent, conveyance, education.
- Behaviorally determined level of other non-food expenses.
- For the first time, apart from calorie, it also considered fats and proteins as part of normative nutrition.

Based on these, it fixed Rs. 972 in rural and Rs. 1407 in urban areas as poverty line. Accordingly, the all-India poverty ratio was 29.5% and 38.2%, in 2011-12 and 2009-2010, respectively. This was quite high than 21.9% and 29.8% as estimated by the

Tendulkar Committee methodology for the corresponding periods. These contrasting estimates were due to different methodologies adopted.

Impact of economic reform on poverty:

There are two conclusions on trends in poverty:

- Poverty declined by 1.3 percentage points per annum after 1991, compared to that of 0.44 percentage points per annum prior to 1991. Among other things, urban growth is the most important contributor to the rapid reduction in poverty in the post-reform period.
- In the post-reform period, poverty declined faster in the 2000s than in the 1990s.

According to Tendulkar committee, around 138 million people were lifted above the poverty line during 2004 to 2009 alone. Rangarajan committee report also showed faster reduction in poverty during 2009-10 to 2011-12. This indicates the success of reforms in reducing poverty.

Statistically, change in poverty can be separated into two components (assuming constant inflation indexed poverty line) - Growth and redistribution of income. If distribution (i.e. inequality) remains constant, only through growth can poverty be addressed.

However, as inequality increases, as has been the case in India, the growth would have to outstrip the pace of increase in inequality in order to reduce poverty. Another way of seeing this is that if the incomes of the super-rich increase at a higher pace (causing increasing inequality), the pace of increase of income of the people below poverty line would have to be higher. This is highly unlikely.

In this kind of scenario, there has be forced redistribution on part of the government. With government adding to incomes of poor through welfare schemes, the net growth of real income of poor becomes higher, contributing to reduced poverty.

Higher economic growth, agriculture growth, rural non-farm employment, increase in real wages for rural labourers, employment in construction and programmes like the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) contributed to higher poverty reduction in the 2000s compared to the 1990s.

World Bank in its latest report also estimated that based on $1.90 income to measure extreme poverty, India's actual extent of poverty may be much less (approx. 11%). Still, 300 million people live below the poverty line in India.

Issues with poverty measurement

- No unanimity on appropriate parameters among different scholars, as shown above.
- Poverty line mainly focuses on economic criteria, whereas poverty may also have social, cultural, and political aspects, which are not addressed by the current approach.

Way forward

- Use the recently concluded Socio-Economic Caste Census for more effective targeting as it's based on 7 parameters to identify the poor.
- Accelerate economic growth along with redistributive justice, for eliminating poverty in medium to long term. For this we need to effectively implement the Sustainable Development Goals.

3. *Despite the potential of Special Employment Programmes in alleviating poverty, their impact has largely been limited. Comment. Also discuss how they can be made more effective.*

Approach:

- By giving introduction in brief mention some Special Employment Programmes.
- Discuss the role of Special Employment Programmes in alleviating property and how their role is limited.
- Suggest some measures to make these programmes more effective.

Answer:

Since the 5th five- year plan, India has launched several special employment generation programs targeting poverty.

These programmes largely fall into two categories:

- Self-Employment Programmes: These include programmes like PM's Employment Generation Programme (PMEGP), NRLM, NULM etc.

Shortcomings:

- Lack of adequate financial resources, skills and capacity, and sustained institutional support.
- Low survival rate of promoted micro-enterprises.
- Bureaucratic apathy and corruption at all levels.
- The incidences of red-tapism by banks.
- Wage Employment Programmes

Under this the flagship program is MGNREGA, launched in 2005 with legal backing guaranteeing 100 days of wage employment on demand at statutory minimum wages, to people in all rural areas.

Shortcomings:

- Work is not adjusted to agricultural lean season resulting in workers migrating for work during the lean season.
- Local government machinery not able to provide work for lack of technical and managerial capability.
- Corruption and fudging of rolls.
- Delayed or non-payment of wages.
- Non maintenance of assets created under it.
- Focus on manual labor with little or no provision of skill development and its utilisation.

Steps to make programs more effective:

- Link them with the infrastructural development programmes.
- Strict monitoring and evaluation made part of the implementation plan.
- Programmes should not be judged only for the economic impacts but for non-economic ones also.
- PRIs also need to be strengthened, especially for extracting accountability.
- MGNREGA work needs to be in line with lean agricultural season.
- MGNREGA should be integrated with the ongoing development programme, including skills and training.
- Transfering cash directly to intended beneficiaries.

Poverty is one of the evils that act as a major impediment in the development of the country. To eradicate poverty and to achieve social inclusion these employment generation programmes are a necessity. To a make them successful they needs to be dove-tailed with JAM (Jan Dhan, Aadhar and mobile banking) and universal social protection scheme (excluding the better off groups). Also **universal basic income** as a concept is good in tackling the problem of poverty but it need to vetted first.

4. Discuss Financial Inclusion as a mean to Inclusive Growth? Also identify the associated issues.

Approach:

Focus on showing 'clearly' how the financial services will help disadvantages section to come out of poverty. Then discuss a few reasons why we are not able to achieve financial inclusion.

Answer:

- Financial inclusion is envisaged to enormously empower the poor through low cost banking services and credit, at an affordable cost to the vast sections of disadvantaged and low-income groups.
- In India, more than 40 per cent of households avail no banking service at all. The ratio of total bank credit outstanding to GDP is only about 57 per cent as against over 140 per cent in East Asia and Pacific. Insurance premia account for less than 1 per cent of GDP, which is only about a third of the international average.
- Owing to difficulties in accessing formal sources of credit, poor individuals and small and macro enterprises usually rely on local moneylenders, who charge exhorbitant interest rates and hence they are unable to come out of their poverty trap. Access to low cost financial services allows the poor to save money outside the house safely, prevents concentration of economic power with a few individuals.
- Among the key financial services that are of great relevance here are risk management or risk mitigation services vis-à-vis economic shocks. Such shocks may be an income shock due to adverse weather conditions or natural disasters, or an expenditure shock due to health emergencies or accidents, leading to a high level of unexpected expenditure. This aspect of financial inclusion is of vital importance in providing economic security to individuals and families.
- Financial services will help in getting easy credit for the small businesses and farmers in agriculture as well. It affects the extent of entrepreneurship and of competition. Though financing of first time entrepreneurs is risky but it a must for inclusive growth. Similarly growth in agriculture will be more of inclusive nature.
- Govt is increasingly relying on banking services e.g. direct cash benefits and insurances products etc., to provide benefits to the disadvantaged sections under various schemes. This helps in better monitoring of schemes and ensures that there are less leakages of money. These efforts will only bring fruit if people are financially inclusive.
- Issues:
  i. Often people do not have proof of identity to represent themselves formally to get into the financial system.
  ii. Govt. banks have limited capacity and private banks are not willing to expand their branches in rural areas.
  iii. People lack awareness and access to the sources of information.
  iv. Microfinance institutions have exploited the rural masses e.g. chit fund scams

or other financial frauds in rural areas.

v. High transactions costs relative to size of accounts are also the main reason for low banking coverage and this is compounded by high risk perception of banks, in part because of lack of insurance.

vi. Agriculture and other forms of MSMEs are particularly ill-served and the situation has in fact deteriorated in some ways over the last two decades because of problems afflicting the cooperative banking sector.

vii. Reaching out to the illiterate people or people who can handle only the regional languages is also difficult without developing a suitable communication mode.

- The promotion of financial inclusion can be done in two major ways:
  1. by expanding the role of the formal financial system, including banking.
  2. through the growth of micro-finance institutions in rural and urban areas.
- Expansion of banking infrastructure, opening new branches, zero-frills bank accounts, banking correspondents(BCs) (use of services of intermediaries in providing financial and banking services through the use of Business Facilitators (BFs) and Business Correspondents (BCs), setting up of ultra small branches etc. are a few of the modalities under financial inclusion strategies of the govt.

5. Most rural poor are excluded from the ambit of the formal financial system, which raises their dependence on informal sources as well as exposure to financial distress. In this context, explain why formal sector lending, especially to farmers, is so limited. Also suggest some steps that need to be taken to increase access to formal credit in rural areas.

Approach:

- Introduce the statement by writing about ineffectiveness of formal financial system in rural areas.
- Discuss the limitation of the government's financial initiatives in rural areas.
- List the relevant remedies.

Answer:

The ratio of agricultural credit to agricultural GDP has increased from 10 per cent in 1999-2000 to around 38 per cent by 2012-13. However, the share of long-term credit in agriculture or investment credit has declined (55 % in 2006-07 to 39% in 2011-12). Moreover the following trends depict the issues with formal credit in rural sector:

- **Inequity in credit disbursed**—the share of loans above Rs.10 lakh is going up and over a quarter of the credit is advanced from urban and metropolitan branches of banks. These loans mostly cater to input dealers, agri-businesses such as food and agro-processing industries and warehousing companies.
- **Steady share of informal sector** in loans to agricultural households (around 40% between 2003 and 2013).
- **The declining share of small loans (less than 2 lakh)**.
- **March Phenomenon**-banks lent over 46% of agricultural credit between January and March— perhaps to meet year-end targets —although farm loans are most likely required before the crop season begins, around June and November.

Reasons for limited formal nature of credit to farmers

- Banks' reluctance to lend to small farmers which is further accentuated by **inherent risks (say, deficit or unseasonal rains)** associated with farming. Partly, the decline could also be due to **rising costs of cultivation, inflationary pressures, and more people moving out of farming**

- A large share of credit has channelized through **non-bank financial intermediaries without collateral;** in contrast to commercial banks, which requires collateral. But they charged higher rate of interest and resorted to coercive practices (example: microfinance crisis in Andhra Pradesh. The credit disbursed by MFIs has not resulted in raising agricultural productivity because these loans require regular monthly repayments and regular meeting and oversight on borrowers)
- **A part of credit under priority lending and interest subvention scheme being diverted to agribusiness, input dealers etc.**
- High cost of disbursing loans in rural areas and mandated interest rates being too low under various schemes.
- Rural branches have declined to 37% of total branches from 54% in 1994.

Steps required to be taken

- **Priority Sector Lending Certificate (PSLCs):** it will provide a market-driven incentive for efficiency, will enable banks to sell their surplus lending and thus earning a premium for their efficiency/geographical spread. RBI has already issued instructions on trading in Priority Sector Lending Certificates in April this year.
- **Popularising Negotiable Warehouse Receipts (NWRs):** The small and marginal farmers with Kisan Credit Cards (KCCs) can also avail the benefit of interest subvention scheme extended for a further period of up to six months (post-harvest) against Negotiable Warehouse Receipts (NWRs) at the same rate as available to crop loan to discourage distress sale of corps by small farmers.
- **Creating Big-sized banks:** which unlike smaller ones, have the ability to cross-subsidize their stakeholders. Former RBI deputy governor K.C. Chakrabarty has highlighted the importance of big banks in improving allocation efficiency between rural and urban areas.
- The government may consider **removing the subvention restrictions** on interest rates. Then banks would be free to set interest at rates that cover their costs and it would make loans viable.
- The bank may **channel credit through non-bank intermediaries** such as MFIs and allow the MFIs to charge rate of interest above the rate charged by banks.
- There should be **provisioning for delivering institutional credit to poor farmers without collateral.** It may lead to increased credit availability to rural poor.
- **Banking correspondents** need to be appointed and adequately incentivized with commissions linked to loan repayments.
- There is also a need to **incentivize the financial institutions** to provide farmers with credit.

6. ***Examine the advantages of direct cash transfer of subsidies over other mechanisms of disbursing them. In this context, bringing out the role of JAM Trinity, identify the challenges in its implementation and suggest possible solutions to address them.***

Approach:

- Evaluate the advantages of direct cash transfer of subsidies.
- Bring out the role of JAM Trinity in its implementation.
- Discuss the challenges in its implementation.
- Conclude by suggesting possible solutions.

Answer:

Direct cash transfer is a mechanism by which government subsidies and other benefits are directly credited in the bank account of beneficiary.

Advantages

- **Market distortions are minimized** through direct cash transfers of subsidies. Otherwise dual price markets are created where two sets of prices for the same goods are present.
- **Leakages, corruption and black marketing can be eliminated** by direct transfer of cash. In PDS system where goods are physically moved, lots of diversions take place.
- **Cash transfer reduces cost and is simpler to administer**. Government spends a huge amount of money over administrative apparatus for subsidy disbursement.

Role of JAM

For effecting direct cash transfers, government must be able to identify beneficiaries;. transfer money to beneficiaries; and beneficiaries must be able to easily access their money.

- **Aadhar** helps in beneficiary identification.
- **Jan Dhan Yojana** increased people with bank accounts. It enables transferring money to intended beneficiaries.
- The **Mobile money payments** technologies enable beneficiaries to access their money.

Challenges in implementation

The implementation challenges can be categorized as first mile, middle mile and last mile challenges.

First mile

- **Targeting**: targeted subsidies require detailed information about beneficiaries.
- **Beneficiary databases**: the databases needs to be continuously updated and seeded with Aadhaar and bank account information and mobile numbers.
- **Eligibility**: Some benefits are for households while others are for individuals.

Middle mile

- **Within-government coordination**: ministries and state government departments share authority in administering subsidies and transfers.
- **Supply chain interest groups**: agents along a commodity's supply chain can obstruct the spread of JAM if their interests are threatened.

Last mile

- **Beneficiary financial inclusion**: in rural areas physical connectivity to the banking system remains limited.
- **Beneficiary vulnerability**: exclusion error risks increase when the beneficiary population is poorer.

Way forward

The government should incentivize the ministries and states to:

- Invest in first-mile capacity (by improving beneficiary databases).

- Deal with middle-middle challenges (by designing incentives for supply chain interest groups to support DBT).
- Improve last-mile financial connectivity (by developing the BC and mobile money space).

7. Suggest some measures to make implementation of Targeted PDS more effective.

Approach:

Straight forward question. Suggest few measures.

Answer:

- Sugar should be kept outside the purview of PDS. It should be decontrolled and the system of levy on sugar discontinued.
- The average shelf life of coarse grains is limited, making them unsuitable for long-term storage and distribution under PDS. Initiatives on the part of state governments catering to the needs of specific localities are possible.
- Kerosene oil witness large-scale diversion of this commodity and subsidized kerosene is used for adulteration with diesel. The subsidy on kerosene should be phased out by raising its supply price under PDS while eliminating all domestic central nd state taxes on it.
- All further attempts to include more and more commodities under the coverage of food subsidy should be resisted.
- The FPS should be permitted to sell all commodities (other than rice and wheat) at full market prices in order to ensure their economic viability.

8. Starvation in the midst of plenty; this reflects the sorry state of affairs associated with the issue of food security today. In light of this statement, what role does buffer stock play in promoting food security? Comment on the Institutional Setup for the management of buffer stocks and bring forward challenges as well as solutions associated with the same.

Approach:

Explain the concept of Buffer Stock and why it is required to maintain. Further, Elaborate on the institutional setup for the management of stocks, analysing the current shortcomings and suggestions for revamping the system.

Answer:

The Buffer norms are the minimum food grains the Centre should have in the Central pool at the beginning of each quarter to meet requirement of public distribution system and other welfare measures. Buffer stock constitutes an important parameter for ensuring food security in the country. It is well known that a modicum of self-sufficiency in food is desirable which immediately means that the state will have the responsibility of maintaining a certain amount of food stocks. Further, it is argued that in a big country like ours, it is politically risky to rely entirely on private traders and international trade to iron out excessive price fluctuation and international experiences in the past have shown that relying entirely on international market comes with its own strategic costs.

Maintaining buffer stocks helps in achieving multiple objectives i.e. they are required to feed TPDS and other welfare schemes; ensure food security during the periods when production is short of normal demand during bad agricultural years and stabilize prices during period of production shortfall through open market sales.

The Food Corporation of India, is the nodal agency for procurement, storage and release of food grains in India. It was setup under the Food Corporation Act 1964. The objectives of FCI are

- Effective price support operations for safeguarding the interests of the farmers
- Distribution of food grains throughout the country for public distribution system
- Maintaining satisfactory level of operational and buffer stocks of food grains to ensure National Food Security.

Buffer stocks have been under frequent attacks in recent times. The level of stocks is said to be too high in relation to the buffer stock norms which is causing huge cost in terms of storage, interest on value of produce, and wastage, tying up huge resources that could have been put to better use. It is argued that price stabilization can be better achieved through trade rather than stocks and the former is found to be much cheaper than latter. Further, it is also argued that buffer stocks for absorbing shocks due to production fluctuation were justified when India did not have enough foreign exchange reserve to maintain excessive stocks held by public agencies.

What needs to be done is to vary our procurement, taking in more when the weather is good, supply plentiful and with low prices, when the weather is bad and prices are high. Further, the efficacy of the policy of offloading of grains is enormously dependent on the size of packages to be offloaded in the open market.

Inspired by the sight of food grain going waste, it is often made out to be that our central problem is that of poor food grain storage. Though there is no doubt regarding improving our storage facilities, it is important to be clear that this will not lower the price of food. To achieve that we need to redesign the mechanics of how we acquire and release food on the market.

9. Financial inclusion is a pre requisite for inclusive growth in India. What do you understand by the term financial inclusion? What are the challenges to achieve financial inclusion in India? Examine the various models of financial inclusion in India.

Approach:

- Define Financial inclusion.
- Establish a relation between financial inclusion and inclusive growth.
- Discuss the challenges in achieving financial inclusion.
- Examine the various models of financial inclusion.

Answer:

Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by deprived and low income groups at an affordable cost, in a fair and transparent manner.

Financial Inclusion and Inclusive growth

Inclusive growth implies participation as well as sharing the benefits from the growth process. Financial inclusion and inclusive growth are the two sides of same coin. Both are interrelated and interdependent. For growth to be inclusive, all people should be come under access to financial services.

Challenges in achieving Financial Inclusion

- Inadequate last mile delivery.
- Lack of financial literacy, lack of awareness of financial services and products, social exclusion and the unsuitable products for the poor.
- Naxal Movement, low Return-on-Investment (ROI), operating expenses inhibits banks from expansion in rural areas.
- Low formal link of micro and small enterprises.
- Seasonal inflow of income from agricultural operations.
- Migration from one place to another.
- Seasonal and irregular work availability
- Over indebtedness.
- Agrarian Distress

The two most prominent model of Financial Inclusion in India are:

- Business Correspondent model
- Bank led or Brick and Mortar Branch Model

Business correspondent Model:

The role of Business Correspondents (BCs) is considered as important for increasing the extent of financial inclusion in rural areas. They offer cost –effective alternative to traditional brick-mortar branch approach. However their effectiveness is limited by the following concerns:

- **Low aspirational value of BC as a profession**: The lack of permanency and growth opportunities are important reasons for the low value attached to the profession.
- **Preference for a brick and mortar branch:** Large segment of the population was not comfortable with salesman like BC and preferred a brick and mortar branch for banking
- BCs are not making enough income due to catering of services to low-income customers with low volume transactions.

More and more innovative products will have to be introduced which would benefit both banks as well as the rural people and at the same time make the BC model more viable.

Bank led Model:

The bank- led model requires increasing density of bank branches to promote financial inclusion. The goal of financial inclusion is better served through mainstream banking institutions as only they have the ability to offer the suite of products required to bring in effective/meaningful financial inclusion.

However, in rural and remote areas, it is not always financially viable to operate bank branches. To overcome this challenge, the Banking Correspondence model has been adopted by many banks.

Thus, India requires blend of both the models to promote financial inclusion. The job of BC need to be made more specialized and adequate training should be imparted. On the other hand, banks should partner with new finance – technology companies to promote financial inclusion.

10. Instead of running piecemeal schemes that do not address the specific challenge of poverty-ridden households it is better to use concrete tools such as SECC. In light of the above statement, explain how SECC data can be utilized to address multi-dimensional aspects of poverty.

Approach:

- Highlight failure of earlier approaches in getting results. Discuss benefits of a targeted approach.
- Enumerate the criteria for determining deprivation in SECC.
- Mention how can various schemes be targeted based on these criteria.

Answer:

Anti-poverty programmes in the past have been based on National Sample Surveys, covering 1,50,000 households nationally. However, reliability and utility of even such a large survey declines as one moves down administrative levels. The programmes and targets have been based on national averages, which have less relevance in the local context. Further, these have been based on household's consumption expenditure and sources of livelihood, and do not consider asset ownership pattern, which is also an important determinant of design of poverty alleviation program.

The SECC data, on the other hand addresses multi-dimensionality of poverty by identifying indicators of deprivation and consequent inclusion or exclusion of households from poverty alleviation programmes. It divides the total rural households (17.91 Cr) into three categories:

- Automatically included: Based on fulfilling **any of the 5** of the criteria viz. Primitive tribal Groups, Released bonded labour, those living on alms, manual scavengers or households without shelter.
- Automatically excluded: Based on fulfilling **any of the 14** parameters of exclusion such as motorised vehicle/fishing boat, mechanised agricultural equipment, KCC limit more than Rs. 50,000, etc.
- Households based on **7 markers of deprivation**:
    - Households with Kutchha house
    - No adult member in working age

- o Household headed by female and no working age male member
- o Household with handicapped members and no able bodied adult
- o Household with no literate over 25 years
- o Landless households engaged in manual labour
- o SC/ST households.

Households of third category show poverty on some markers, even though the depth of poverty may not be enough to categorise them as absolute poor. Rather than using income as a sole determinant, SECC data addresses this multidimensionality of poverty. It provides information to assess dimensions of poverty in a household – income, literacy, disease, social or gender inequality, indebtness, exploitation and landlessness.

The data can be utilised for a convergent, evidence based planning with Gram Panchayat as a unit. It provides for criteria based selection, prioritisation and targeting of beneficiaries in different programmes. For example, 2.34 Crore households with one room or less and kutchha house should be the first claimants of any rural housing scheme when targeted properly. Instead of extending monetary help to a homeless family, the government should be providing them with a house under one of its schemes and use the funds for sustaining livelihood through skill development, MGNREGS, etc.

The data shows inter-state and intra-state variations in states that were presumed similar – Bihar has much higher landlessness (51%) than UP (31%); Tamil Nadu (56%) is more than Karnataka (22%). It will help governments at all levels to delve into variations across regions, identify the causes of deprivation and design differentiated approaches to tackle poverty.

Used effectively, the SECC data can be leveraged to combine economies of scale with benefits of precision targeting. With use of technology, progress can be monitored on real time basis and targets and targeted groups updated regularly.

11. Rising income inequality is a widespread concern for advanced as well as emerging economies. Illustrate how inequality impedes economic growth. Also, examine the steps taken by India to tackle income inequality.

Approach:

- Introduce the answer by illustrating the rising income inequality.
- Discuss the impact of income inequality on economic growth.
- Analyze the initiatives by India to reduce income inequality.

Answer:

Widening income inequality is the defining challenge of our time. In advanced economies, the gap between the rich and poor is at its highest level in decades. Inequality trends have been more mixed in emerging markets and developing countries (EMDCs), with some countries experiencing declining inequality, but pervasive inequities in access to education, health care and finance remain.

Wealth is now even more concentrated at the top level, exacerbating the overall disadvantage of low-income households. In 2012, the bottom 40% owned only 3% of total household wealth. In contrast, the top 10% controlled half of all total household wealth and the wealthiest 1% owned 18%. The top 1% share almost 10% of total income worldwide.

Economic Growth and Income Inequality:

- **Inequality affects growth drivers**. Higher inequality lowers growth by depriving the ability of lower-income households to stay healthy and accumulate physical and human capital.
- For instance, it can lead to underinvestment in education as poor children end up in lower-quality schools and are less able to go on to college. As a result, labor productivity could be lower than it would have been in a more equitable world.
- Increasing concentration of incomes could also reduce aggregate demand and undermine growth, because the wealthy spend a lower fraction of their incomes than middle- and lower-income groups
- Inequality dampens investment and hence growth by fueling economic, financial and political instability. Extreme inequality may damage trust and social cohesion and thus is also associated with conflicts, which discourage investment.
- A growing body of evidence suggests that rising influence of the rich and stagnant incomes of the poor and middle class have a causal effect on crises, and thus directly hurt short- and long-term growth. In particular, studies have argued that a prolonged period of higher inequality in advanced economies was associated with the global financial crisis of 2008.

Examining steps taken by India to reduce Income inequality:

- Social protection is a cushion for those at the bottom against the effects of inequality. Social protection policies play an important role in reducing poverty and inequality and supporting inclusive growth by boosting human capital. However, India fares poorly in case of social protection measures. The global average on social spending is 8.8% of GDP. Among BRICS nations, India spends the lowest proportion of public expenditure on social protection around 4%, while the highest is Brazil with 21.2%.
- The performance of existing protection measures is dismal in terms of access, quality and equity. Health, education and nutrition schemes face great challenges.
- Taxation policy is critical in income redistribution. Regressive tax code and complex tax structure has resulted in widespread tax evasion in India. The redistributive role of fiscal policy could be reinforced by greater reliance on wealth and property taxes, more progressive income taxation, removing opportunities for tax avoidance and evasion. Government is in the process to reform the tax code in India. However, the rate of reforms is dismal. Direct tax code, Goods and Services tax proposals are still awaiting the approval by the Parliament.

CAPITAL MARKET

Contents

1. Introduction

Financial markets comprise both capital and money markets. Capital markets refer to markets that trade financial instruments with maturities longer than one year. Money markets trade debt securities or instruments of maturities of a year or less.

In the simplest terms, capital markets can be defined as a marketplace where buyers and sellers can engage in the trade of long term financial securities. Long term here means for a period greater than one year.

Markets are further segregated by the type of instrument—debt or equity—used to raise capital, i.e. debt market or stock market, and the derivatives market, which is used to manage risk. Capital markets are also distinguished as either primary or secondary. Borrowers raise funds in primary markets via primary issuances of stocks or bonds. Once these instruments are issued, they can be traded in secondary markets.

1.1. Primary Markets

The primary capital market is a market for new or fresh issues. This new or fresh issue of shares are called **Initial Public Offerings.** Primary market deals in the long-term flow of fund from the surplus sector to the government and corporate sector through primary issues and to banks and non-bank financial intermediary. Primary issues of the corporate sector lead to capital formation.

1.2. Secondary Markets

The secondary market also called "aftermarket" is the financial market for trading of securities that have already been issued in its initial private or public offering. Secondary market is also called share market. Share market includes exchange of those securities which are already sold and listed in the Primary market. Any transaction in the share market can be executed by the members of the exchange keeping in mind the rules and regulations of the SEBI.

2. Capital Markets vis-a-vis Commercial Banks

Intermediation between lenders (or savers) and borrowers (or users of funds) is a fundamental function of the financial system in an economy and is performed primarily by commercial banks and primary capital markets. The key distinction is that capital markets provide direct funding from saver to user via the issuance of securities, while bank intermediation involves indirect funding with banks as the go-between connecting the saver and user.

3. Characteristics of Capital Markets

Following characteristics are typical of Capital Markets:

1. The capital market is the market for securities, where companies and governments can raise long-terms funds.
2. The market in which corporate equity and loner-term debt securities those maturing in more than one year are issued and traded.
3. The capital market is market for long-term debt equity shares. In this market, the capital funds comprising of both equity and debt are issued and traded.
4. The market in which long-term securities such as stocks and bonds are bought and sold.
5. The capital market comprises financial securities, government securities, semi-government securities.
6. The capital market concerns two broad types of securities traded - debts and equity. Buying stock allows investors to gain an equity interest in the company and become an owner of the company.

4. Significance of Capital Markets

Growth rate of an economy depends on infrastructure development, which in turn requires deep capital markets as banks may be averse to the risk or to the funding tenures.

Capital markets have several beneficial features for different participants in the economy.

For a *Company or entity in need of funding*:

- Capital markets provide an alternative source of funding that can complement bank financing.
- Capital markets can offer better pricing and longer maturities, as well as access to a wider investor base.
- They can also offer funding for riskier activities that would traditionally not be served by the banking sector, and by doing so contribute significantly to innovation in an economy.

For *Government*:

- A developed local capital markets can increase access to local currency financing and thereby help manage foreign exchange risk and inflation better.
- Local markets have the benefit of more easily tapping local investors, and often local banks.
- It can allow them to finance fiscal deficits by borrowing from local markets without exchange rate risk.
- The creation of local capital markets is enormously beneficial to governments attempting to finance development internally.

For *Investors and Savers*:

- Capital markets can offer more attractive investing opportunities—with better returns—than bank deposits, depending on risk profile, liquidity needs, and other factors.
- With a wider range of securities and instruments offered, capital markets can help investors diversify their portfolios and manage risk.
- This is particularly important for institutional investors, including pension funds and insurance companies.

For the *Economy as a whole*:

- Well-developed capital markets provide benefits at the macroeconomic level by supporting monetary policy transmission, which is facilitated through liquid securities markets.
- They can serve the financial sector by enhancing financial stability and reducing vulnerabilities to exchange rate shocks and sudden interruptions of capital flows.
- World Bank Group research has shown that emerging market countries with robust government bond markets were better able to manage the 2008 global financial crisis, averting major economic dislocations and helping firms and citizens maintain financial solvency and liquidity.

In this way, capital markets have a deeper impact on society. Through the use of derivatives, well-developed markets provide risk management tools not only to market participants, but also to end users as diverse as companies and agriculture producers.

5. Capital Market Participants

The supply in this market comes from savings from different sectors of the economy. These savings accrue from the following sources:

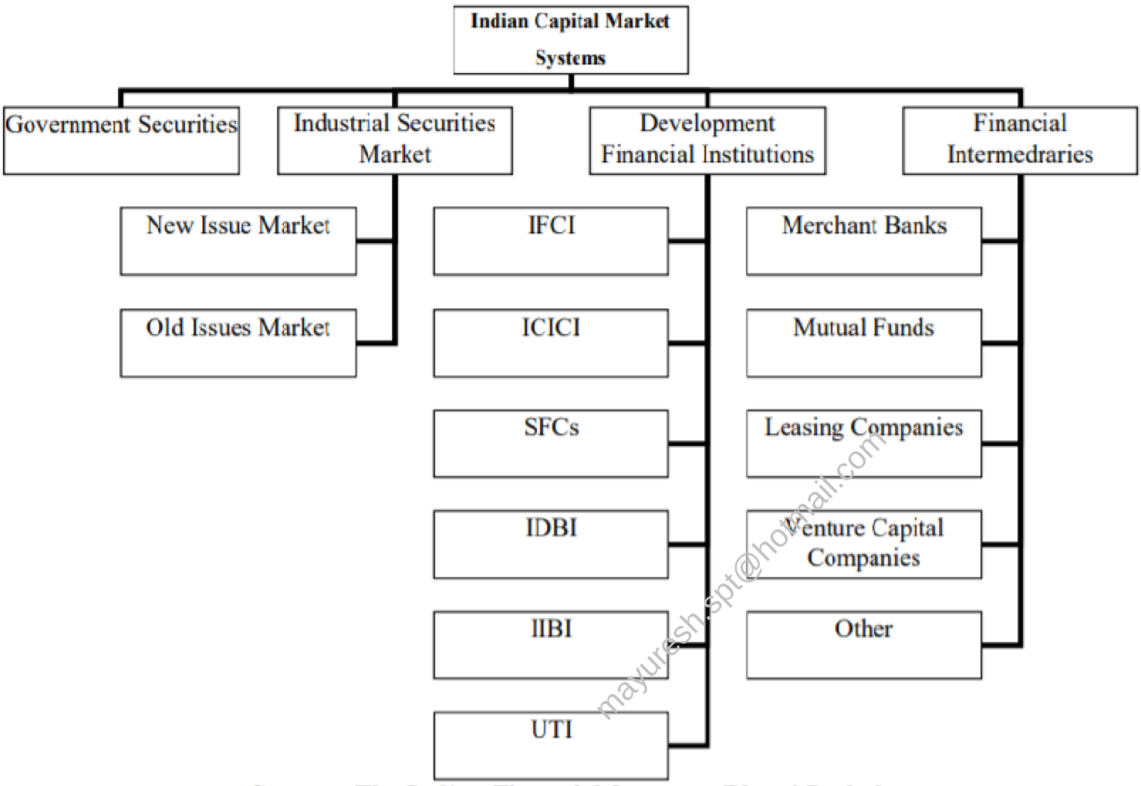
1. Individuals.
2. Corporate.

3. Governments.
4. Foreign countries.
5. Banks.
6. Provident Funds.
7. Insurance Funds
8. Financial Institutions.

Individuals invest in these markets directly by investing in shares or debentures of companies through bond issues of public sector units or through mutual funds. Corporate who have more savings than their requirement for funds also are participants in this market.

Chart 1.1

Indian Capital Market Systems



6. Capital Market Instruments

Financial instruments that are used for raising capital resources in the capital market are known as Capital Market Instruments.

The various capital market instruments used by corporate entities for raising resources are as follows: 1. Preference shares 2. Equity shares 3. Non-voting equity shares 4. Cumulative convertible preference shares 5. Company fixed deposits 6. Warrants 7. Debentures 8. Bonds 9. Mutual fund 10. Derivatives 11. Commodities 12. Currency exchange

7. Indian Capital Market

The Indian capital market was not properly developed before Independence. The growth of the industrial securities market was very much hampered since there were very few companies and the number of securities traded in the stock exchanges was still smaller. Most of the British enterprises in India looked to the London capital market for funds than to the Indian capital market. A large part of the capital market consisted of the gilt-edged marker for government and semi-government securities.

Since Independence and particularly after 1951, the Indian capital market has been broadening significantly and the volume of saving and investment has shown steady improvement. All types of encouragement and tax relief exist in the country to promote savings. Besides, many steps have been taken to protect the interests of investors and public at large which changed the Indian economy as a whole.

As a result, today Capital Markets in India is fairly developed. However, retail investors are yet to play a substantial role in the market as long-term investors. Retail participation in India is very limited considering the overall savings of households. Investors who hold shares in limited companies and mutual fund units are about 20-30 million. Those who participated in secondary markets are 2-3 million.

8. SEBI and Regulations of the Capital Market

Before the establishment of the securities and exchange board of India, the principal legislations governing the securities market in India were the Capital Issues Control Act 1956 and the Securities Contract Act, 1956.

Securities and Exchange Board of India (SEBI) was established in 1988 and given statutory powers in 1992 through the SEBI Act, 1992. It mandates the SEBI to perform a dual function: investor protection through regulation of the securities market and fostering the development of this market. The SEBI has full autonomy and authority to regulate and develop the capital market.

SEBI has been vested with most of the functions and powers under the Securities Contract Regulation (SCR) Act, which brought stock exchanges, their members, as well as contracts in securities which could be traded under the regulations of the Ministry of Finance. It has also been delegated certain powers under the Companies Act.

Functions of the SEBI are as follow:

1. Regulate the business in stock exchanges and any other securities markets.
2. Register and regulate the working of capital market intermediaries like brokers, merchant bankers, portfolio managers and so on.
3. Register and regulate the working of mutual funds.
4. Promote and regulate self-regulatory organizations.
5. Prohibit fraudulent and unfair trades' practices in securities markets.
6. Promote investors' education and training of intermediaries of securities markets.
7. Prohibit insider trading in securities.
8. Regulate substantial acquisition of shares and takeover of companies.
9. Perform such other functions as may be prescribed by the government.
10. Review any intermediary or market participant information.
11. Review books of depository participants, issuers of beneficiary owners.
12. Investigate and inspect books of accounts and record of insiders.
13. Suspend the registration of banker in case of any malpractice.

The government has framed rules under the Securities Contracts Act (SCRA), the SEBI Act and the Depositories Act. The power in respect of the contracts for sales and purchase of government securities, money market securities and ready forward contracts in debt securities are exercised concurrently by the RBI.

The *four main legislations* governing the capital market are as follows:

1. *The SEBI Act, 1992* which establishes the SEBI with four fold objectives of protection of the interests of investors in securities, development of the securities market, regulation of the securities market and matter connected therewith and incidental thereto.
2. The *Companies Act, 1956 as amended in 2013* which deals with issue, allotment and transfer of securities, disclosures to be made in public issues, underwriting, rights and bonus issues and payment of interest and dividends.
3. The *Securities Contracts Regulation Act, 1956* which provides for regulations of securities trading and the management of stock exchanges.
4. The *Depositories Act, 1996* which provides for establishment of depositories for electronic maintenance and transfer of ownership of demat securities.

9. Challenges in Regulation of Capital Market

In the next four to five years, the direction of the capital markets will primarily depend on:

- Structural changes, including consolidation, to existing capital markets participants' business models.
- Non-traditional players challenging the status quo.
- Innovations including extensive use of big data, artificial intelligence (AI) and machine learning. Participants will seek to reduce cost and create competitive advantages.
- Straight through processing and use of distributed ledger and blockchain technology.
- Pools of capital increasingly looking to reach out directly to consumers of capital, thereby lowering costs and increasing overall liquidity. Crowd sourcing and peer to peer opportunities, real estate investment trusts and infrastructure investment trusts gaining momentum.
- Investment management seeing impetus through robo advice, smart contracts and electronic trading.
- Successful resolution of applications filed under the Insolvency and Bankruptcy Code (IBC).
- Cost pressures and innovation compelling market participants to maximize outsourcing arrangements. Regulators will have to deal with the attendant risks, especially of cross-border outsourcing.

An inter-regulatory working group set up by the Reserve Bank of India has recommended that an appropriate framework be introduced for "regulatory sandbox/innovation hub" within a well-defined space and duration where financial sector regulators will provide the requisite regulatory support, so as to increase efficiency, manage risks and create new opportunities for consumers in the Indian context similar to other regulatory jurisdictions.

10. Performance of Indian Capital Markets – Recent Scenario

The Indian economy has shown unprecedented growth in the last few decades post liberalisation. A robust capital market supplemented by technological advancement and a strengthened legal framework has played a major role in driving the growth thus far.

Indian capital market has done fairly well in 2018 as compared to other global markets. In this success, IPOs hold a special place.

The reasons for robust growth of Indian Capital Market are:

1. The promising corporate earnings combined with a rising domestic investor appetite
2. Development of junior platforms such as the NSE Emerge and BSE SME with a corresponding surge in offerings on these IPOs have been a bumper trend in recent times

3. Having overcome the effects of two bold moves by the current government, the demonetisation drive of 2016 and implementation of the Goods and Services Tax led to a better-than-expected corporate earnings and a stable GDP growth
4. The policy changes brought about by the market watchdog SEBI have also played a very important role in maintaining the current pace of fundraising activity with factors such as good corporate governance, robust financials and the timing always playing a critical role in the success of any public issue.

10.1. Recent Measures undertaken by the SEBI

Few measures undertaken by SEBI in the year 2018 to make the market environment IPO friendly are as follows-

To uphold investor confidence and preservation of interest of all stakeholders, following steps have been taken -

1. The definition of independent director has been tweaked to enhance their accountability in a scenario where this role has often been called into question in the wake of several scams.
2. The role of the independent directors will now be evaluated for their performance as well as fulfilment of the independence criteria by the board of a listed entity.
3. Further, the year 2019 and 2020 are set to witness the implementation of the cap on maximum number of directorships such as no person must serve as an independent director in more than seven listed entities. Same goes for related party transactions.
4. The Board of Directors has now been made responsible for review of the approved policy once every three years and a complete ban on a related party from voting on any related party transactions.
5. Emphasis has also been laid on the separation of the positions of chairperson from that of a managing director or a chief executive officer. This, too, is going to become a reality by the year 2020 for top 500 listed entities to start with.

To ease the process of public issues so that more companies come forward and avail the benefits, following steps have been taken-

1. The replacement of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("ICDR Regulations 2009") with the new regulations of 2018.
2. Rationalisation of disclosure requirement which include financial information to be provided for a period of three years instead of five, threshold for identifying promoter group increased from 10% to 20%, criteria for identification of group companies, etc.
3. To boost participation by a wider gamut of investors including domestic investors, the shortfall in promoter contribution can now be met by alternative investment funds, foreign venture capital investors, scheduled commercial banks, public financial institutions and insurance companies without being categorized as a promoter.
4. SEBI has also permitted anchor investors to make a minimum application of Rs.2 crores in case of SME IPOs, a move which is likely to enhance participation by anchor investors in SME IPOs.

Miscellaneous steps taken by the SEBI and the Government are as follows:-

1. It has been made mandatory for large borrowers to source 25% of their incremental borrowings from the bond market.
2. Complete ban on wilful defaulters and fugitive economic offenders from coming up with an initial public offering
3. disciplinary actions including past penalties against the promoters in the past five financial years are to be mandatorily disclosed

4. To further boost foreign investment, SEBI has relaxed the eligibility and KYC norms for foreign portfolio investment (FPIs) and allowed the FPIs a period of two years for complying with the relaxed norms.
5. The government has also relaxed FDI norms by enhancing sectoral limits across various sectors in an effort to boost foreign investment.
6. SEBI has also introduced algo-trading, a computer based trading system where investors have an upper hand in executing trades and benefit from their speedy execution.
7. SEBI has also proposed incorporating the United Payments Interface ("UPI") with the Application Supported by Blocked Amount ("ASBA") mechanism, in order to streamline the process of raising funds via public issue. This method will cut down the listing time for an IPO from its current 6 days to 3 days
8. Government of India in the Union Budget 2018-19 stated that: "SEBI will also consider mandating, beginning with large corporates, to meet about one-fourth of their financing needs from the debt market."

11. Outlook For 2019

The reform initiatives recently undertaken in the realm of capital markets is likely to see an active market for IPOs even in the year 2019.

With such favourable regulatory environment, there are greater chances of the markets becoming more attractive to both domestic and foreign investors with current investment pattern providing comfort in the long run. SEBI, as a torchbearer of the capital markets, by maintaining higher regulatory standards has demonstrated the depth and maturity of the Indian capital markets and is gradually helping restore investor confidence.

Barring the threat of external factors such as the global cues and the forthcoming general elections, there still remains a strong pipeline of drafts filed with the regulator to look forward to in 2019.

12. Way Forward

To reliably extract the benefits of well-functioning markets, adequate regulation for issuers, investors, and intermediaries in addition to robust supervisory arrangements to protect investors, promote deep and liquid markets, and manage systemic risk are critical. Such a framework in turn needs to be anchored in a good investment climate that includes a sound taxation and accounting framework, reliable and quality accountancy, creditor rights, property rights, and bankruptcy and competition law.

In this Context, the Indian Government and the SEBI has taken a number of laudable measures. Also, both SEBI and retail participants should be active in spreading market wisdom and empowering investors in planning their finances and understanding the markets. The reform process should continue in consultation with all stakeholders.

13. Miscellaneous

13.1. Exchanges in India

The stock exchanges are important player of the capital market. They are the platform of trading in securities and as such they assists and control the buying and selling of securities. Thus, stocks exchanges constitute of a market where securities issued1 by the central and state, governments, public bodies and joint stock companies are traded. There are mainly four stock exchanges in India as follow:

13.1.1. Bombay Stock Exchange (BSE)

The BSE is a voluntary, non-profit making association of broker members which emerged as premier stock exchange after the 1960s. In March 1995, the BSE turned to electronic trading whereby brokers trade using computers and technology. This system is known as the BSE on line trading system.

13.1.2. National Stock Exchange (NSE)

The NSE was set up in November 1992 to encourage stock exchange reform through system modernization and competition. It is an electronic screen based system where members have equal access and equal opportunity of trade irrespective of their location in different parts of the country as they are connected through a satellite network.

13.1.3. The Over The Counter Exchange of India (OTCEI)

The OTCEI arose out of the need to have a second tire market in the country. It was set up to provide small and medium companies an access to capital market for raising finance in a cost effective manner and investors with a convenient, transparent and efficient avenue for capital market investment. The OTCEI was the first ring less, electronic and national exchange with a screen based trading system listing an entirely new set of companies of small size. It allowed companies with a paid up capital as low as 30 lacs to get listed.

13.1.4. Regional Stock Exchanges

The regional stock exchanges provided investors an access to big brokers in Mumbai. They also serve as a link between the local companies and local investors. Each regional stock exchange followed its own practice and procedures in respect of listing and trading of securities, clearing and settlement of transaction, and risk containment measures. Some examples of Regional Stock Exchanges are –Bombay Stock Exchange; Kolkata Stock Exchanges; Pune Stock Exchange etc.

14. Depository Receipt

Concept

- A DR is a type of negotiable (transferable) financial security traded on a local stock exchange usually in the form of equity, issued by a foreign, publicly-listed company.
- The DR, which is a physical certificate, allows investors to hold shares in equity of other countries.

Significance

- It is an important mechanism through which issuers can raise funds outside their home jurisdiction. DRs are issued for tapping foreign investors who otherwise may not be able to participate directly in the domestic market.
- It is perceived as the beginning point of connecting with the foreign investors (i.e. a stage before the actual listing the shares /securities in a foreign stock exchange) or a way of introducing the company to a foreign investor.
- For investors, depository receipt is a way of diversifying the risk, by getting exposure to a foreign market, but without the exchange rate risk as they are foreign currency denominated. Further, they feel safer to invest from their home location.

Working of Depository Receipts (DRs)

- DRs are created when a foreign company wishes to list its securities on another country's stock exchange. For this, the issuing company has to fulfill the listing criteria for DRs in the other country.

- Before creating DRs, the shares of the foreign company, which the DRs represent, are delivered and deposited with the custodian bank of the depository creating the DR.
- Once the custodial bank receives the delivery of shares, the depository creates and issues the DR to investors in the country where the DRs are listed.
- These DRs are then listed and traded in the local stock exchanges of the other country.

Types

Depending on the location in which these receipts are issued they are called as

- **ADRs** or American Depository Receipts (if they are issued in USA)
- **IDR** or Indian Depository Receipts (if they are issued in India) or
- **GDR** or Global Depository Receipt, in general.

14.1. American Depository Receipt (ADR)

- It is a certified negotiable instrument representing the shares of a foreign company issued by an American bank that can be traded in U.S. financial markets. It provide US based investors with an opportunity to trade in shares of a foreign company.
- These are further classified based on the detailed rules under the US securities laws. The classification is based on applicable disclosure norms and consists of:
    - **Level 1**: These programs establish a trading presence in the US but cannot be used for capital raising. They may only be traded on OTC markets, and can be unsponsored.
    - **Level 2**: These programs establish a trading presence on a national securities exchange in the US but cannot be used for capital raising.
    - **Level 3**: These programs can not only establish a trading presence on a national securities exchange in the US but also help raise capital for the foreign issuer.

14.2. Global Depository receipts (GDRs)

- As per the Companies Act, 2013 GDRs means any instrument in the form of a depository receipt created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.
- GDR is a collective term for DRs issued in non-US jurisdictions and includes the DRs traded in London, Luxembourg, Hong Kong, Singapore.

Example

- Volkswagen, a German company trades on New York Stock Exchange. The investor in America can easily invest into the German company, through the stock exchange.
- Volkswagen is listed on the American stock exchange after complying the required laws.
- On other hand if the shares of Volkswagen are listed in stock markets of countries other than US then it is termed as GDR.

14.3. Indian Depository Receipts (IDRs)

- IDRs are transferable securities to be listed on Indian stock exchanges in the form of depository receipts created by a Domestic Depository in India against the underlying equity shares of the issuing company which is incorporated outside India.
- In India any company - whether private limited or public limited or listed or unlisted - can issue DRs. However listed DRs enjoy some tax benefits.

Benefits of IDRs

- **To companies**- They lead to increased access to capital, are a means of increasing global visibility and trade, allow increased liquidity and global benchmark valuation and an international shareholder base

- **To investors**- They allow global investing opportunities without the risk of investing in unfamiliar markets, ensure more information and transparency and improve the breadth and depth of the market.

14.4. Difference between IDRs, ADRs and GDRs

- GDRs and ADRs are amongst the most common DRs. When the depository bank creating the depository receipt is in the US, the instruments are known as ADRs.
- Similarly, other depository receipts, based on the location of the depository bank creating them, have come into existence, such as the GDR, the European Depository Receipts, International Depository Receipts, etc.
- ADRs are traded on stock exchanges in the US, such as Nasdaq and NYSE, while GDRs are traded on the European exchanges, such as the London Stock Exchange.
- Both ADRs and GDRs are usually denominated in US dollars, but can also be denominated in Euros.

15. Derivatives

Types of derivatives

- **Forwards:** A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's preagreed price.
- **Futures:** A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are special types of forward contracts in the sense that the former are standardized exchange-traded contracts, such as futures of the Nifty index.
- **Options:** An Option is a contract which gives the right, but not an obligation, to buy or sell the underlying at a stated date and at a stated price. While a buyer of an option pays the premium and buys the right to exercise his option, the writer of an option is the one who receives the option premium and therefore obliged to sell/buy the asset if the buyer exercises it on him. Options are of two types - **Calls** and **Puts** options:
  - ***"Calls'*** give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future dates.
  - ***"Puts'*** give the buyer the right, but not the obligation to sell a given quantity of underlying asset at a given price on or before a given future date.
- **Warrants:** Options generally have lives of up to one year. The majority of options traded on exchanges have maximum maturity of nine months. Longer dated options are called Warrants and are generally traded over-the-counter.

Commodity exchange

- A Commodity Exchange is an association, or a company of any other body corporate organizing futures trading in commodities.

Difference between Commodity and Financial derivatives

- The basic concept of a derivative contract remains the same whether the underlying happens to be a commodity or a financial asset. However there are some features which are very peculiar to commodity derivative markets.
- In the case of financial derivatives, most of these contracts are cash settled. Even in the case of physical settlement, financial assets are not bulky and do not need special facility for storage. Due to the bulky nature of the underlying assets, physical settlement in commodity derivatives creates the need for warehousing.

- Similarly, the concept of varying quality of asset does not really exist as far as financial underlyings are concerned. However in the case of commodities, the quality of the asset underlying a contract can vary at times.

16. Mutual Funds (MFs)

Concept

- Mutual Funds refer to a pool of money accumulated by several investors who aim at saving and making money through their investment.
- The corpus of money so created is invested in various asset classes, viz. debt funds, liquid assets and the like.
- Just like gains and rewards earned over the period of investment, losses are also shared by all the investors in equal proportion, i.e. in accordance with their proportion of contribution to the corpus.
- Mutual Funds are registered with SEBI (Securities and Exchange Board of India) that regulates security markets prior to the collection of the funds from the investors.

Benefits of investing in Mutual Funds

- **Small investments**: Mutual funds help you to reap the benefit of returns by a portfolio spread across a wide spectrum of companies with small investments.
- **Professional fund management**: Professionals having considerable expertise, experience and resources manage the pool of money collected by a mutual fund. They thoroughly analyse the markets and economy to pick good investment opportunities.
- **Spreading risk**: An investor with limited funds might be able to invest in only one or two stocks/bonds, thus increasing his or her risk. However, a mutual fund will spread its risk by investing a number of sound stocks or bonds.
- **Transparency**: Mutual Funds regularly provide investors with information on the value of their investments. Mutual Funds also provide complete portfolio disclosure of the investments made by various schemes and also the proportion invested in each asset type.
- **Choice**: The large amount of Mutual Funds offer the investor a wide variety to choose from. An investor can pick up a scheme depending upon his risk/return profile.
- **Regulations**: All the mutual funds are registered with SEBI and they function within the provisions of strict regulation designed to protect the interests of the investor.

Risks involved in Mutual Funds

Mutual Funds do not provide assured returns. Their returns are linked to their performance. Some of the risk to which Mutual Funds are exposed to is given below:

- **Market risk**- If the overall stock or bond markets fall on account of overall economic factors, the value of stock or bond holdings in the fund's portfolio can drop, thereby impacting the fund performance.
- **Non-market risk**- Bad news about an individual company can pull down its stock price, which can negatively affect fund holdings. This risk can be reduced by having a diversified portfolio that consists of a wide variety of stocks drawn from different industries.
- **Interest rate risk-** Bond prices and interest rates move in opposite directions. When interest rates rise, bond prices fall and this decline in underlying securities affects the fund negatively.
- **Credit risk**- Bonds are debt obligations. So when the funds invest in corporate bonds, they run the risk of the corporate defaulting on their interest and principal payment obligations and when that risk crystallizes, it leads to a fall in the value of the bond causing the NAV of the fund to take a beating.

Net Asset Value (NAV)

- NAV or Net Asset Value of the fund is the cumulative market value of the assets of the fund net of its liabilities. NAV per unit is simply the net value of assets divided by the number of units outstanding. Buying and selling into funds is done on the basis of NAV-related prices.

Types of Mutual Funds

A. <u>On the basis of objective</u>

- **Equity Funds/ Growth Funds**- Funds that invest in equity shares are called equity funds. They carry the principal objective of capital appreciation of the investment over the medium to long-term. They are best suited for investors who are seeking capital appreciation. There are different types of equity funds
    - **Diversified funds**- These funds invest in companies spread across sectors. These funds are generally meant for risk-averse investors who want a diversified portfolio across sectors.
    - **Sector funds**- These funds invest primarily in equity shares of companies in a particular business sector or industry. These funds are targeted at investors who are bullish or fancy the prospects of a particular sector.
    - **Index funds**- These funds invest in the same pattern as popular market indices like CNX Nifty or CNX 500. The money collected from the investors is invested only in the stocks, which represent the index. For e.g. a Nifty index fund will invest only in the Nifty 50 stocks. The objective of such funds is not to beat the market but to give a return equivalent to the market returns.
- **Tax Saving Funds**- These funds offer tax benefits to investors under the Income Tax Act. Opportunities provided under this scheme are in the form of tax rebates under the Income Tax act.
- **Debt/Income Funds**- These funds invest predominantly in high-rated fixed-income-bearing instruments like bonds, debentures, government securities, commercial paper and other money market instruments. They are best suited for the medium to long-term investors who are averse to risk and seek capital preservation. They provide a regular income to the investor.
- **Liquid Funds/Money Market Funds**- These funds invest in highly liquid money market instruments. The period of investment could be as short as a day. They provide easy liquidity. They have emerged as an alternative for savings and short-term fixed deposit accounts with comparatively higher returns.
- **Gilt Funds-** These funds invest in Central and State Government securities. Since they are Government backed bonds they give a secured return and also ensure safety of the principal amount. They are best suited for the medium to long-term investors who are averse to risk.
- **Balanced Funds**- These funds invest both in equity shares and fixed-income-bearing instruments (debt) in some proportion. They provide a steady return and reduce the volatility of the fund while providing some upside for capital appreciation. They are ideal for medium to long-term investors who are willing to take moderate risks.

B. <u>On the basis of flexibility</u>

- **Open-ended Funds**- These funds do not have a fixed date of redemption. Generally they are open for subscription and redemption throughout the year. Their prices are linked to the daily net asset value (NAV). From the investors' perspective, they are much more liquid than closed-ended funds.
- **Close-ended Funds**- These funds are open initially for entry during the Initial Public Offering (IPO) and thereafter closed for entry as well as exit. These funds have a fixed date of redemption. One of the characteristics of the close-ended schemes is that they

are generally traded at a discount to NAV; but the discount narrows as maturity nears. These funds are open for subscription only once and can be redeemed only on the fixed date of redemption.

17. Exchange Traded Fund (ETF)

Concept

- Exchange Traded Funds (ETFs) are mutual funds listed and traded on stock exchanges like shares. Index ETFs are created by institutional investors swapping shares in an index basket, for units in the fund.
- Usually, ETFs are passive funds where the fund manager doesn't select stocks on your behalf. Instead, the ETF simply copies an index and endeavours to accurately reflect its performance. In an ETF, one can buy and sell units at prevailing market price on a real time basis during market hours.
- Lately, the Government has latched upon the Exchange Traded Funds (ETFs) route to disinvest its holdings in public sector companies rather than sell them on a piecemeal basis in the market. One such vehicle is the Bharat 22 ETF, a fund which houses 22 public sector companies.

Importance

- ETFs are cost efficient. Given that they don't make any stock (or security choices), they don't use services of star fund managers.
- ETFs allow investors to avoid the risk of poor security selection by the fund manager, while offering a diversified investment portfolio.
- Stocks in the indices are carefully selected by index providers and are rebalanced periodically.
- ETFs offer anytime liquidity through the exchanges.
- ETFs provide easy access to asset classes by tracking the performance of underlying indices.

Structure

- Exchange Traded Funds are pools of securities whose ownership units are known as shares.
- Shareholders are indirect owners of the underlying assets of an ETF and the said shares are the proof of this ownership.
- An ETF can take the structure like that of a corporation or a trust and this is dependent on the structures permitted by the country of domicile.
- For instance, in the US, ETFs are mostly structured as open-end management investment companies.

Disadvantages

- **Tracking error**- Though no ETF can completely replicate its underlying index, a noticeable tracking error can be witnessed in strategies which may not allow complete replication of the index due to liquidity issues, like leverage strategies or ETFs investing in commodities.
- **Illiquid due to small size**- For relatively small funds, it may be difficult to completely replicate an index, which may not only increase its tracking error but also make it illiquid, especially in times of distress.
- **Tax implications**- For ETFs which invest beyond the traditionally popular asset classes of equities and fixed income, investors need to exercise caution as apart from an increased tracking error, tax implications may be high at best or unclear at worst, which may have a sizable impact on returns.

Bharat 22 ETF

- It allows the Government to park its holdings in selected PSUs in an ETF and raise disinvestment money from investors at one go.
- It tracks the specially made S&P BSE Bharat 22 Index, managed by Asia Index Private Limited. This index is made up of 22 PSU stocks and with a few private sector companies.

18. Corporate Bonds

Concept

- Corporate bonds are debt securities issued by private and public corporations.
- Companies issue corporate bonds to raise money for a variety of purposes, such as building a new plant, purchasing equipment, or growing the business.
- When one buys a corporate bond, one lends money to the "issuer," the company that issued the bond.
- In exchange, the company promises to return the money, also known as "principal," on a specified maturity date. Until that date, the company usually pays you a stated rate of interest, generally semiannually.
- While a corporate bond gives an IOU from the company, it does not have an ownership interest in the issuing company, unlike when one purchases the company's equity stock.

Valuation of Corporate Bonds

Corporate bonds tend to rise in value when interest rates fall, and they fall in value when interest rates rise. Usually, the longer the maturity, the greater is the degree of price volatility.

By holding a bond until maturity, one may be less concerned about these price fluctuations (which are known as interest-rate risk, or market risk), because one will receive the par, or face, value of the bond at maturity.

The inverse relationship between bonds and interest rates—that is, the fact that bonds are worth less when interest rates rise and vice versa can be explained as follows:

- When interest rates rise, new issues come to market with higher yields than older securities, making those older ones worth less. Hence, their prices go down.
- When interest rates decline, new bond issues come to market with lower yields than older securities, making those older, higher-yielding ones worth more. Hence, their prices go up.
- As a result, if one sells a bond before maturity, it may be worth more or less than it was paid for.

19. Commercial Papers

Concept

- Commercial paper, or CP, is a short-term debt instrument issued by companies to raise funds generally for a time period up to one year.
- It is typically issued by large banks or corporations to cover short-term receivables and meet short-term financial obligations, such as funding for a new project.

Reason for introduction

- It is an unsecured money market instrument which was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors.
- Subsequently, primary dealers and all-India financial institutions were permitted to issue CP to enable them to meet their short-term funding requirements for their operations.

Denominations and maturity period

- CPs have a minimum maturity of seven days and a maximum of up to one year from the date of issue.
- However, the maturity date of the instrument typically should not go beyond the date up to which the credit rating of the issuer is valid.
- They can be issued in denominations of ₹ 5 lakh or multiples thereof.

Types of investors

- Individuals, banking companies, other corporate bodies (registered or incorporated in India) and unincorporated bodies, non-resident Indians and foreign institutional investors etc. can invest in CPs.

Rating requirements

- Any company keen to raise funds through CP needs to obtain the credit rating either from CRISIL, ICRA, CARE, FITCH or any other credit rating agency (CRA) that may be specified by RBI.
- The minimum credit rating shall be A-2 as per SEBI guidelines. The issuers also needs to ensure that at the time of issuance of Commercial Paper the rating so obtained is current and has not fallen due for review.
- Since such instruments are not backed by collateral, only firms with high credit ratings from a recognised rating agency will be able to sell their commercial paper at a reasonable price.
- CPs are usually sold at a discount from face value, and carries higher interest repayment rates than bonds.

20. Participatory-Notes

Concept

- Participatory Notes or P-Notes are financial instruments issued by foreign institutional investors to investors and hedge funds who wish to invest in Indian stock markets. These are also called Offshore Derivative Instruments.
- P-Notes, mostly used by overseas HNIs (high net worth individuals), hedge funds and other foreign institutions, allow such investors to invest in Indian markets through registered foreign institutional investors (FIIs).
- Till a few years ago, P-Notes used to account for more than 50 per cent of the total FII investments, but their share has fallen after SEBI tightened the disclosure norms and other regulations for such investments.

Working

- Brokers and Foreign institutional investors (FIIs) registered with SEBI, issue the financial instruments to investors in other countries who want to invest in Indian securities.
- This system lets unregistered overseas investors buy Indian shares without the need to register with the Indian regulatory body. These investments are also beneficial to India. They provide access to quick money to the Indian capital market
- Because of the short-term nature of investing, regulators have fewer guidelines for foreign institutional investors. To invest in the Indian stock markets and to avoid the cumbersome regulatory approval process, these investors trade participatory notes.

Pros and cons of P-notes

- Participatory notes are easily traded overseas through endorsement and delivery. They are popular because investors anonymously take positions in Indian markets, and hedge funds may anonymously carry out their operations. Some entities route their investments through participatory notes to take advantage of tax laws that are available in certain countries.

- However, because of the anonymity, Indian regulators face difficulty determining a participatory notes original owner and end owner. Therefore, substantial amounts of unaccounted for money enters the country through participatory notes. This flow of untracked funds has raised some red flags. Also, it can be used for round-tripping of black money.
- To quote Manmohan Singh – "The PN system is blatantly discriminatory and seems to favour ghost investors. Any self-respecting market, if it discriminates at all, does so against outsiders. But we have done the unthinkable. We should recognise and internalise the fact that funds are in search of markets, and not the other way."

P-note regulation in India

In the background of the hunt for black money, restrictions over P-Notes are tightened. Hence, over the last one decade, SEBI was slowly tightening norms on P-Notes.

- In May 2016, SEBI has extended the KYC (Know Your Client) norms and anti-money laundering norms to the PN subscribers also
- In July 2017, Sebi had notified stricter norms stipulating a fee of USD 1,000 on each instrument to check any misuse for channelising black money.
- SEBI also issued a circular banning FPIs from issuing Participatory Notes for investing in equity derivatives. However, investment in the cash segment can be continued. But this move of eliminating derivate investment in equity shares is a step towards minimising the use of PNs by foreign investors.

Example

- An investor deposits funds with the U.S. or European operations of a registered foreign institutional investor (FII), such as HSBC or Deutsche Bank.
- The investors then inform the bank the Indian security or securities they wish to purchase. Funds transfer from the investor to the FII account, and the FII issues the participatory notes to the client and buys the underlying stock or stocks in the correct quantities from the Indian marketplace.
- The investor is eligible to receive dividends, capital gains and any other payouts due to stockholders holding the shares of the Indian company.

21. Previous Years Vision IAS GS Mains Questions

1. The National Spot Exchange Ltd. crisis has been in news recently. Discuss the crisis, its causes and suggest a way forward.

Approach:

- This question involves some intricate concepts of economics, which may require some extra effort to understand.
- Key points that require understanding:
  - The original intended role of NSEL i.e. spot market for commodities
  - NSEL's involvement in forward trading, which was beyond its original mandate.
  - Recent decision of the govt. to stop launching the new forward contracts triggered the crisis.
  - Failure of the regulator to keep a watch over the exchange activities; so regulatory system should be strengthened.
- If you are able to comprehend the key points, then it should be sufficient to write this answer without going into too much details.

- But in case, you are not able to comprehend the key points – its still ok. Just refer the basic concepts of economics related to spot markets and forward trading.

Answer:

- The National Spot Exchange Ltd. (NSEL)'s mandate is to offer a national electronic spot-trading platform for agricultural commodities and metals. But by deciding to go well beyond its brief into forward trading of commodities the exchange has run into a big crisis.
- Though it was founded mainly to offer a national spot market for commodities, the exchange secured specific approval from the government to offer one-day forward contracts.
- The conditions were that there would be no short-sales and that all outstanding positions will be settled by delivery. However, NSEL allowed forward contracts to be rolled over under the excuse that the FCRA does not prescribe a period for delivery. It also appears to have turned a blind eye to short-sales by traders speculating in the forward market.
- Spotting the opportunity, brokers and traders started offering "products" tailored for their clients with assured returns of 15 per cent and more for speculating in commodities on NSEL. And forward contracts became the mainstay of its business with spot trading being the poor sibling.
- The crisis began when recently, Ministry of Consumer Affairs (MCA), which oversees commodities bourses, and the FMC asked NSEL to stop launching new contracts until further orders. The FMC also sought an undertaking that all existing contracts will be settled on their due dates.
- Bowing to the directives, NSEL told its members that contracts have to be settled within 11 days and it would be on a trade-to-trade basis, that is, payment against delivery of the commodity. This lead to a fall in trading volumes as traders, who were active in forwards, lost interest in spot trading.
- As traders failed to roll-over their contracts and demanded settlement, the exchange ran into trouble. NSEL was also forced to down its shutters by suspending trading in order to counter speculation of a payments crisis.
- Crisis like these force us to rethink on the role of regulators. Most expert committees on finance have recommended that the system needs a 'unified regulator' for markets to plug such holes. The NSEL scam may give way to the merger of the FMC with the SEBI.
- The government should no longer allow the present regulatory structure to continue which provides opportunities for unscrupulous operators to escape regulation.

2. What are Offshore Rupee Bonds? Giving examples, discuss their benefits with regards to mobilisation of resources for domestic sector. Also, comment on their role in internationalisation of Indian Rupee.

Approach:

The definition should clearly explain the meaning of all the three terms –'Offshore', 'Rupee' and 'bonds'. Giving examples of IFC (Masala bonds), or Railway finance corp. bonds, benefits such as alternate and cheaper source of finance, increasing foreign investor base, hedging, etc. can be provided. Internationalisation through greater offshore trading should be mentioned. The role of retaining investor confidence must be emphasised.

Answer: Offshore Rupee Bonds (ORBs) are debt instruments offered in capital markets outside India and are denominated in Indian rupees (meaning that the principal amount is linked to exchange rate of rupee). They are offered and settled in dollars to raise Indian rupees from international investors. The issuer converts bond proceeds from dollars into rupees in the domestic (Indian) market and uses them to finance its requirements in India. As such, the currency risk in these bonds resides with the investor. The investor base in these bonds is much wider than the FIIs, which invest in the Indian markets.

ORBs have been issued in past by the International Finance Corporation (IFC) with a maturity upto seven years. The latest issue is called 'Masala Bonds' which have a maturity of 10 years and are the first ORBs to be listed on London Stock Exchange. They are named so because masala is a globally recognised term that invokes culture and cuisine of India. Similar bonds are proposed to be offered by Indian Railway Finance Corporation and Asian Development bank. Reserve Bank of India has also allowed Indian corporates to issue ORBs. There are several benefits of ORBs, such as –

- Bringing liquidity and depth to offshore rupee market
- Crowding in foreign investors to invest in rupee bonds and fund domestic investment
- Paving the way for an alternative source of funding for Indian Companies
- As currency risk is borne by the investor, the cost of borrowing as compared to External Commercial Borrowings (ECBs) comes down for the investor as there is no need for hedging.
- The cost of borrowing has also been lesser than government bonds in domestic markets.

It has been estimated that domestic corporates are likely to raise $30 billion in ECBs this fiscal year, while their Offshore Bond issues are likely to be $6 billion. In the next fiscal year, the bond issuances are likely to be $12 billion, but the quantum of ECBs will remain stagnant at $30 billion. However, the cost of funds for Indian companies will significantly depend on their ratings, which will be lesser than AAA rated Masala bond.

Internationalisation of the currency has two essential features:

- A state where exporters from other countries (such as Oil companies in Saudi Arabia) agree to take payments in rupees, and
- Where currency risks in international borrowings are borne by lenders rather than borrowers in India.

At the heart of internationalisation lies stability and confidence in the currency which makes it acceptable for cross-border transactions. Internationalisation is desired because countries that can borrow in their own currency are less susceptible to international crises. Please note that internationalisation is different from capital account convertibility, which means that domestic and foreign assets can be freely exchanged.

ORBs are a significant step towards internationalisation of rupee - they are international borrowings with currency risk at lenders' side. The Masala bonds were well received by foreign investors, notwithstanding the fact that rupee is still not fully convertible. ORBs are launch pad to sell strength of rupee to overseas investors as listing on foreign bourses will provide visibility and set benchmarks for yields in future issuances. Views on rupee will now be partially formed offshore, albeit in a very small way as ORBs will be subject to caps on external commercial borrowings. They could also increase demands for similar products as liquidity of these bonds rises. This also shows the confidence of international investors in Indian economy and rupee. This will require the government and the central bank to impart stability and confidence in the rupee internationally. Critical elements such as fiscal policy, current account balances and inflation have to be benchmarked to best standards to retain investor confidence in rupee. Putting these elements on a firm footing will be essential requirement for rupee internationalisation.

FINANCIAL INSTITUTIONS

Contents

1. World Trade Organisation (WTO)

1.1. About WTO

The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. It's an organization for liberalizing trade. It's a forum for governments to negotiate trade agreements. It's also a place for them to settle trade disputes. It operates a system of trade rules.

1.2. History

The WTO began life on 1 January 1995, even though its trading system is half a century older as earlier **General Agreement on Tariffs and Trade** (GATT) had provided the rules for the system. Whereas GATT had mainly dealt with trade in goods, the WTO and its agreements now cover trade in services, and in traded inventions, creations and designs (intellectual property).

Over the years GATT evolved through several rounds of negotiations. The last and largest GATT round, was the **Uruguay Round** which lasted from 1986 to 1994 and led to the WTO's creation.

1.3. Organisational structure

The WTO is run by its member governments. The WTO has 164 members, accounting for 98% of world trade. A total of 22 countries are negotiating membership.

All major decisions are made by the membership as a whole, either by ministers (who meet at least once every two years) or by their ambassadors or delegates (who meet regularly in Geneva). Decisions are normally taken by consensus. Reaching decisions by consensus among some 150 members can be difficult. Its main advantage is that decisions made this way are more acceptable to all members

- Topmost is the ministerial conference which has to meet at least once every two years. The Ministerial Conference can take decisions on all matters under any of the multilateral trade agreements.
- Day-to-day work in between the ministerial conferences is handled by three bodies:
  - The General Council
  - The Dispute Settlement Body
  - The Trade Policy Review Body

1.4. Principles of WTO

Although WTO agreements are lengthy and complex, a number of simple, fundamental principles run throughout all of these documents. These principles are the foundation of the multilateral trading system:

1. **Trade without discrimination**
   - **Most Favored Nation**: **Treating other people equally:** MFN clause under WTO requires a country to provide any concessions, or granted in a trade agreement to one nation to all other World Trade Organization member countries. It ensures non-discriminatory trade policy because it ensures equal trading among all WTO members. However, it allows certain exceptions:
     - Countries can set up a **free trade agreement** that applies only to goods traded within the group — discriminating against goods from outside
     - Countries can give **developing countries** special access to their markets.
     - **Action against dumping:** A country can raise barriers against products that are considered to be traded unfairly from specific countries.

   - **In services**, countries are allowed, in limited circumstances, to discriminate. But the agreements only permit these exceptions under strict conditions.
- **National treatment: Treating foreigners and locals equally:** Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. National treatment only applies once a product, service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally-produced products are not charged an equivalent tax.

2. **Freer trade: gradually, through negotiation:** Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively. From time to time other issues such as red tape and exchange rate policies are also discussed.
3. **Predictability: through binding and transparency:** This gives businesses a clearer view of their future opportunities. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition — choice and lower prices.
4. **Promoting fair competition:** The WTO is sometimes described as a "free trade" institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. The rules on non-discrimination — MFN and national treatment — are designed to secure fair conditions of trade. So too are those on dumping (exporting at below cost to gain market share) and subsidies.
5. **Encouraging development and economic reform:** The WTO system contributes to development while giving developing countries the flexibility in the time to implement the system's agreements.

1.5. WTO Agreements

The WTO agreements cover goods, services and intellectual property.

1.5.1. General Agreements on Trade in Services (GATS)

The GATS was inspired by essentially the same objectives as its counterpart in merchandise trade, GATT: creating a credible and reliable system of international trade rules; ensuring fair and equitable treatment of all participants (principle of non-discrimination); stimulating economic activity through guaranteed policy bindings; and promoting trade and development through progressive liberalization.

Services negotiations in the WTO follow the so-called **positive list approach**, whereby members' schedules of specific commitments list all of the services sectors and sub-sectors where they undertake to bind the market opening and the granting of national treatment to foreign service suppliers, apart the listed barriers that remain. Sectors and sub-sectors not included in the schedule are exempt from any obligations as regards market access and national treatment.

West is pushing hard to move from positive list approach to negative list approach. In negative list approach, services where GATS is not applicable will have to be negotiated, agreed upon and specified. India is against this concept as it will throw open almost whole Indian services sector to western multinational giants.

Negotiations in services under GATS are classified in 4 modes, interests of different countries depend upon this classification –

- **Mode 1** – It includes cross border supply of services without movement of natural persons. For eg. Business Process Outsourcing, KPO or LPO services. Here, it's in India's interest to push for liberalization given its large human resource pool and competitive IT industry.
- **Mode 2** – This mode covers supply of a service of one country to the service consumer of any other country. E.g. telecommunication
- **Mode 3** – Commercial presence – which covers services provided by a service supplier of one country in the territory of any other country. This opens door of relevant sector in one country to investments from another country. Accordingly, it is in west's interest to push for liberalization here. There has been sustained pressure to open up higher education sector, insurance sector, Medical sector etc through this mode.
- **Mode 4** – Presence of natural persons – which covers services provided by a service supplier of one country through the presence of natural persons in the territory of any other country. E.g. Infosys or TCS sending its engineers for onsite work in US/Europe or Australia. Here again it's in India's interest to push for liberalization. In 2012, India dragged the US to the World Trade Organization's (WTO's) dispute settlement body (DSB) over an increase in the professional visa fee (H1B/L1).

1.5.2. TRIPS

The TRIPS Agreement plays a critical role in facilitating trade in knowledge and creativity, in resolving trade disputes over intellectual property. The Agreement is legal recognition of the significance of links between intellectual property and trade. "Intellectual property" refers to creations of the mind. These creations can take many different forms (see box below)

Different types of IPR

- **Copyright:** Copyright usually refers to the rights of authors in their literary and artistic works. In a wider sense, copyright also includes 'related rights': the rights of performers, producers of phonograms and broadcasting organizations.
- **Trademarks:** A trademark is a sign or a combination of signs used to distinguish the goods or services of one enterprise from another.
- **Geographical indications:** A name or indication associated with a place is sometimes used to identify a product. This "geographical indication" does not only say where the product comes from. More importantly, it identifies the product's special characteristics, which are the result of the product's origins.
- **Industrial designs**: Industrial design is generally understood to refer to the ornamental or aesthetic aspect of an article rather than its technical features. TRIPS Agreement, original or new industrial designs are protected for at least 10 years.
- **Patents**: The TRIPS Agreement says patent protection must be available for eligible inventions in all fields of technology that are new, involve an inventive step and can be industrially applied. Eligible inventions **include both products and processes**. They are protected for at least 20 years. The TRIPS Agreement describes the minimum rights that a patent owner must enjoy, but also defines the conditions under which **exceptions** to these rights are permitted.
    - **Compulsory licences:** It allows a competitor to produce the product or use the process under licence without the owner's consent. But this can only be done under specific conditions set out in the TRIPS Agreement aimed at safeguarding the interests of the patent-holder.
- **Layout designs of integrated circuits**: An integrated circuit is an electronic device that incorporates individual electronic components within a single 'integrated' platform configured to perform an electronic function.
- **Undisclosed information**: It includes trade secrets and test data. Trade secrets must be protected against unauthorized use, including through breach of contract or confidence or other acts contrary to honest commercial practices.

The extent of protection and enforcement of these rights varied widely around the world. The WTO's TRIPS Agreement is an attempt to narrow the gaps in the way these rights are protected and enforced around the world, and to bring them under common international rules. It establishes minimum standards of protection and enforcement that each government has to give to the intellectual property held by nationals of fellow WTO members.

1.5.3. TRIMS

The Agreement on Trade-Related Investment Measures (TRIMS) recognizes that certain investment measures can restrict and distort trade. It states that WTO members may not apply any measure that discriminates against foreign products or that leads to quantitative restrictions, both of which violate basic WTO principles. A list of prohibited TRIMS, such as **local content requirements**, is part of the Agreement. Recently India was dragged to WTO by U.S. over former's specification of Domestic Content Requirement in relation to procurement of Solar Energy cells and equipments.

1.5.4. Agreement on agriculture

Agriculture Agreement is to reform trade in the sector and to make policies more market-oriented. The agreement does allow governments to support their rural economies, but preferably through policies that cause less distortion to trade. It also allows some flexibility in the way commitments are implemented.

- **Tariffs only:** Before the Uruguay Round, some agricultural imports were restricted by quotas and other non-tariff measures. These have been replaced by tariffs that provide more-or-less equivalent levels of protection. It was agreed that developed countries would cut the tariffs by an average of 36%, in equal steps over six years. Developing countries would make 24% cuts over 10 years while Least-developed countries do not have to cut their tariffs.
    - **Special Safeguard:** For products whose non-tariff restrictions have been converted to tariffs, governments are allowed to take special emergency actions ("special safeguards") in order to prevent swiftly falling prices or surges in imports from hurting their farmers.
- **Domestic support**: The main complaint about policies which support domestic prices, or subsidize production in some other way, is that they encourage over-production. This squeezes out imports or leads to export subsidies and low-priced dumping on world markets. The Agriculture Agreement distinguishes between support programmes that stimulate production directly, and those that are considered to have no direct effect.
    - **Amber box subsidies** - Domestic policies that do have a direct effect on production and trade. WTO members calculated how much support of this kind they were providing per year in the base years of 1986-88. for the agricultural sector known as "total aggregate measurement of support" or "Total AMS". These total AMS figures were to be reduced in various amounts by developed and developing countries.
        - ✓ **De-Minimis provision**: Under this provision developed countries are allowed to maintain trade distorting subsidies or 'Amber box' subsidies to level of 5% of total value of agricultural output. For developing countries this figure was 10%.
    - **Green box subsidies -** Measures with minimal impact on trade. They can be used freely. They include government services such as research, disease control, infrastructure and food security. They also include payments made directly to farmers that do not stimulate production, such as certain forms of direct income support, assistance to help farmers restructure agriculture, and direct payments under environmental and regional assistance programmes.

- **Blue Box subsidies**: Certain direct payments to farmers where the farmers are required to limit production. These are also permitted.

- **Export subsidy:** These can be in form of subsidy on inputs of agriculture, making export cheaper or can be other incentives for exports such as import duty remission etc. These can result in dumping of highly subsidized (and cheap) products in other country. This can damage domestic agriculture sector of other country. These subsidies are also aligned to 1986-1990 levels, when export subsidies by developed countries was substantially higher and Developing countries almost had no export subsidies that time.
    - **Special Safeguard Mechanism** (SSM) for Developing Country Members- a mechanism that would allow developing countries to temporarily raise import tariffs on agriculture products in cases of import surges or price declines.

1.5.5. Sanitary and Phytosanitary Measures Agreement or SPS

It is a separate agreement on food safety and animal and plant health standards. It allows countries to set their own standards. But it also says regulations must be based on science. They should be applied only to the extent necessary to protect human, animal or plant life or health. And they should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail.

1.5.6. The Technical Barriers to Trade Agreement (TBT)

Even though countries' rights to adopt the standards they consider appropriate is recognized, this agreement is to ensure that regulations, standards, testing and certification procedures do not create unnecessary obstacles.

1.6. Key Round of Negotiations Over the Years

1.6.1. Uruguay Round

The Uruguay Round brought about the biggest reform of the world's trading system since GATT was created at the end of the Second World War.

The Marrakesh Declaration, and the creation of the WTO.

Results

- **Agreements having six main parts → Establishing WTO**; Agreements for each of the three broad areas of trade that the WTO covers **(goods, services and intellectual property – GATT, GATS and TRIPS); Dispute settlement and Reviews of governments' trade policies**.
- **Commitments to cut and "bind" their customs duty rates** on imports of goods. In some cases, tariffs are being cut to zero. There is also a significant increase in the number of "bound" tariffs — duty rates that are committed in the WTO and are difficult to raise.

Sticking points

- They disagreed on how to reform agricultural trade and decided to extend the talks.
- New points of major conflict emerged to join agriculture: services, market access, anti-dumping rules, and the proposed creation of a new institution.

The Marrakesh agreement did already include commitments to reopen negotiations on agriculture and services at the turn of the century. These began in early 2000 and were incorporated into the Doha Development Agenda in late 2001.

1.6.2. Singapore ministerial meet

It was at the **first ministerial conference** of the WTO in Singapore in 1996. It brought up four possible areas, popularly known as 'Singapore Issues' - trade and investment; trade and competition policy; trade facilitation; and transparency in government procurement.

Among these, only 'trade facilitation' is directly related to trade, while other three are only indirectly related to trade. Developed countries wanted to include all these areas in negotiations. However, countries like India felt that having a multilateral agreement on issues like **investment and competition policy** would be a serious impingement on the sovereign rights of countries.

1.6.3. Doha Ministerial Meet

On resistance from developing countries regarding Singapore issues, all the countries agreed to a development agenda known as Doha Development Agenda. The intent of this round was to make trade rules fairer for developing countries. Main issues taken up were

- **Public stockholding Issue:** As per the Agreement on Agriculture of WTO, a developing country's food subsidy bill should not breach the limit of 10 per cent of the value of production taking 1986-88 as base year. India and other developing countries have been seeking amendments in the formula to calculate the food subsidy cap and the base year, as this limit is insufficient to meet domestic food security challenges.
- **The special and differential treatment** for developing countries shall be an integral part of all elements of the negotiations to enable developing countries to effectively take account of their development needs, including food security and rural development.
- **Services:** The qualitative improvement in the revised offers especially on crosses border supply and movement of natural persons. The negotiations on trade in services shall be conducted with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries.
- **Patents**: A major topic at the Doha ministerial regarded the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The issue involves the balance of interests between the pharmaceutical companies in developed countries that held patents on medicines and the public health needs in developing countries. Before the Doha meeting, the United States claimed that the current language in TRIPS was flexible enough to address health emergencies, but other countries insisted on new language. On 30 August 2003, WTO members reached agreement on the TRIPS and medicines issue. Voting in the General Council, member governments **approved a decision that offered an interim waiver under the TRIPS Agreement allowing a member country to export pharmaceutical products made under compulsory licenses** to least-developed and certain other members. It also allows members to not to allow evergreening of Patents.

1.6.4. Bali Package

At the 2013 Ministerial Conference in Bali, Indonesia, ministers agreed on a package of issues, including four decisions on agriculture:

- an agreement **to negotiate a permanent solution** to public stockholding for food security purposes, and to refrain from challenging breaches of domestic support commitments resulting from developing countries' public stockholding programmes for food security provided certain conditions are met. This is known as **'peace clause'**
- a call for **more transparency in tariff (or tariff-rate) quota administration** – whereby quantities inside a quota are charged lower import duty rates - and for governments not to create trade barriers by how they distribute quotas among importers
- an **expansion of the list of "General Services"** - to include spending on land use, land reform, water management, and other poverty-reduction programmes -that qualify for Green Box support (i.e. domestic support that is allowed without limits because it does not distort trade, or at most causes minimal distortion).
- a declaration to **reduce all forms of export subsidies** and to enhance transparency and monitoring

In Bali, ministers also agreed to enhance transparency and monitoring in the trading of cotton in recognition of the importance of this sector to developing countries and to work towards the reform of global trade in cotton

1.6.5. Nairobi Ministerial Conference

The WTO's Tenth Ministerial Conference in Nairobi in 2015. At the 2015 WTO Nairobi Ministerial Conference:

- WTO members adopted a historic decision to **eliminate agricultural export subsidies** and to set disciplines on export measures with equivalent effect. Under this decision, export subsidies will be eliminated by developed countries immediately, except for a handful of agriculture products, while developing countries have longer periods to do so. By eliminating export subsidies, WTO members delivered a key target of the Sustainable Development Goal on Zero Hunger. It will help to level the playing field for farmers around the world, particularly those in poor countries which cannot compete with rich countries that artificially boost their exports through subsidies.
- WTO members agreed to **engage constructively in finding a permanent solution to developing countries' use of public stockholding programmes for food security** purposes.
- Ministers also agreed to **continue negotiations on a special safeguard mechanism** that would allow developing countries to temporarily raise tariffs on agriculture products in cases of import surges or price falls.
- The Nairobi Ministerial Decision **on Cotton** contains provisions on **improving market access for least-developed countries**, reforming domestic support and eliminating export subsidies. It also underlines the importance of effective assistance to support the cotton sector in developing countries.

In Nairobi, ministers declared that "there remains a **strong commitment of all members to advance negotiations on the remaining Doha issues**. This includes advancing work in all three pillars of agriculture, namely domestic support, market access and export competition".

1.6.6. Bruno Aires conference

The WTO's Eleventh Ministerial Conference in Nairobi in 2017. Its key takeaways are:

- **Fishery subsidies:** Member nations committed to securing a deal on fisheries subsidies for prohibiting subsidies for **illegal, unreported and unregulated (IUU) fishing** by the end of 2019. They also committed to improving the reporting of existing fisheries subsidy programmes.
- **Public Stockholding** – There was no outcome on public stockholding for food security purposes or on other agriculture issues. As a result, India's food security programmes and its current public distribution system will not be impacted. However, to use the peace clause, India has to give information to WTO about the size of its food subsidy bill till last year.
- **E-commerce** – While there was a strong push by some countries to initiate negotiations on this issue, this was resisted by India. The consensus decision was to continue discussions in a non-negotiating mode — a vindication of India's stand.
- **Non-trade issues** – Developed nations strived to bring into the discussions a stream of issues from rules for small and medium enterprises to gender rights in global trade, which India has categorized as nontrade issues.
- Further, no agreement was reached on special safeguard mechanism (SSM) for developing countries to curb unforeseen surges in imports of agricultural products or the special and differential treatment of developing countries.

1.7. Threats to WTO

Increased bilateral and multilateral preferential trade agreements indeed pose existential threat to WTO. Also the biggest success of WTO i.e. Dispute Settlement Body (DSB) has been undermined by the US. When Qatar instituted a dispute against Saudi Arabia, United Arab Emirates and Bahrain, the US categorically stated that it will not support WTO panels and the appellate body.

Further, WTO seems to be weakened by the frivolous steps taken by US such as The US steel and aluminum measures in March 2018 on frivolous grounds of national security was a violation of the WTO spirit as well as US lack of interest in pursuing the WTO's agreed Doha agenda is evident by not allowing the appointment of an Appellate Body judges leading to strangulation the WTO's dispute panel.

Reasons for Crumbling Of WTO

- **Changing world order**: The unipolar world under US was represented through institutions like WTO. Trade during this phase became rule based in nature which favored the west. But this unipolar world order is facing structural changes with rise of developing countries and their increasing share in world trade. This is perceived by US and EU as unfavorable whom they have attacked by resorting to policies of protectionism. E.g. China via trade war, Solar panel case against India in Dispute Settlement Body.
- **Process Loopholes**: The negotiation process prime facie seems democratic but Ministerial Conferences are accused of being opaque and overly technical. The green room meetings prohibit participation of majority of countries. It has proven to be disproportionately advantageous to developed countries. Moreover, consensus-based rule making has become a root cause in stagnation in reforms.
- **Nature of agreements**: Agreements signed under WTO are alleged to be discriminatory and exclusionary in functioning. DDA (Doha Development Agenda has still not been able to provide permanent solution to subsidies under domestic support. WTO do not have any agreement to deal with digital enabled trade i.e. ecommerce. Allegations are leveled by developed countries against developing of flouting TRIPS. They oppose generic medicines, compulsory license and import substitution. On the other hand, developing countries cite public health concerns and level allegations of ever-greening against pharmaceutical companies.
- **Dispute Resolution**: The dispute resolution mechanism is costly and lengthy. It is majorly resorted to by developed countries and developing countries are victims to the mechanism. There is politicization of the Appellate Body appointment and reappointment process. E.g. solar panel dispute was adjudged in favor of US is a case in point.

1.8. Relevance of WTO

Amidst all these challenges that WTO faces, we cannot deny the role it has played in integrating and opening the world trade.

- WTO regulates 98% of global trade flows. The average value of tariffs has reduced by 85% since 1942. Tariff reduction along with technological advances have driven extra-ordinary expansion of global trade.
- Trade as a share of GDP has grown from 24% in 1960 to 60% in 2015. Expansion of trade has fueled economic growth, created jobs and increased household incomes around the world.
- An ever-deepening rules-based system—notably under the GATT and WTO—brought more openness, transparency, and stability.

* Trade act as a powerful force too for inclusive Growth, by lowering poverty and by opening opportunities for small firms, women, farmers as well as fishermen.
* As nations' economies have become more and more inter-dependent, breakdown of a trade organization will be major blow to international trade order.
* Filing of dispute resolution suits before the WTO is increasing which signifies that economies around the world want the system to work.
* By bringing complaints to the WTO, countries also draw the world's attention to violations, naming and shaming violators of the rules. This effectively damages the reputations of leaders who erect discriminatory barriers.
* WTO is an essential platform for small countries to address their grievances. Barbados and Antigua took the US to the Dispute Settlement Body (DSB) on the issue of gambling and

Relevance of WTO for India

* Regional trade groups cannot be an alternative as they have succeeded in some places and they have not elsewhere. India's own experience with bilateral trade agreements has not always been good.
* Bilateral and regional treaties also open the door to the stricter "WTO plus" conditions in select areas like patents.
* India is in a better position with its food procurement and public stock holding policies protected within the WTO than with having to negotiate separate deals with major farm exporters like the U.S., Canada and Australia.

2. IMF

2.1. About IMF

The International Monetary Fund (IMF) was created in **1945** with an **aim** to (i) foster global monetary cooperation, (ii) secure financial stability, (iii) facilitate international trade, (iv) promote high employment and (v) sustainable economic growth, and (vi) reduce poverty around the world.

It was established along with the International Bank for Reconstruction and Development at the Conference of 44 nations held at **Bretton Woods**, New Hampshire, USA in July 1944. It was created out of a need to **prevent economic crises like the Great Depression.** With its sister organization, the World Bank, the IMF is the largest public lender of funds in the world. It is a **specialized agency of the United Nations**

Membership is open to any country that conducts foreign policy and accepts the organization's statutes. The IMF membership currently includes **189 countries** that make up its near-global membership. India is a founder member of IMF.

2.1.1. Purpose

The IMF's **primary purpose is to ensure the stability of the international monetary system** — the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. It does so in three ways:

* **Keeping track of the global economy and the economies of member countries**. It highlights possible risks to stability and advises on needed policy adjustments. When a country joins the IMF, it agrees to subject its economic and financial policies to the scrutiny of the international community. It also makes a commitment to pursue policies that are conducive to orderly economic growth and reasonable price stability, to avoid manipulating exchange rates for unfair competitive advantage, and to provide the IMF with data about its economy.

  - This process of monitoring and discussing countries' economic and financial policies is known as **bilateral surveillance**. On a regular basis—usually once each year—the IMF conducts in depth appraisals of each member country's economic situation.
  - It also carries out extensive analysis of global and regional economic trends, known as **multilateral surveillance**. Its key outputs are **three semiannual publications, the World Economic Outlook, the Global Financial Stability Report, and the Fiscal Monitor**. The IMF also publishes a series of regional economic outlooks.
- **Lending to countries with balance of payments difficulties** to help them rebuild their international reserves, stabilize their currencies, continue paying for imports, and restore conditions for strong economic growth, while correcting underlying problems. IMF lending serves three main purposes.
  - First, it can **smooth adjustment to various shocks**, helping a member country avoid disruptive economic adjustment or sovereign default, something that would be extremely costly, both for the country itself and possibly for other countries through economic and financial ripple effects (known as contagion).
  - Second, IMF programs can **help unlock other financing**, acting as a catalyst for other lenders. This is because the program can serve as a signal that the country has adopted sound policies, reinforcing policy credibility and increasing investors' confidence.
  - Third, IMF lending can **help prevent crisis**. The experience is clear: capital account crises typically inflict substantial costs on countries themselves and on other countries through contagion. The best way to deal with capital account problems is to nip them in the bud before they develop into a full-blown crisis.

  It is to be noted that The IMF is **not a development bank** and, unlike the World Bank and other development agencies, it does not finance projects.
- **Giving practical help to members** in terms of modernizing their economic policies and institutions, and training their people. This helps countries strengthen their economy, improve growth and create jobs. The IMF's technical assistance takes different forms, according to needs, ranging from long-term hands-on capacity building to short-notice policy support in a financial crisis. About 80 percent of the IMF's technical assistance goes to low- and lower-middle-income countries, in particular in sub-Saharan Africa and Asia. Post-conflict countries are major beneficiaries.

2.1.2. IMF Governance

IMF is governed by and accountable to the 189 member countries. the IMF is run by a Board of Governors, an Exe-cutive Board and an international staff.

- **Every member country delegates a representative** (usually heads of central banks or ministers of finance) **to the Board of Governors**—the top link of the chain of command. It meets **once a year** and **takes decision on fundamental matters** such as electing new members or changing quotas.
- **The Executive Board** is entrusted to the management of **day-to-day policy decisions**. The Board comprises **24 executive directors** who supervise the implementation of policies set by the member governments through the Board of Governors.
- The IMF is headed by the Managing Director who is elected by the Executive Board for a 5 year term of office.

2.1.3. IMF Finances

The money for lending comes from the **member countries** primarily through their **payment of quotas.** Each member country of the IMF is assigned a quota, **based broadly on its relative position in the world economy.** Quotas are denominated in **Special Drawing Rights (SDRs),** the IMF's unit of account.

Current quota formula is weighted average of **GDP (50%), Openness (30%), Economic Variability (15%) and International Reserves (5%).** The capital subscriptions or quota is now made up of 25 p.c. of its quota in SDRs or widely accepted currencies (such as the US dollar, euro, the yen or the pound sterling) instead of gold and 75 p.c. in country's own currency.

2.1.3.1. Multiple role of Quotas

Resource Contributions	Voting Power	Access to Financing	SDR Allocations
Quotas determine the maximum amount of financial resources a member is obliged to provide to the IMF.	Quotas are a key determinant of the voting power in IMF decisions. Votes comprise one vote per SDR100,000 of quota plus basic votes (same for all members).	The maximum amount of financing a member can obtain from the IMF under normal access is based on its quota.	Quotas determine a member's share in a general allocation of SDRs.

The IMF regularly conducts general reviews of quotas to assess the adequacy of overall quotas and their distribution among members. The 14th Review was concluded in 2010 and the quota increases in that review became effective in 2016. (see box)

Impact of 2016 IMF reforms

- The reforms doubled quota resources to SDR 477 billion (about US$660 billion).
- The emerging and developing economies gained more influence in the governance architecture of the International Monetary Fund (IMF).
- More than six per cent of the quota shares will shift to emerging and developing countries from the U.S. and European countries.
- India's voting rights increase to 2.6 per cent from the current 2.3 per cent, and China's, to 6 per cent from 3.8, as per the new division.
- The reforms bring India and Brazil into the list of the top 10 members of IMF, along with the U.S, Japan, France, Germany, Italy, the United Kingdom, China and Russia.
- For the first time, four emerging market countries of the BRIC bloc —Brazil, China, India, and Russia —will be among the 10 largest members of IMF. Canada and Saudi Arabia slip below the top ten in the process.
- As part of the reforms, for the first time, the IMF's Executive Board will consist entirely of elected Executive Directors, ending the category of appointed Executive Directors. Currently the members with the five largest quotas appoint an Executive Director, a position that will cease to exist.

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. The U.S.'s vote share is 16.52% giving it a unique veto power over crucial decisions at the IMF, many of which require a supermajority of 85%.

2.1.3.2. What are Special Drawing Rights (SDR)?

The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. It is an interest bearing - international reserve asset, which can be exchanged for freely usable currencies. The value of the SDR is based on a basket of five major currencies—the **US dollar, the euro, the Chinese renminbi (RMB), the Japanese yen, and the British pound sterling.**

The Chinese RMB was included in the SDR basket from Effective October 1, 2016. The Board also decided at that time that the weights of each currency would be **41.73 percent for the U.S. dollar, 30.93 percent for the Euro, 10.92 percent for the Chinese yuan, 8.33 percent for the Japanese yen, and 8.09 percent for the Pound sterling.**

The SDRs are allocated to the member countries in proportion to their quota subscriptions. Only the IMF members can participate in SDR facility. SDRs being costless as it is just a book entry in the Special Drawing Account of the IMF, is often called **paper gold**. Whenever such paper gold is allocated, it gets a credit entry in the name of the participating countries in the said account. It is to be noted that SDRs, once allocated to a member, are owned by it and operated by it to overcome BOP deficits.

Criteria for inclusion in the SDR basket

- **Export criterion:** Issuer of currency is an IMF member or a monetary union, that includes IMF members, who is one of the top five exporters of the world.
- **Determined to be "freely usable" currency by the IMF:** Currency is widely used to make payments for international transactions and widely traded in the principal exchange markets.

2.1.3.3. 15th General Review of quotas

The 15th Review happened in 2019 provided 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.

In this review, members of the International Monetary Fund (IMF) agreed to maintain its funding at $1 trillion but postponed changes to its voting structure. The deal is a compromise with the U.S., the Fund's largest shareholder, which has resisted changes to the organisation's voting structure as well as increases in its permanent resource base.

2.1.3.4. How it lends?

IMF does not allow any member to enjoy financial assistance over a long time period. The total amount that a country is entitled to draw is determined by the amount of its quota. A member is entitled to draw an amount not exceeding 25 p.c. of its quota. The first 25 p.c. called the 'gold tranche' or 'reserve tranche' can easily be drawn by countries with BOP problems.

This 25 p.c. of the quota is the members' owned reserves and therefore no conditions are attached to such drawings. This may be called 'ordinary, drawing rights; even the Fund cannot deny its use. However, no interest for the first credit tranche is required to be paid though such drawings are subject to repayment within 3-5 years period. Beyond this, the credit is available with limits on its amount and subjected to IMF approval.

2.2. Analysis of working of IMF

2.2.1. Achievement

The IMF acts both as a financing and an adjustment-oriented international institution for the benefit of its members It has been providing financial assistance to the deficit countries to **meet their temporary disequilibrium in BOP**.

The Fund aims at **promoting exchange rate stability**. In its early phase, the Fund made arrangements of avoidance of competitive exchange depreciation. It has made an attempt to solve the problem of international liquidity by creating Special Drawing Rights (SDRs)—an artificial currency as foreign exchange reserves to benefit the developing countries in particular. SDR allocations are made to member countries to finance the BOP deficits.

The IMF has assisted its members in the formulation of appropriate monetary, fiscal, and trade policies by his assistance in the form of surveillance, which it conducts on a yearly basis for individual countries, regions and the global economy as a whole. However, a country may ask for financial assistance if it finds itself in an economic crisis, whether caused by a sudden shock to its economy or poor macroeconomic planning.

2.2.2. Criticism

However, since the IMF lends its money with "strings attached" in the form of structural adjustments needed to be made to the economy, many people and organizations are vehemently opposed to its activities as they consider it as an undemocratic and inhumane means of loaning funds to countries facing economic failure. Further, it is seen that IMF imposed the policies on countries without understanding the distinct characteristics of the countries that made those policies difficult to carry out, unnecessary, or even counter-productive.

Further, the Fund often brings political and social unrest. Many of the policy measures suggested by the Fund (e.g., subsidy cut, labour retrenchment, golden handshake, etc.) caused widespread strikes, riots, etc., in many countries. Actually, finding no other alternatives, these countries had to swallow the bitter painful SAP medicine.

IMF is also accused for its lack of capability to take independent policy decisions. It complies with the 'order' of the superpowers. Further, it has minimal influence over the policy decisions of the major industrial powers. In these cases, its mandate to exercise 'firm surveillance' over some influential members or superpowers is virtually meaning-less—it has no influence over the US deficits or European interest rates.

Also, IMF's governance is an area of contention. For decades, Europe and the United States have guaranteed the helm of the **IMF to a European** and that of the **World Bank to an American**. The situation leaves little hope for ascendant emerging economies that, despite modest changes in 2015, do not have as large an IMF voting share as the United States and Europe.

3. World Bank

The World Bank Group (WBG) was established in 1944 to rebuild post-World War II Europe under the International Bank for Reconstruction and Development (IBRD).

Today, the World Bank functions as an international organization that fights poverty by offering **developmental assistance to middle-income and low-income countries**. By giving loans and offering advice and training in **both the private and public sectors**, the World Bank aims to **eliminate poverty** by helping people help themselves. Under the World Bank Group (WBG), there are complementary institutions that aid in its goals to provide assistance.

3.1. About World Bank Group (WBG)

- **The IBRD** offers assistance to middle-income and poor, but creditworthy, countries. It also works as an umbrella for more specialized bodies under the World Bank. It was the original arm of the World Bank that was responsible for the reconstruction of post-war Europe. Before gaining membership in the other four WBG's affiliates a country must be a member of the IBRD.
- **The International Development Association** offers loans to the world's poorest countries. These loans come in the form of "credits" and are essentially interest-free.

- **The International Finance Corporation (IFC)** works to promote private sector investments by both foreign and local investors. It provides advice to investors and businesses, and it offers normalized financial market information through its publications, which can be used to compare across markets. The IFC also acts as an investor in capital markets and will help governments privatize inefficient public enterprises.
- **The Multilateral Investment Guarantee Agency (MIGA)** supports direct foreign investment into a country by offering security against the investment in the event of political turmoil. These guarantees come in the form of political risk insurance, meaning that MIGA offers insurance against the political risk that an investment in a developing country may bear.
- **The International Centre for Settlement of Investment Disputes** facilitates and works toward a settlement in the event of a dispute between a foreign investor and a local country.

3.2. Goal

The World Bank Group has set two goals for the world to achieve by 2030:

- End extreme poverty by decreasing the percentage of people living on less than $1.90 a day to no more than 3%
- Promote shared prosperity by fostering the income growth of the bottom 40% for every country

3.3. Membership and Organisation Structure

There are 189 member countries that are shareholders in the IBRD, the primary arm of the WBG. To become a member, however, a country **must first join the International Monetary Fund** (IMF). The size of the World Bank's shareholders, like that of the IMF's shareholders, depends on the size of a country's economy. Thus, the cost of a subscription to the World Bank is a factor of the quota paid to the IMF.

The **president** of the World Bank comes from the largest shareholder, which is the United States, and members are represented by a **board of governors**. Throughout the year, however, powers are delegated to a board of 24 **executive directors** (EDs). The five largest shareholders—the U.S., U.K., France, Germany, and Japan—each have an individual ED, and the additional 19 EDs represent the rest of the member states as groups of constituencies. Of these 19, however, China, Russia, and Saudi Arabia have opted to be single-country constituencies, which means that they each have one representative within the 19 EDs. This decision is based on the fact that these countries have large, influential economies, requiring that their interests be voiced individually rather than diluted within a group.

3.4. Achievements of World Bank

Over the years, the amount of approval of loan to the member countries has been increasing. has advanced a significant amount of **loan for various development projects** and for productive purposes, especially for the development of agriculture, irrigation, electricity and transportation projects. Economic development of a country depends on the basic infrastructure. Therefore, the Bank is lending for these aforesaid projects for this rapid economic development.

The World Bank has been sending **technical missions** to member countries for collecting necessary information regarding the functioning of their economies. The Bank has been giving technical assistance to its member countries in order to solve their complicated economic problems and for assessing economic resources of the country and setting up of priorities for development programmes.

It has been playing a **special role for assisting the underdeveloped countries** by undertaking special economic and welfare schemes in the form of: Financial and technical assistance, Developing 'third window' to advance loan at lower rate of interest, Organizing meetings of creditor countries for providing loan to developing countries such as Aid India Club etc.

It has also been playing an important role in the **settlement of international disputes** successfully for the promotion of world peace. For eg- resolution of Indus river water dispute between India and Pakistan and Suez Canal dispute between England and Egypt.

3.5. Issues with World Bank

- It is believed that the fundamental structure of the Bank only exacerbates the already existing imbalance between the world's rich and poor. The system allows the largest shareholders to dominate the vote, resulting in WBG policies being decided by the rich, but implemented by the poor which results in policies that are not in the best interests of the developing country receiving assistance, whose political, social, and economic policies will often have to be molded around WBG resolutions.
- Moreover, even though the Bank provides training, assistance, information, and other means that may lead to sustainable development, opponents have observed that developing countries often have to put health, education, and other social programs on hold in order to pay back their loans.
- Further, The capital and financial resources of the Bank are considered as inadequate for meeting the increasing financial needs of member countries and especially of developing countries.
- The Bank has also been criticized on 'he ground that it has been extending loans only for specific projects, neglecting the needs of general development of developing countries. For e.g. - the developing countries need considerable amount of funds for general welfare schemes such as education, public health etc. but the Bank's rule does not permit it to provide assistance for such purposes.

3.6. Measures taken

The emerging economies, in a desire for alternatives for financial assistance, has established alternatives themselves. the BRICS's New Development Bank and the China-led Asian Infrastructure Investment Bank (AIIB) have presented developing countries with alternatives to the Bretton Woods institutions. They were born out of two main grievances about the World Bank and IMF that developing nations shared. First, developing countries have long complained about the conditionality of World Bank loans and have cast their terms as onerous. Second, emerging markets—China in particular—have been frustrated with their relative lack of influence at the World Bank and the IMF.

3.7. Changes required in the approach of world bank

World Bank is still relevant for countries to ensure that any other country does not dominate the world order. This multilateral institution is required for relatively small economies to get their opinion heard. Thus, World Bank should bring these following changes in its approach:

First, the Bank needs to be more ambitious in identifying and addressing the most pressing knowledge gaps we face today. Policy advocacy must give way to well-informed and objective country-specific analysis. This can be accommodated within the existing structure based on the traditional country-lending model.

Second, the Bank's lending operations must be driven by knowledge of the binding constraints on poverty reduction in specific country contexts and its analytic capabilities must be brought more systematically into its operations from the outset. The Bank's knowledge generation efforts must inform the nature of its lending and be informed by that lending—rather than simply serving lending when called upon. This requires quite fundamental changes in staff and managerial incentives and resource allocation within the current structure.

Third, the Bank's present country-based model needs to be supplemented by a model with greater capacity for supporting the provision of global public goods. If one was to sit down today to design a mechanism to support the cross-country coordination needed to address shared threats it is unlikely that one would come up with the Bank's current country-lending model. A new model, or possibly a new institution, is called for.

4. Previous Years Vision IAS GS Mains Questions

1. According to a recent WTO agreement, Least Developed Countries need not comply with IPR protection for pharmaceutical patents till 2021. Explain how these countries can use this opportunity to promote access to drugs, vaccines and diagnostics?

Approach:

- Explain how this decision has major implications for public health. In LDCs access to essential medicines has been a pressing concern for several decades.
- Least Developed Countries need to use this opportunity to productively and imaginatively promote access to medical products.

Answer:

WTO's TRIPS Agreement has been in force since 1995 and is to date the most comprehensive multilateral agreement on intellectual property. The TRIPS Agreement requires all WTO members, with a few exceptions, to adapt their laws to the minimum standards of IPR protection.

However, TRIPS also contains provisions that allow a degree of flexibility and sufficient room for countries to accommodate their own patent and intellectual property systems and developmental needs. The TRIPS Agreement provides for transition periods, permitting developing countries additional time to bring national legislation and practices into conformity with TRIPS provisions. Member states of the World Trade Organization (WTO) agreed to extend the transition period for adherence to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) among least-developed countries (LDCs). It means, LDCs need not comply with international rules of intellectual property rights (IPR) protection for pharmaceutical patents till up to 2021.

LDCs need to use this opportunity to productively and imaginatively promote access to drugs, vaccines and diagnostics in the following ways:

- Since, for many such countries options are limited by the small size of their markets and lack of indigenous technological, productive and regulatory capacities; this lack of capacity to create a competitive environment needs to be addressed.
- Further, the economics of supply to an individual country with a limited market may be insufficient to attract potential generics suppliers. To allow, therefore, for economies of scale and a degree of competition, it is important that small markets engage together as much as is possible.
- Intellectual Property Management:
    - These countries need to consolidate new approaches to intellectual property management for public health.
    - A new platform for benefit sharing - WHO Pandemic Influenza Preparedness (PIP) Framework has emerged, since the time when Indonesia focused the

attention of the global health community on sharing of viruses. It enables the sharing of benefits derived from such viruses and includes new methods of management of related intellectual property (IP) through developing Standard Material Transfer Agreements. In turn, these provide for a range of options for biological material recipients, such as influenza vaccine manufacturers, to enter into benefit-sharing agreements.

- The success of the PIP framework has opened the door to exploring future collaborations in access to medicines, both traditional and modern. Moreover, quite often, traditional medicines provide lead for the development of new treatments, with many modern medicines being originally based on herbal products.
- Since LDCs have a wide variety of genetic resources, they need to explore strategies to optimize the lessons of PIP in the context of medical products.
- Thus it can be safely concluded that LDCs should use the intellectual-property window over, say, the next eight years to address the issue of access to medicines for the longer term.

2. ***Even within the multilateral format of WTO the FTA route has served India well. Comment. How can India effectively deal with the challenges posed by the new mega regional agreements such as TPP?***

Approach:

- Briefly explain what FTAs are.
- Contextually provide how within WTOs multilateralism FTAs are permitted and how India has utilised this.
- Delineate gains made by India and also add the concerns raised by relevant actors.
- For the second part briefly explain mega regional deals with the example of TPP.
- Briefly enumerate the likely challenges it poses to India.
- The ways to deal with these challenges should be delineated in relatively detailed manner.

Answer:

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. While remaining committed to the multilateralism of WTO, under Article 1 of the GATT, India has negotiated a series of FTAs, with Sri Lanka, Singapore, ASEAN, Malaysia, Japan and Korea etc, under the exemptions of the Articles XXIV of GATT and Article V of GATS. Thus, the FTA route has been a preferred method to promote trade with mutually advantageous groups and countries.

It has served India well by:

- Ensuring Market Access to the preferred countries
- Increase in exports
- Increase in overall trade by about 50% over roughly four years.

However, industry associations have repeatedly complained to the commerce ministry that because of FTAs, India's imports from these nations have significantly jumped, while exports have not increased proportionately. Thus there has been a clamor to have a relook at the FTA strategy

The emergent mega regional agreements like Trans Pacific Partnership (TPP) also require a relook at the strategy. On the one hand higher standards on environment, labor and Intellectual Property make the TPP exclusionary, on the other hand the non-participation in this may pose challenges in terms of reduced GDP to the tune of 0.2%, making Indian exports uncompetitive in certain markets, challenges to food security, pressure on sectors such as pharmaceutical industry.

Keeping these effects in mind, India needs to take the following measures quickly:

- **International Coalition** - India needs to stitch together a coalition of like-minded countries
- **Attain higher standards in production** - We should, side by side, try to meet those upgraded standards to avoid the risk of exclusion
- **Conclude ongoing free trade negotiations soon** - These include the India-EU Bilateral Trade and Investment Agreement and the mega Regional Comprehensive Economic Partnership with the Association of Southeast Asian Nations, China and others. Benefits from these agreements will help mitigate some of the export losses that India may face in leather goods, textile, and plastics on account of trade diversion due to TPP.
- **Diversify exports** - Aiming to diversify export destinations to hitherto untapped markets like Latin America and Africa would also help.
- **Identify India's trade interest areas**- India also needs to identify its trade interest areas and propose alternative negotiating templates. One such area is biopiracy, protection of traditional knowledge, and the link between the WTO's Trade-Related Aspects of Intellectual Property Rights agreement and the Convention on Biological Diversity.
- **Infrastructure development**- including port congestion and poor road connectivity, is one of the main hurdles in attaining this cost competitiveness. Addressing India's infrastructural deficiency will have the dual effect of not only making India's exports cost-competitive, but making them attractive for international lead firms to integrate India in global value chains.

3. Agricultural subsidies are hotly contested at the WTO negotiations. What are the concerns of developing countries, especially India, vis-a-vis the attitude of developed countries on the issue? What is Special Safeguard Mechanism (SSM)? In this context, what are the reasons underlying India's keenness on a permanent solution on public stockholding for food security?

Approach:

- Describe the reservations of developing countries in respect of agricultural subsidies at WTO negotiations. It should be a comparative outlook vis-a-vis developed countries.
- Define Special Safeguard Mechanism, and mention its ad-hoc nature.
- Finally, mention why India is keen on a permanent solution on public stockholding.

Answer:

Agriculture occupies crucial space at the WTO negotiations and the issue of subsidies therein is a bone of contention between the developing countries such as India and developed countries such as the United States and those from Europe. The Agreement on Agriculture has been criticised for reducing tariff protections for small farmers in developing countries while simultaneously allowing rich countries to continue subsidizing agriculture at home.

The concern of developing countries regarding the attitude of the developed countries can be summed up thus:

- Whereas the developed countries want subsidies to be removed, the developing countries view agricultural subsidies as crucial for their farm livelihood and food security.
- The box-shifting practices and use of green box as well as amber box subsidies by rich countries such as US cause concern in developing countries. For example under a 2006 ministerial agreement, agriculture subsidies in rich countries were to be eliminated by 2013 to spur export competition in global agriculture, but this did not happen. In fact, new policies, such as the US Farm Bill of 2014 have ensured that there will be no cut in their export subsidies.
- The insistence of countries such as US for Countries like India to limit Amber box subsides to 1986 production (not adjusted to inflation) is a major bone of contention.
- While developed countries including the US, Australia, the EU oppose public stock-holding of food crops, it is crucial for India's food security programme.
- The developing countries are concerned about the issue of import surges and tariffs to be imposed in case of livelihood threatening. This is perhaps most visible in the differences over the structure of the Special Safeguard Mechanism (SSM).

Special Safeguard Mechanism (SSM) is a trade remedy that allows developing countries to impose additional safeguard duties in the event of an abnormal surge in imports or the entry of unusually cheap imports.

India argued for higher level of tariff and lower import surge for making the SSM. On the other hand, the US and allies argued for lower tariffs and higher imports. India and the G33 insist that the SSM mechanism can come into play if imports rise by about 10%, while developed countries want it as 40%.

For a permanent solution, India had proposed either amending the formula to calculate the food subsidy cap of 10 per cent, which is based on the reference price of 1986-88, or allowing such schemes outside the purview of subsidy caps of the AOA. This would enable India to continue with its policy of public stockholding for food security without violating any of the extant provisions.