

# MONETARY AND FISCAL POLICY OF INDIA

## MONETARY POLICY

The use by the Central Bank of interest rate and other instruments to influence money supply to achieve certain macro economic goals is known as monetary policy. Credit policy is a part of monetary policy as it deals only with how much and at what rate credit is advanced by the banks. Objectives of monetary policy are: accelerating growth of economy, maintaining price stability, stabilization of exchange rate, balancing savings and investment and generating employment.

Monetary policy is generally referred to as either being an expansionary policy, or a contractionary policy, where an expansionary policy increases the total supply of money in the economy, and a contractionary policy decreases the total money supply. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates, while contractionary policy has the goal of raising interest rates to combat inflation.

The Reserve Bank of India announces the Monetary and Credit Policy twice a year—October and April. October policy is called busy season as it is the harvesting time for the kharif season which used to account for the major part of India's agricultural operations. This policy determines the supply of money in the economy and the rate of interest charged by banks. The policy also contains an economic overview and presents future forecasts.

The instruments of monetary policy are bank rate, SLR, CRR and open market operations by the RBI on the basis of repo and reverse repo rates (buying and selling of Government

securities in the open market to regulate money supply). Monetary policy works through influencing the cost and availability of credit and money.

### **Tools of Monetary Policy**

The tools available for the central bank to achieve the above ends are: Bank rate, Reserve ratios, Open market operations, Intervention in the forex market and Moral suasion

#### **Bank rate**

Bank Rate is the rate at which RBI lends to commercial banks. Bank Rate is a tool which RBI uses for managing money supply and credit. Any revision in Bank Rate by RBI is a signal to banks to revise deposit rates as well as Prime Lending Rate. It stands at 6% presently (2008 July)

#### **Reserve Requirements**

In economics, fractional-reserve banking is the near-universal practice of banks in which banks keep a fraction of the total deposits managed by a bank as reserves and are not lent. The reserve ratios are periodically changed by the RBI. The reserve requirement (or required reserve ratio) is a bank regulation that sets the minimum reserves each bank must hold as a part of the deposits. These reserves are designed to satisfy various needs like providing loans to the Government (SLR) and inflation management (CRR). They are in the form of RBI approved securities (SLR) kept with themselves or cash that is kept with the RBI (CRR).

#### **Statutory liquidity Ratio (SLR)**

It is the portion of time and demand

liabilities of banks that they should keep in the form of designated liquid assets like government and other RBI-approved securities like public sector bonds; current account balances with other banks and gold. SLR is aimed at ensuring that the need for government funds is partly but surely met by the banks. The commitment of the Government to reduce fiscal deficit means that it will borrow less and so the SLR was progressively brought down from 38.5% in 1991 to 25% today.

The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 fixed the floor and cap on SLR at 25% and 40% respectively. But the amendment made in these statutes removed the limits-lower and upper: RBI has, as a result, the freedom to fix the SLR at any rate depending on the macro economic conditions. The amendment was an enabling one.

#### **Cash Reserve Ratio (CRR)**

CRR is a monetary tool to regulate money supply. It is the portion of the bank deposits that a bank should keep with the RBI in cash form. CRR deposits earn no interest.

The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 fixed the floor and cap on CRR at 3% and 20% respectively. But the amendment made in these statutes removed the limits-lower and upper. RBI has, as a result, the freedom to fix the CRR at any rate depending on the macro economic conditions. The amendment was an enabling one.

CRR is adjusted to manage liquidity and inflation the more the CRR, the less the money available for lending by the banks to players in the economy. CRR was 15% in 1991 and today it is 8.75%. If inflation is high, money supply needs to be taken out and so CRR is generally increased. But in a regime of moderate inflation, low CRR is in place.

RBI increases CRR to tighten credit for example, CRR today (July 2008) stands at

8.75%-high because inflation is also at 13-year high at 1.89% on WPI (July 2008). It needed to be controlled by a variety of means one of which was hike in CRR.

CRR as a tool of monetary policy is used when there is a tremendous need to reduce inflation and tighten credit as in 2008. Otherwise, normally, RBI relies on open market operations for liquidity management.

#### **Open Market Operations (OMOs) of RBI**

OMOs of the RBI can be described as: Purchases and sales of government and certain other securities in the open market (banks and financial institutions) by the RBI in order to influence the volume of money and credit in the economy: Purchases of government securities injects money into the market and thus expands money and credit; sales have the opposite effect – absorb excess

Liquidity and shrink credit. Open market operations are RBI's most important and flexible monetary policy tool. Open market operations do not change the total stock of government securities but change the proportion held by the RBI, commercial and cooperative banks.

#### **Ready Forward Contracts (Repos)**

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

In India, RBI lends on a short term basis to banks on the security of the government paper (repo). Banks undertake to repurchase the security at a later date-over night or few days. RBI charges a repo rate for the money it lends. It is 8.5% presently (2008 July).

Reverse repo is when RBI borrows from the market (absorbs excess liquidity) with the sale

of securities and repurchases them the next day or after a few days. The rate at which it borrows is called reverse repo rate as it is the reverse of the repo operation. Reverse repo rate presently is 6% (July 2008)

The repo rate and reverse repo rate are 6% and 8.5% respectively today (July 2008)

The Repo/ Reverse Repo transaction can only be done at Mumbai and in securities as approved by RBI (Treasury Bills, Central/ State Govt securities). RBI uses Repo and Reverse repo as instruments for liquidity adjustment in the system.

### **Selective Credit Controls**

Certain businesses can be given more and certain others may get less credit from banks on the orders of the RBI. Thus, selective credit controls can be imposed for meeting various goals like discouraging hoarding and black-marketing of certain essential commodities by traders etc. Either credit can be rationed or interest rate can be hiked by RBI as a part of SCCs. In SCCs, the total quantum of credit does not change, but the amount lent and the cost of credit may be changed for specific sector or sectors.

### **Moral suasion**

A persuasion measure used by central bank to influence and pressure, but not force, banks into adhering to policy. Measures used are closed-door meetings with bank directors, increased severity of inspections discussion, appeals to community spirit etc.

Recently the RBI Governor appealed to banks not to raise rates even though the central bank was following a tight money policy.

## **FISCAL POLICY**

Fiscal policy refers to the policy related to revenue and expenditure of the government with a view to correcting the situations of excess demand or deficient demand in the economy. The instruments of fiscal policy are:

**(a) Fiscal Instruments Related to Government Expenditure:** The government of a country incurs various types of expenditure such as expenditure on public works (construction of roads, dams, bridges etc), education and public welfare, defence, maintenance of law and order, various types of subsidies, and transfer payments to the public. Government corrects the situations of excess demand or deficient demand in the economy by varying any or all types of expenditure.

**(b) Fiscal Instruments Related to Financing of Government Expenditure:** Taxation, public debt and deficit financing are the three fiscal instruments related to financing of government expenditure. Government can correct the situations of excess demand or deficient demand in the economy by using above mentioned instruments.

**(c) Fiscal Policy and Deficient Demand:** Following fiscal measures to correct the situation of deficient demand:

**(1) Decrease in Taxes:** Government decreases taxes, which leaves the households with more purchasing power and the firms with more cash reserves. Direct taxes like income tax, corporation tax etc are reduced. As a result both households as well as investors will be encouraged to spend more. Consequently, demand will increase.

**(2) Increase in Public Expenditure:** To stimulate the demand the government increases expenditure over public health, education, subsidies and transfer payments, and public works. Public expenditure causes the level of income to increase in economy. Higher level of income causes high level of demand.

**(3) Increase Deficit financing:** Deficit financing (by way of printing more notes for additional expenditure) is increased during times of deficient demand so that the overall level of purchasing power is enhanced in the economy.

**(4) Public Borrowing:** Public borrowing is reduced so that people are left with greater disposable income.

**(d) Fiscal Policy and Excess Demand :** Excess demand generates inflationary pressures in the system. Following fiscal measures are taken to correct the inflationary situation.

**(i) Increase in taxes:** Tax rates are increased progressively to mop up additional purchasing power within the economy.

**(ii) Decrease in Government Expenditure:** Government expenditure is reduced so as to cause the demand to decline.

**(iii) Reduce Deficit Financing:** Deficit financing is greatly restricted. The printing of more notes would only increase the rate of inflation.

**(iv) Public Borrowing:** The situation demands less purchasing power with the people. So, the government takes resort to increased public borrowing.

#### **Main Objectives of Fiscal Policy in India**

The fiscal policy is designed to achieve certain objectives as follows:-

**1. Development by effective Mobilization of Resources :** The principal objective of fiscal policy is to ensure rapid economic growth and development. This objective of economic growth and development can be achieved by Mobilization of Financial Resources.

The central and the state governments in India have used fiscal policy to mobilize resources.

The financial resources can be mobilized by :-

**a) Taxation:** Through effective fiscal policies, the government aims to mobilize resources by way of direct taxes as well as indirect taxes because most important source of resource mobilization in India is taxation.

**b) Public Savings:** The resources can be mobilized through public savings by reducing government expenditure and increasing surpluses of public sector enterprises.

**c) Private Savings:** Through effective fiscal

measures such as tax benefits, the government can raise resources from private sector and households. Resources can be mobilized through government borrowings by ways of treasury bills, issue of government bonds, etc., loans from domestic and foreign parties and by deficit financing.

**2. Efficient allocation of Financial Resources:** The central and state governments have tried to make efficient allocation of financial resources. These resources are allocated for Development Activities which includes expenditure on railways, infrastructure, etc, whereas Non-development Activities includes expenditure on defence, interest payments, subsidies, etc.

But generally the fiscal policy should ensure that the resources are allocated for generation of goods and services which are socially desirable. Therefore, India's fiscal policy is designed in such a manner so as to encourage production of desirable goods and discourage those goods which are socially undesirable.

**3. Reduction in inequalities of Income and Wealth :** Fiscal policy aims at achieving equity or social justice by reducing income inequalities among different sections of the society. The direct taxes such as income tax are charged more on the rich people as compared to lower income groups. Indirect taxes are also more in the case of semi-luxury and luxury items, which are mostly consumed by the upper middle class and the upper class. The government invests a significant proportion of its tax revenue in the implementation of Poverty Alleviation Programmes to improve the conditions of poor people in society.

**4. Price Stability and Control of Inflation :** One of the main objectives of fiscal policy is to control inflation and stabilize price. Therefore, the government always aims to control the inflation by reducing fiscal deficits, introducing tax savings schemes, Productive use of financial resources, etc.

**5. Employment Generation:** The government is making every possible effort to

increase employment in the country through effective fiscal measure.

**6. Balanced Regional Development:** Another main objective of the fiscal policy is to bring about a balanced regional development. There are various incentives from the government for setting up projects in backward areas such as Cash subsidy, Concession in taxes and duties in the form of tax holidays, Finance at concessional interest rates, etc.

**7. Reducing the Deficit in the Balance of Payment:** Fiscal policy attempts to encourage more exports by way of fiscal measures like Exemption of income tax on export earnings, Exemption of central excise duties and customs, Exemption of sales tax and octroi, etc.

The foreign exchange earned by way of exports and saved by way of import substitutes helps to solve balance of payments problem. In this way adverse balance of payment can be corrected either by imposing duties on imports or by giving subsidies to export.

**8. Development of Infrastructure:** Government has placed emphasis on the infrastructure development for the purpose of achieving economic growth. The fiscal policy measures such as taxation generates revenue to the government. A part of the government's revenue is invested in the infrastructure development. Due to this, all sectors of the economy get a boost.



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# MANUFACTURING SECTOR

## MANUFACTURING SECTOR

Manufacturing Industry in India has gone through various phases of development over the period of time. Since independence in 1947, the Indian manufacturing sector has traveled from the initial phase of building the industrial foundation in 1950's and early 1960's, to the license-permit Raj in the period of 1965–1980, to a phase of liberalization of 1990's, emerging into the current phase of global competitiveness. It has grown at a robust rate over the past ten years and has been one of the best performing manufacturing economy. In a country like India, where employment generation is one of the key policy issues, this makes this sector a critical sector to achieve inclusiveness in growth.

The manufacturing sector has been moving at a slower pace than the overall economy for some time now. As a result, the sector's contribution to GDP has declined marginally from 16.1 to 15.2% in the five years till March 2013. Growth rate in manufacturing reduced from 9.7% in 2010-11 to 2.7% in 2011-12 and 1% in 2012-13. In FY13, only 3.3% of the country's growth was generated by manufacturing as opposed to 83% contributed by services. The sector is not at its strongest at the moment, but are the manufacturing companies in lockstep with rest of the economy?

### **Why do we need focus on manufacturing?**

The Eleventh Plan has targeted growth in manufacturing at 10-11 percent but actual performance will be only about 7.7 percent. It is a matter of concern that the manufacturing sector has not shared in the dynamism of the economy, not just in the XIth Plan, but even in preceding Plan periods. As a result, the share

of the manufacturing sector in the country's GDP has remained stagnant at 15% (excluding mining) for the last 30 years. This share is very low, especially when compared with 34 percent in China and 40 percent in Thailand. The slow pace of growth of the manufacturing sector at this stage of India's development is not an acceptable outcome, and we must ensure that manufacturing becomes the driver for GDP growth. This can be accomplished by the manufacturing sector growing at a faster rate than GDP. Only then will manufacturing be able to attain a significant share of the GDP. In order to attain a 25% share of the GDP by 2025, manufacturing would need to grow at a rate of 2-4% higher than the GDP. This will ensure that manufacturing becomes the engine of growth for the economy.

In addition, manufacturing must provide a large portion of the additional employment opportunities required for India's increasing number of youth. Agriculture cannot be expected to provide more jobs. On the contrary, it should be releasing labour which has very low productivity in agriculture to be absorbed in other sectors. While the services sector has been growing fast, it alone cannot absorb the 250 million additional income seekers that are expected to join the workforce in the next 15 years. Currently, manufacturing in India provides only 12% of jobs, and this share is significantly less than that of other countries. Unless manufacturing becomes an engine of growth, providing at least 100 million additional decent jobs, it will be difficult for India's growth to be inclusive.

India's trade balance must also be improved, and this necessitates a larger volume of exports of manufactured goods. In order to increase

exports as well as provide its internal market with domestically produced manufactured goods that compete with imports, India must manufacture a much larger volume of products at competitive costs and quality.

A strong focus on improving the "depth" in Indian manufacturing is essential. "Depth" can be defined as the capability and expertise in all aspects of a product value chain. Achieving a greater depth in manufacturing entails ensuring a higher level of value addition within the country. This requires focus on a few key areas like the heavily import-skewed capital goods sector, technological advancements in nearly all manufacturing sectors, and a focus on improved domestic research and development.

The shape of global manufacturing supply chains has changed dramatically with the advent of computers and telecommunications. Manufacturing has been 'deconstructed'. Therefore, the ability to engineer products quickly and at low cost is becoming an increasing source of competitive advantage. In today's open-trade world, it is essential that Indian industry develop global competitiveness. While scale remains an advantage in industry, the deconstructed value chain of manufacturing ensures that this scale and competitiveness can be achieved through growth of networks of manufacturing enterprises.

While industrial growth is the need of the hour, we must also ensure that this growth happens in a sustainable manner, especially with regard to the environment. Industrial growth is a leading factor in the degradation of the environment. With the high rates of growth targeted by the manufacturing sector, it must be ensured that this growth happens in a sustainable manner and with minimal cost to the environment.

## **INITIATIVES TO BOOST MANUFACTURING IN THE LAST FIVE YEARS**

Manufacturing has shown a fluctuating growth trend measured in terms of the Index

of Industrial Production in the last few years while there has been both moderation and decline growth, (IIP), in the last few months as shown in the previous sections.

Government has taken a number of initiatives and confidence building measures for improving the industrial climate and boosting manufacturing in the country. Government had approved the National Manufacturing Policy (NMP) in October, 2011 with the objectives of enhancing the share of manufacturing in GDP to 25% by 2022 and creating additional 100 million jobs. One of the instruments in the NMP is the creation of National Investment and Manufacturing Zones (NIMZ) as planned integrated industrial townships. Nine NIMZs have been announced, eight of which are along the Delhi Mumbai Industrial Corridor (DMIC). Other measures for facilitation of industrial investment include promotion of foreign direct investment through consolidation of press notes into a single document; development of industry relevant skills and regular meetings with industry associations and stakeholders to fast track implementation of industrial projects.

### **National Manufacturing Policy**

The Government of India notified the National Manufacturing Policy on 4th November, 2011 with the objective of enhancing the share of manufacturing in GDP to 25% within a decade and creating 100 million jobs. It also seeks to empower rural youth by imparting necessary skill sets to make them employable. Sustainable development is integral to the policy and technological value addition in manufacturing has received special focus. The policy is based on the principle of industrial growth in partnership with States. The Central Government will create the enabling policy frame work, provide incentives for infrastructure development on a Public Private Partnership (PPP) basis through appropriate financing instruments, and State Governments will be encouraged to adopt the instrumentalities provided in the policy. The proposals in the policy are generally sector

neutral, location neutral and technology neutral except incentivisation of green technology.

One of the instruments in the NMP is the creation of National Investment and Manufacturing Zones (NIMZ) as planned integrated industrial townships. Nine NIMZs have been announced, eight of which are along the Delhi Mumbai Industrial Corridor (DMIC). Approval, in principle, has been secured for setting up of the ninth NIMZ at Nagpur. Apart from NIMZs, NMP also applies to manufacturing industry throughout the country including wherever industry is able to organize itself into clusters and adopt a model of self-regulation as enunciated. Policy instruments for manufacturing industry are applicable to both NIMZ and Clusters. These include Rationalization/ simplification of business regulations; simple/ expeditious exit mechanism for non viable units; Technology development, including green technologies; Industrial training and skill upgradation measures; Incentives for MSMEs; Special Focus Sectors; Leveraging infrastructure deficit and Government procurement; and Trade Policy.

Major feature of NMP is the rationalization and simplification of regulations based on the basic tenet of self regulation of industry to the extent possible. The Central/ State Governments will suspend operation of particular provisions wherever such powers exist subject to an alternative mechanism, annual audits by concerned departments and third party certification. Other features include delegation of powers to a single body in case of other provisions, combined application forms and common registers as far as possible and Systematization of inspections through third party certification.

Some of the important initiatives undertaken/ being undertaken under NMP, include formulation of a scheme on Job Loss Policy; simplification of forms / register / returns under 13 central Labour Laws into 3 Forms; setting up of Technology Acquisition and Development Fund (TADF) for acquisition of

appropriate technologies including environment friendly technology.

For the effective implementation of the NMP, a number of institutional structures have been constituted. These include Manufacturing Industry Promotion Board (MIPB), under the Chairmanship of Commerce & Industry Minister; High Level Committee (HLC) under the Chairmanship of Secretary, DIPP; Board of Approval (BOA) under the concerned Joint Secretary. In addition Green Manufacturing Committee (GMaC) has also been set up to promote green technology for manufacturing under NIMZ.

### ***Delhi Mumbai industrial corridor (DMIC)***

As part of the Japan India Special Economic Partnership Initiative for developing requisite infrastructure and facilitating investment, DMIC Project was conceptualized to take benefit of the high quality rail and road connectivity offered by 1483 km long Delhi Mumbai Dedicated Rail Freight Corridor (DFC), existing rail passenger- cum- freight corridor and National Highways. The vision of DMIC is to create strong economic base on both the sides of the Dedicated Freight Corridor with globally competitive environment and state-of-the-art infrastructure to activate local commerce, enhance foreign investments and attain sustainable development.

The Government of India accorded in principle approval to the project outline of DMIC Project in August, 2007. Twenty four Investment Regions/ Industrial Areas across the six States of Uttar Pradesh, Haryana, Madhya Pradesh, Rajasthan, Gujarat and Maharashtra were identified for development in DMIC. An institutional framework with a dedicated Special Purpose Vehicle (SPV) viz. Delhi Mumbai Industrial Corridor Development Corporation (DMICDC) was set up for project development, coordination and implementation of the numerous projects.

As the Master Plans progressed, it was felt necessary and essential that new industrial cities must be created on the back of world class trunk infrastructure i.e. drainage, sewage, solid waste, water supply, internal roads. Without the trunk infrastructure the development of PPP projects in Greenfield cities was not feasible and may lead to real estate development without trunk infrastructure and a developed backbone. The Government of India, therefore, in September, 2011 restructured the DMIC Project with an Implementation Fund of Rs.17,500 crore to be utilized over a period of five years and an additional project development Fund of Rs.1000 crore. The land for the new industrial cities will be the contribution of the State Government. The Japanese Government have also announced their financial support for DMIC project to an extent of US \$ 4.5 billion for projects with Japanese participation in the first phase of the project.

Looking at the magnitude and diversity, the entire project has been planned to be implemented in phases. Initially, the following industrial cities have been taken up for development as industrial cities:

- (i) **Ahmedabad-Dholera Investment Region, Gujarat;**
- (ii) **Shendra-Bidkin Industrial Park city near Aurangabad, Maharashtra;**
- (iii) **Manesar-Bawal Investment Region, Haryana;**
- (iv) **Khushkhera-Bhiwadi-Neemrana Investment Region, Rajasthan;**
- (v) **Jodhpur-Pali-Marwar Industrial Area, Rajasthan;**
- (vi) **Pithampur-Dhar-Mhow Investment Region, Madhya Pradesh;**
- (vii) **Dadri-Noida-Ghaziabad Investment Region, Uttar Pradesh;**
- (viii) **Dighi Port Industrial Area, Maharashtra.**
- (ix) In addition one more NIMZ is being considered near Nagpur.

The overall perspective plan for the entire DMIC Region has been completed. The Master Planning of the first six industrial cities mentioned above have been completed. The concerned State Governments have initiated the process of Land pooling/ procurement/ acquisition for the industrial cities as well as for the Early Bird Projects. Project Development of four (04) Gas Based Power Projects is complete including the final Environmental clearance.

## **PROMOTION OF BUSINESS ENVIRONMENT**

**Promoting FDI-** Significant changes have been made in the FDI policy regime in the recent times to ensure that India remains increasingly attractive and investor-friendly. Some of the main changes have been as follows:

**Consolidation-** For ease of reference, all existing regulations on FDI were integrated into one consolidated document. The consolidation involved integration of 178 Press Notes, covering various aspects of FDI policy since 1991, as also other regulations governing FDI. The document was released as Circular 1 of 2010, effective 1 April, 2010.

**Rationalization and liberalization-** In order to make the FDI policy more liberal and investor-friendly, further rationalization and simplification has been carried out since. Accordingly, a number of clarifications were issued on various subjects, including interalia the concepts of controlled conditions for FDI in Agriculture/ Animal Husbandry etc., value-addition in case of mining and mineral separation of Titanium bearing minerals and introduction of a specific provision for downstream investment through internal accruals .

Subsequently, significant policy changes were introduced in Circular 1 of 2011 effective from 1.4.2011. These include: (i) flexibility in fixing pricing of convertible instruments through a formula, rather than upfront fixation

(ii) Inclusion of fresh items for issue of shares against non-cash considerations, including import of capital goods/ machinery/ equipment and pre-operative/ pre-incorporation expenses  
(iii) Removal of the condition of prior approval in case of existing joint ventures/ technical collaborations in the same field (iv) simplification and rationalization of guidelines

relating to down-stream investments and (v) development and production of seeds and planting material, without the stipulation of having to do so under controlled conditions . FDI has also recently been permitted in Limited Liability Partnerships (LLPs), subject to specified conditions.

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## PARALLEL ECONOMY IN INDIA

The Indian economy has continuously recorded high growth rates and has become an attractive destination for investments; but the recent unearthing of corruption cases has thrown light on the dark side of the growth that is rise of the black money circulation in the economy.

In 1955, a study conducted by noted economist Nicholas Kaldor showed that the black economy accounted for 4-5 % of the country's gross domestic product (GDP) amounting to roughly Rs 600 crore. In 1969, a panel headed by Justice Wanchoo recommended several measures to streamline the taxation system and estimated the size of the black economy at Rs 7,000 crore. Since then, several experts have undertaken various projects and given their assessments of the problem. A study conducted by the National Institute of Public Finance and Policy under the chairmanship of Raja Chelliah in 1980-81 showed that the black economy accounted for 20% of GDP which would now translate to about Rs 15 lakh crore. A study by S.B Gupta in 1992 put the figure at 42% of GDP for 1980-81 and 51% for 1987-88.

Estimates by eminent economists reveal that India's parallel economy has risen from a mere 3 percent of the GDP in the mid 50s to around 50 percent today.

### WHAT IS PARALLEL ECONOMY?

Black money or unaccounted money circulating in the parallel economy is a big menace to the economy. Thus it is necessary to understand the concept of parallel economy.

According to Feige when economic activities goes unreported or not measured by societies current techniques to monitor economic activity it falls under parallel or hidden economy.

Parallel economy connotes the functioning of an unsanctioned sector in the economy. A hidden economy in its broadest sense may consist of - a) illegal economy, such as money laundering, smuggling, etc; b) unreported economy including tax evasion; c) unregulated economy, ie economic activities outside regulations.

Money laundering involves disguising financial assets so that they can be used without detection of the illegal activity that produced them. Through money laundering, the launderer transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source. The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians and public officials, mobsters, terrorists and con artists.

### BRIEF HISTORY OF PARALLEL ECONOMY IN INDIA

The Indian black economy is immense, lucrative, widespread, and has grown significantly since independence. The black economy has grown from about 3% in the mid-50s to 20% by 1980, to 35% by 1990, and 40% by 1995. As a percentage of GDP and at almost \$1 trillion in absolute terms, the black economy is larger than both the industrial and agricultural sectors. Corruption is pervasive from the lowest to the highest levels of public administration, public enterprise, bureaucracy, judiciary, law enforcement, and elected officials.

The history of corruption in India can be traced to late 18th century British East India company rule. The first governor-general of India, Warren Hastings was notably impeached on accounts of corruption in 1787. Though he

was acquitted in 1795, his lengthy trial brought various aspects of illegitimate company activity to light. The East India Company laid the foundations of both a corrupt bureaucracy and a parallel economy. During World War II, this black economy experienced a surge. When large quantities of products and resources were allocated to the war effort, the general public experienced acute shortages of daily necessities. Scarcity, government controls, and private hoarding stimulated the growth of the parallel economy.

The most significant growth in the black economy occurred during and after the 1960s. Until this time, Gandhian and Nehruvian politicians who had been part of the independence struggle had largely administered the government. As their careers ended, officials who lacked their idealism, and were more likely to engage in corruption and rent-seeking practices, entered the government.

Today, corruption pervades the political leadership, the bureaucracy, law enforcement and the judiciary. Some of the most prominent causes have been patron-client relationships and communalism in the democracy, excessive bureaucratic administration and low wages at the bottom rung of public sector employment, ineffective punitive and combative measures, and a social environment conducive to corrupt practices.

## REASONS FOR GROWTH OF BLACK MONEY

There are several factors responsible for the emergence of black money.

### a) Controls and licensing system:

The system of controls, permits, quotas and licenses which are associated with misdistributions of the commodities in short supply results in the generation of black money. Since considerable discretionary powers lies in the hands of those who administered controls this provided them with a scope for corruption – 'speed money' for turning a blind eye to the

violation of controls. All this gave rise to trading in permits, quotas and licenses, malpractices in distribution and in the process; it generated sizeable sums of black money.

Price and distribution controls have in the past led to the generation of black money on a significant scale. Any price control without any adequate machinery of distribution and speedy arrangement for increasing supplies is potentially a source of black money generation.

Similarly, the system of licenses requires large number of inspectors for completing various formalities and thus good amount of hush money has to be paid. Where controls are not implementable, they have led to harassment and black money generation.

### b) Tax structure:

High tax rates and defective tax structure have also been responsible for the existence of black money to a large extent. Till recently the tax on income and on wealth was very high to invite evasion. The marginal rate of income tax was as high as 75 per cent. And when it was combined with the tax on wealth, it was still higher. This was the situation in respect of personal taxation until a decade ago. The corporate tax rate too was very high. In these circumstances the temptation/gain from tax evasion was substantial.

Tax-laws in country are so complicated that a layman fails to understand it. Even honest assesses are unable to file cor-rect returns. This encourages people to evade tax.

### c) Donation to political parties:

Black money also arises from political activities such as elections where candidates spend well above the ceiling prescribed by the Election Commission. This huge expense in turn makes them corrupt.

The Government has decided to ban donations to political parties in 1968; it prompted businessmen to fund political parties, especially the ruling party, with the help of black money.

Ostensibly, this decision was taken to reduce the influence of big business on the electoral process, but in practice what happened was precisely the opposite. Businessmen everywhere have by now learnt that they should pay a certain charge out of the black money to the coffers of political parties and then be sure that the political leaders will only bark but not bite. Big business, in the process, has been able to tame the political leadership. This is evidenced by the relaxation of various controls, permitting business houses to enter areas reserved for the public sector, putting a large number of banned items on the Open General License list etc.

**d) Generation of black money in the public sector:**

Every successive five-year plan is planned for a larger size of investment in the public sector. The projects undertaken by the public sector have to be monitored by the bureaucrats in Government departments and public sector undertakings. Tenders are invited for the various works and these tenders are awarded by the bureaucracy in consultation with the political bosses.

Thus, a symbiotic relationship develops between the contractors, bureaucracy and the politicians and by a large number of devices costs 'are artificially escalated and black money is generated by underhand deals. Instability of the political system has given a further momentum to this process. Since the ministers are not sure of their tenure and in a majority of cases, the tenure is very short, the principle 'Make hay while the sun shines' is adopted by most of them. The larger number of scandals that are unearthed by the Opposition only support the contention that huge investment in the public sector is a big potential source for black money generation. In this process, bureaucrats act as brokers for political leaders and thus the nexus between business, bureaucracy and politicians promotes the generation of black money.

**e) Deterioration in the moral and civic standards:**

The most important reason of tax-evasion and

black-money is the general deterioration in the moral and civic standards of our people.

Our businessmen employ very ingenious methods to generate black-money. Large amounts of black-money can be generated through the sale of fixed assets and scrap. Sometimes influential firms obtain quotas or import licenses in excess of their actual requirements and sell them at cash premiums. Industrial manufacturing licenses are similarly obtained through influences and sold to a second party at an enhanced value. Purchase bills are over-invoiced or dummy bills are prepared. Large-scale smuggling of gold and various luxury items is an important source of black-money. Sometimes, relatives whose income is not taxable are kept on the payrolls of a company; they are paid their salary which is taken back in the forms of black-money.

### **IMPACT OF BLACK MONEY**

The economic impact of corruption is a powerful one. The circulation of black money has adversely affected the Indian economy in several ways.

In India, the black economy has resulted in an immense loss of tax revenue. If it accounted for 40% of GDP in 1998-99, the loss of direct tax revenue at the prevailing rate would amount to at least Rs. 200,000 crore, or 47.5 billion U.S. Dollars (Kumar 1999). According to the BBC (2004), only 2 million of India's billion people pay taxes, just 2% of the population. The government therefore suffers a perennial shortage of funds and public services languish.

Because of the growing black economy, policies fail both at the macro-level and the micro-level. Planning or monetary policy or fiscal policies do not achieve the desired results because of the existence of a substantial black economy. Targets for education, health, drinking water and so on are not achieved because "expenditures do not mean outcomes." The economy does not lack resources but faces resource shortage. Much investment goes into wasteful and unproductive channels, like

holding gold or real estate abroad. The flight of capital lowers the employment potential and the level of output in the economy. Capital sent abroad does not generate output in India but does so where it goes. A country that is considered capital-short has been exporting capital. A nation that gives concessions to multinational corporations to bring in capital loses more capital than it gets, and that too at a high cost, from foreign institutional investments or foreign direct investment. India's policies are open to the dictates of international capital because the country's businessmen and politicians have taken capital out in large doses since Independence. The costs are huge.

The direct and indirect costs are of policy failures, unproductive investments, slower development, higher inequity, environmental destruction and a lower rate of growth of the economy than would have been possible. It has enormously worsened the income-distribution, and has thereby undermined the fabric of the fixed income salary class finds itself ever be the lower rung of the income-ladder.

The inflation rises while the black money circulates in the market. The price of eatable / others goods are increased to supply of that black money and less production of things in the market. So people which have that money they offer more price in the market. As compared from other person in the market.

At the social level, the cost is a loss of faith in society and its functioning. At the political level there is fragmentation, with States demanding their own packages because the belief that the nation as a whole can deliver has been dented. The demand for smaller States is a corollary because the bigger States neglect the less vocal regions. Each caste, community and region now wants to have its own party to represent its narrow interest, leading to the proliferation of smaller parties.

In the absence of Black Money India could have been growing faster, by about 5 per cent,

since the 1970s if it did not have the black economy. Consequently, India could have been an \$8-trillion economy, the second largest in the world. Per capita income could have been seven times larger; India would then have been a middle-income country and not one of the poorest.

## INITIATIVES BY THE GOVERNMENT TO COMBAT BLACK MONEY

Many steps have been taken by the Government from time to time to check the tax-evasion.

Following Wanchoo Committee's recommendations the Government enacted the Taxation Laws (Amendment) Act, 1975. This act has brought on the statute various provisions for preventing tax-evasion and proliferation of black-money Deterrent punishments have been provided for tax-evasion. The other committees were—the Dangli Committee on Controls and Subsidies (1980), The Rajah Chelliah Committee, and the National Institute of Public Finance and Policy (1985).

With a view of bringing about simplification and rationalization of the direct tax laws, the Government appointed a committee of experts known as the "Direct Tax Laws Committee" in June 1977. The recommendations of the Committee are being processed for implementation.

In 1976 the Government imposed a statutory obligation on the management to carryout physical verification of its assets for the satisfaction of the auditors to ensure that no money is created through the sale of fixed assets. Management is also obliged to maintain a proper record of the sale of scrap.

Another step taken by the Government to unearth black-money was the launching of the voluntary disclosure scheme in 1975. No penalties were imposed on the persons disclosing black-money voluntarily. Demonetization of the notes of higher denomination has also been one of the recent steps of the Government to unearth black-

money. Curbing of the smuggling activities in the country has been the main concern of the Government. The conservation of Foreign Exchange and Prevention of Smuggling Activities Act was passed for this matter on 19th December, 1974.

In a bid to mop up black-money, the Government announced on 12th January, 1981 a new scheme of issuing a ten-year bond of the face value of Rs. 10,000 each. An ordinance for this purpose was issued by the President. The bonds were known as 'Special Bearer Bonds.' The scheme gives immunity to the investor from prosecution as well as disclosure of the source of the money invested. Several other series of such bonds have been released in recent years.

To tackle the menace of illicit funds, the government has adopted a five-pronged strategy. It comprises joining the global crusade against 'black money'; creating an appropriate legislative framework; setting up institutions for dealing with illicit funds; developing systems for implementation; and imparting skills to the manpower for effective action.

During the last two years, India has negotiated 19 new Double Taxation Avoidance Agreements (DTAAs) and 17 new Tax Information Exchange Agreements (TIEAs). In addition, 22 existing DTAAs have been re-negotiated.

### **What is Double Taxation Avoidance Agreement?**

*Double taxation refers to taxation by two or more countries of the same income, asset or transaction. India has adopted the system under which Income Tax on residents is imposed on the "total world income" i.e. income earned anywhere in the world. Whereas the source of income may be in some other country and that country also claims a right to tax the income arising in the country. The result is that income arising to a resident out of India is subjected to tax in India as it is part of total world income and, also in host country which provides the source for that income.*

*"In the case of non-residents, however, it is not the "total world income" but only that income is subjected to tax in India which is earned in this country. Since a resident is taxed in respect of foreign income in his own country as well as in the country where it is earned, he is subjected to tax in both the countries in respect of the same income. The purpose of double tax avoidance agreement is to avoid such double taxation to the extent agreed upon.*

*The DTAA provides that business profits will be taxable in the source state if the activities of an enterprise constitute a Permanent Establishment (PE) there. The Agreement provides for fixed place PE, building site, construction & installation PE, service PE, insurance PE and agency PE. Dividends, interest and royalties & fees for technical services income will be taxed both in the country of residence and in the country of source.*

India also became a full member of global economic body the Financial Action Task Force (FATF) last year in pursuit of its fight against black money.

The government simultaneously has strengthened its tax enforcement agencies like the Income Tax department, allowing them to create a new Directorate of Criminal Investigation to probe illicit funds including those stashed abroad. It has strengthened its Financial Intelligence Unit (FIU) to detect suspicious transactions in economic channels.

India has recently signed the Convention on Mutual Administrative Assistance in Tax Matters, developed jointly by the Council of Europe and the Organisation for Economic Co-operation and Development (OECD).

All members of the G20 have now become signatories but the Convention will have to be ratified by the Indian Parliament to become law.

Tax evasion and illicit flows are a serious problem and over the last two years, in order

to check this trend, India has negotiated 19 new double taxation avoidance agreements and 17 new tax information exchange agreements.

The Convention facilitates international co-operation for a better operation of national tax laws, while respecting the fundamental rights of taxpayers. The Convention provides for all possible forms of administrative co-operation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. This co-operation ranges from exchange of information, including automatic exchanges, to the recovery of foreign tax claims. However the Convention imposes safeguards to protect the confidentiality of the information exchanged.

Further India has signed an Agreement with the Eurasian Group (EAG) to enhance cooperation in curbing Money laundering and Terrorist Financing. The agreement was signed by Dr. Thomas Mathew, Joint Secretary (Capital Markets) Division of the Department of Economic Affairs.

The EAG is a Financial Action Task Force (FATF) styled regional body with 9 members including India, Russia and China and 29 observers of which 12 are countries and 17 are international organisations. India was accorded membership in the EAG in December 2010.

At the 15th Plenary meeting of the Eurasian Group on Combating Money laundering and Financing of Terrorism India has offered help to member nations in enhancing their technical skills in establishing better financial systems, capital market monitoring and surveillance through sophisticated IT tools. Help was also offered in drafting legislation, law enforcement techniques and strengthening of their respective Financial Intelligence Units.

and financing of terrorism.

**Government proposes new measures to tackle bureaucratic corruption**

*Government has suggested new measures to check corruption at bureaucratic level. Under the civil services code, penalties are divided as major and minor. The major includes the provisions of Reduction to Lower Rank; Compulsory Retirement; Removal from Service and Dismissal from Service. Whereas minor penalties include: Censure; Withholding of Increments; Withholding of Promotions; Recovery of Pecuniary Loss.*

*The salient features of proposed guidelines are:*

- *After even retirement proceedings against corrupt government servants will not end. The person will now have to face a 10 per cent cut in pension in case of minor penalty.*
- *Major penalty of compulsory retirement with full benefits will be changed to a new provision of having a cut of 20 per cent in pension.*
- *Cases will be solved using fast track method. The intermediaries for consultation in between will be eliminated to increase the pace of solving the case.*
- *A cut in pension upto 10 per cent may be imposed in case of minor penalty. This cut will have a ceiling of five years as a life-long reduction in pension would come under the category of major penalty.*
- *There would be no cut in pension in those cases of compulsory retirement of officers being weeded out for non-performance.*
- *The departments and ministries will have to appoint serving officers as Inquiry and Presenting Officers to speed up the process of proceedings.*
- *In important cases, the officers may request the Central Vigilance Commission to appoint their Commissioner of Direct Inquiries as IO (Inquiry officers).*
- *The prescribed limit for sanctioning of prosecution of public servants within 3 months.*

## **CONCLUSION**

There had been umpteen talks and voluntary disclosure schemes in the past for checking evasion and black money, but no perceivable results have come. Rather, the quantum of black money in circulation has increased substantially in volume. Recently the government has been forced to commission a study by three top economic think tanks to get an estimate on the size of the black economy. The study is expected to be over by September 2012 and provide fresh insights.

A major factor contributing to the increasing level of black money are the tax havens. Tax havens are those countries which has zero or very low income tax, where no questions are asked on origin of money coming into their banks, which keep all banking records secrets and cooperate very little with other countries. During the years 2002-06, around \$3 trillion were deposited in such tax havens from the

developing countries. During the same period, a sum of \$136.5 billion Indian black money was deposited. The most notorious of the more than 70 tax havens in the world is Switzerland. It is estimated that the share in Swiss banks account for almost a third of the total black money in the world. Hence, it could be safely assumed that some \$45 billion out of the 136.5 billion stashed away from India would have been hoarded in Swiss.

India must summon the strength and courage to bring back the money that is stashed away in the tax havens. India can enter into agreements with the foreign banks and governments put the topic on a global agenda and cooperate with other powerful countries. This money belongs to the poor farmers and unorganized workers of India. It is assumed that, India will be in the top-five league if all the ill-gotten money is brought back. It will change the Indian scenario. It will change the life of the common man.

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## **MONEY LAUNDERING : BRIEF INTRODUCTION**

Money laundering involves disguising financial assets so that they can be used without detection of the illegal activity that produced them. Through money laundering, the launderer transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source. The most common types of criminals who need to launder money are drug traffickers, embezzlers, corrupt politicians and public officials, mobsters, terrorists and con artists.

Every year, billions of dollars are derived from drug trade and are then reinvested throughout the world by otherwise legitimate businessmen, accountants and bankers and it is the increasing awareness of the huge profits generated from this criminal activity that has created the impetus for governments to legislate against such activities.

Money laundering is becoming very protuberant with the passage of time. The estimated amount of money laundered globally in one year is 2 to 5% of the global GDP (or USD 800 billion to USD 2 trillion). In December, 2012, HSBC Holdings Plc. had to agree to pay a record USD 1.92 billion in fines to US authorities for getting itself involved in money-laundering issues.

**The basic money laundering process has three steps:**

### **i) PLACEMENT**

This is the first stage in the washing cycle. Money laundering is a "cash-intensive" business, generating vast amounts of cash from illegal activities (for example, street dealing of drugs where payment takes the form of cash in small denominations). The monies are placed into the

financial system or retail economy or are smuggled out of the country. The aims of the launderer are to remove the cash from the location of acquisition so as to avoid detection from the authorities and to then transform it into other asset forms; for example: travellers cheques, postal orders, etc.

### **ii) LAYERING**

In the course of layering, there is the first attempt at concealment or disguise of the source of the ownership of the funds by creating complex layers of financial transactions designed to disguise the audit trail and provide anonymity. The purpose of layering is to disassociate the illegal monies from the source of the crime by purposely creating a complex web of financial transactions aimed at concealing any audit trail as well as the source and ownership of funds.

Typically, layers are created by moving monies in and out of the offshore bank accounts of bearer share shell companies through electronic funds' transfer (EFT). Given that there are over 500,000 wire transfers representing in excess of \$1 trillion - electronically circling the globe daily, most of which is legitimate, there isn't enough information disclosed on any single wire transfer to know how clean or dirty the money is, therefore providing an excellent way for launderers to move their dirty money. Other forms used by launderers are complex dealings with stock, commodity and futures brokers. Given the sheer volume of daily transactions, and the high degree of anonymity available, the chances of transactions being traced is insignificant.

### **iii) INTEGRATION**

The final stage in the process. It is this stage

at which the money is integrated into the legitimate economic and financial system and is assimilated with all other assets in the system. Integration of the "cleaned" money into the economy is accomplished by the launderer making it appear to have been legally earned. By this stage, it is exceedingly difficult to distinguish legal and illegal wealth.

**Methods popular to money launderers at this stage of the game are:**

- a) the establishment of anonymous companies in countries where the right to secrecy is guaranteed. They are then able to grant themselves loans out of the laundered money in the course of a future legal transaction. Furthermore, to increase their profits, they will also claim tax relief on the loan repayments and charge themselves interest on the loan.
- b) the sending of false export-import invoices overvaluing goods allows the launderer to move money from one company and country to another with the invoices serving to verify the origin of the monies placed with financial institutions.
- c) a simpler method is to transfer the money (via EFT) to a legitimate bank from a bank owned by the launderers, as 'off the shelf banks' are easily purchased in many tax havens.

### **IMPACT OF MONEY LAUNDERING ON THE ECONOMY OF THE COUNTRY**

Money laundering constitutes a serious threat to national economies and respective governments. The infiltration and sometimes saturation of dirty money into legitimate financial sectors and nations accounts can threaten economic and political stability.

Economic crimes have a devastating effect on a national economy since potential victims of such crimes are far more numerous than those in other forms of crime. Economic crimes

also have the potential of adversely affecting people who do not prima-facie, seem to be the victims of the crime.

For example, tax evasion results in loss of government revenue, thus affecting the potential of the government to spend on development schemes thereby affecting a large section of the population who could have benefited from such government expenditure. A company fraud not only results in cheating of the people who have invested in that company but may also adversely affects investors' confidence and eventually the growth of the economy.

The negative economic effects of money laundering on economic development are difficult to quantify, yet it is clear that such activity damages the financial-sector institutions that are critical to economic growth, reduces productivity in the economy's real sector by diverting resources and encouraging crime and corruption, which slow economic growth, and can distort the economy's external sector international trade and capital flows to the detriment of long-term economic development.

Developing countries' strategies to establish offshore financial centre (hereinafter OFCS) as vehicles for economic development are also impaired by significant money laundering activity through OFC channels.

The negative effects of money laundering activities may be on financial sector, real sector of formal agents such as state, financial institutions and banking sector.

**• Effect on financial sector:**

Financial sector may get negative effects of money laundering especially financial institutions including banking and non-banking financial institutions (NBFIs), and equity markets- may directly or indirectly be affected. Basically, these institutions facilitate concentration of capital resources from domestic savings and funds from abroad. These institutions provide impetus to furtherance of investment prospects by providing conducive

environment and efficient allocation of these resources to investment projects which contributes substantially to long run economic growth.

***Money Laundering impairs the sustainability and development of financial institutions in two ways:***

1. Firstly the financial institutions are weakened directly through money laundering as there seems to be a correlation between money laundering and fraudulent activities undertaken by employees of the institutions. Similarly, with the increase in money laundering activities, major parts of financial institutions of a state are vulnerable to crime by criminal elements. This strengthens the criminals and other parallel system of money laundering channels. This may lead to the eviction of less equipped competitors & giving rise to monopoly.
2. Customer trust is fundamental to the growth of sound financial institutions, and the perceived risk to the growth of sound financial institutions, and the perceived risk to depositors and investors from institutional fraud and corruption is an obstacle to such trust.

**• Effect on real sector:**

Money laundering adversely affects economic growth through the real sector by diverting resources to less productive activities and by facilitating domestic corruption and crime.

Money laundering carried out through the channels other than financial institutions includes more "sterile" investments such as real estate, art, antiques, jewelry and luxury automobiles, or investments of the type that gives lower marginal productivity in an economy. These sub optimal allocations of resource give lower level of economic growth which is a serious detriment to economic growth for developing countries. Criminals reinvest their proceeds in companies and real estate with the purpose to make further profits, legal or illegal.

Most of these investments are in sectors that

are familiar to the criminal, such as bar, restaurant, prostitution. The real estate sector is the largest and most vulnerable sector for money laundering. Real estate is important for money laundering, because it is a non-transparent market where the values of the objects are often difficult to estimate and where big value increases can happen and is an efficient method to place large amounts of money. The price increase in real estate is profitable and the annual profits on real business create a legal basis for income. The real estate has the following features, which make it attractive for criminal money:

1. a safe investment
2. the objective value is difficult to assess
3. it allows to realize "white" returns.

**• Threat to Banking System**

Across the world, banks have become a major target of Money Laundering operations and financial crime because they provide a variety of services and instruments that can be used to conceal the source of money. With their polished, articulate and disarming behaviour, Money Launderers attempt to make bankers lower their guard so as to achieve their objective. Though norms for record keeping, reporting, account opening and transaction monitoring are being introduced by central banks across the globe for checking the incidence of Money Laundering and the employees of banks are also being trained to recognise suspicious transactions, the dilemma of the banker in the context of Money Laundering is to sift the transactions representing legitimate business and banking activity from the irregular / suspicious transactions. Launderers generally use this channel in two stages to disguise the origin of the funds first, when they place their ill gotten money into financial system to legitimize the funds and introduce these funds in the financial system and second, once these funds have entered the banking system, through a series of transactions, they distance the funds from illegal source. The banks and financial institutions through whom the 'dirt money' is laundered become unwitting victims of this crime.

## **INTERNATIONAL INITIATIVES TO COMBAT MONEY LAUNDERING**

Money laundering has become a crucial crime and there are countless organizations trying to get a handle on the problem. In the United States, the Department of Justice, the State Department, the Federal Bureau of Investigation, the Internal Revenue Service and the Drug Enforcement Agency all have divisions investigating money laundering and the underlying financial structures that make it work.

State and local police also investigate cases that fall under their jurisdiction. Because global financial systems play a major role in most high-level laundering schemes, the international community is fighting money laundering through various means, including the Financial Action Task Force on Money Laundering (FATF), which as of 2005 has 33 member states and organizations. The United Nations, the World Bank and the International Monetary Fund also have anti-money-laundering divisions.

### **• FINANCIAL ACTION TASK FORCE (FATF)**

The Financial Action Task Force (FATF) is an intergovernmental body that works for the development of standards for combating money laundering and terrorist financing. It also ensures adherence to its standards by making sure that countries across the world bring about legislative and regulatory reforms in these areas. It further monitors the progress of the anti-money laundering efforts of its members. Forty plus nine recommendations of FATF are considered as global standards on Anti-money laundering and combating of financing of terrorism.

### **Benefits of implementing the FATF Recommendations:**

- 1. Securing a more transparent and stable financial system that is more attractive to foreign investors:** Corrupt and opaque financial systems are inherently unstable.

Excessive money laundering can cause increased volatility of international capital flows and exchange rates, market disparities, and distortions of investment and trade flows.

- 2. Ensure that financial institutions are not vulnerable to infiltration or abuse by organised crime groups:** Financial institutions that are exploited in this manner are exposed to reputational risk, financial instability, diminished public confidence, threats to safety and soundness and other losses.
- 3. Build the capacity to fight terrorism and trace terrorist money:** Terrorists need money to finance attacks. Tracing this money is one of the few preventive tools that governments have against terrorism.
- 4. Meet binding international obligations, and avoid the risk of sanctions or other action by the international community:** The international community- through numerous international treaties, United Nations Security Council Resolutions and best practices- has endorsed the FATF Recommendations at the highest political level.
- 5. Avoid becoming a haven for criminals:** Countries with weak AML/ CFT systems are attractive to criminals because they provide an environment in which criminals can enjoy the profits of their crimes and finance their illicit activities with little fear of facing punishment.

India became the 34th country member of the Financial Action Task Force in 2010 . India is also a signatory to various United Nations Conventions which deal with anti money laundering and countering financing of terrorism.

### **• BASEL STATEMENT OF PRINCIPLES**

On the financial front, the Committee on Banking Regulation and supervisory Practices

issued the Basel Statement of Principles on the prevention of criminal use of the banking system for the purpose of money laundering in December 1988.

The Statement of Principles does not restrict itself to drug-related money laundering but extends to all aspects of laundering through the banking system, i. e. the deposit, transfer and/ or concealment of money derived from illicit activities whether robbery, terrorism, fraud or drugs. It seeks to deny the banking system to those involved in money laundering by the application of the following principles:

- a) **Know your customer** - banks should make reasonable efforts to determine the customer's true identity, and have effective procedures for verifying the bona fides of new customers (whether on the asset or liability side of the balance sheet)
- b) **Compliance with laws** - bank management should ensure that business is conducted in conformity with high ethical standards, laws and regulations being adhered to and ensuring that a service is not provided where there is good reason to suppose that transactions are associated with laundering activities.
- c) **Co-operation with law enforcement agencies** - within any constraints imposed by rules relating to customer confidentiality, banks should co-operate fully with national law enforcement agencies including, where there are reasonable grounds for suspecting money laundering, taking appropriate measures which are consistent with the law.
- d) **Adherence to the Statement** - The full text of this section of the Statement is worth quoting in full.

## • UN CONVENTION AGAINST ILLICIT TRAFFICKING IN NARCOTIC DRUGS AND PSYCHOTROPIC SUBSTANCES (THE VIENNA CONVENTION).

This is one of the most important international treaties in the past 50 years. It not merely requires its signatory states to criminalise the laundering of drug money, and to confiscate it where found, but lays down so far as possible a common wording for the criminal statutes, and a common mode of enforcement. It also requires full and prompt co-operation between the signatory states for the enforcement of these laws anywhere in the world. This agreement in December 1988 commits all countries that ratify it to introduce a comprehensive criminal law against laundering the proceeds of drug trafficking and to introduce measures to identify, trace, and freeze or seize the proceeds of drug trafficking. The UK was one of the first countries to ratify this Convention which has been ratified by over 50 countries.

This UN Treaty is of foundational importance in relation to international co-operation in the area of drug trafficking. In the European context alone, it exerted a major influence on the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the EC Directive on prevention of the use of the financial system for the purpose of money laundering. On a wider stage it has formed an essential framework for the work of the FATF and, indeed, implementation and ratification of the treaty was the first of the recommendations made by the FATF. Several United Kingdom legislative provisions are taken almost directly from the treaty.

The recitals narrate that the Parties to the Convention recognise that links between illicit drug traffic and other related organised criminal activities which undermine the legitimate economies and threaten the stability, security and sovereignty of States; and that illicit drug trafficking is an international criminal activity that generates large profits and wealth, enabling transnational, criminal organisations to penetrate, contaminate and corrupt the structures of government, legitimate commercial and financial business and society at all its levels

and they are therefore determined to deprive persons engaged in illicit traffic of the proceeds of their criminal activities and thereby eliminating their main incentive for so doing.

#### • International Money Laundering Information Network (IMoLIN).

IMoLIN is an Internet-based network assisting governments, organizations and individuals in the fight against money laundering and the financing of terrorism administered by UN office on Drugs and Crime. IMoLIN has been developed with the cooperation of the world's leading anti-money laundering organizations. It provides with an international database called Anti-Money Laundering International Database (AMLID) that analyses jurisdictions' national anti-money laundering legislation. It is intended as a tool for practitioners to assist them in their international cooperation and exchange of information efforts. Currently, the Anti-Money Laundering International Database (AMLID) 2nd Round of Legal Analysis has been launched by UNODC on 27 February 2006, IMoLIN has twelve participating organization, four international organizations<sup>85</sup>, and five international financial institutions on its website.

### INITIATIVES TAKEN BY INDIA TO COMBAT MONEY LAUNDERING

With its growing financial strength, India is vulnerable to money laundering activities.

In India, before the enactment of the Prevention of Money Laundering Act 2002 (PMLA- 02 hereinafter), the following statutes addressed scantily the issue in question:

- The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.
- The Income Tax Act, 1961.
- The Benami Transactions (Prohibition) Act, 1988.
- The Indian Penal Code and Code of Criminal Procedure, 1973.

- The Narcotic Drugs and Psychotropic Substances Act, 1985.
- The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988.

However, this was not sufficient with the growth of varied areas of generating illegal money by selling antiques, rare animal flesh and skin, human organ, and many such varied new areas of generating money which was illegal. Money-laundering was an effective way to launder the black money (wash it to make it clean) so as to make it white. The international initiatives as discussed above to obviate the threat not only to financial systems but also to the integrity and sovereignty of the nations and the Hawala episode in India triggered the need for an anti money-laundering law.

In view of the urgent need for the enactment of a comprehensive legislation inter alia for preventing money laundering and connected activities, confiscation of proceeds of crime, setting up of agencies and mechanisms for coordinating measures for combating money-laundering etc., the PML Bill was introduced in the Lok Sabha on 4th August 1998, which ultimately was passed on 17th January 2003.

Sec. 3 of PMLA defines offence of money laundering as whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money-laundering. It prescribes obligation of banking companies, financial institutions and intermediaries for verification and maintenance of records of the identity of all its clients and also of all transactions and for furnishing information of such transactions in prescribed form to the Financial Intelligence Unit-India (FIU-IND). It empowers the Director of FIU-IND to impose fine on banking company, financial institution or intermediary if they or any of its officers fails to comply with the provisions of the Act as indicated above.

PMLA empowers certain officers of the Directorate of Enforcement to carry out investigations in cases involving offence of money laundering and also to attach the property involved in money laundering. PMLA envisages setting up of an Adjudicating Authority to exercise jurisdiction, power and authority conferred by it essentially to confirm attachment or order confiscation of attached properties. It also envisages setting up of an Appellate Tribunal to hear appeals against the order of the Adjudicating Authority and the authorities like Director FIU-IND.

PMLA envisages designation of one or more courts of sessions as Special Court or Special Courts to try the offences punishable under PMLA and offences with which the accused may, under the Code of Criminal Procedure 1973, be charged at the same trial. PMLA allows Central Government to enter into an agreement with Government of any country outside India for enforcing the provisions of the PMLA, exchange of information for the prevention of any offence under PMLA or under the corresponding law in force in that country or investigation of cases relating to any offence under PMLA.

#### • Financial Intelligence Unit – India (FIU-IND)

It was set by the Government of India vide O.M. dated 18th November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

#### *The functions of FIU-IND are:*

1. **Collection of Information:** Act as the central reception point for receiving Cash

Transaction reports (CTRs) and Suspicious Transaction Reports (STRs) from various reporting entities.

2. **Analysis of Information:** Analyze received information in order to uncover patterns of transactions suggesting suspicion of money laundering and related crimes.
3. **Sharing of Information:** Share information with national intelligence/ law enforcement agencies, national regulatory authorities and foreign Financial Intelligence Units.
4. **Act as Central Repository:** Establish and maintain national data base on cash transactions and suspicious transactions on the basis of reports received from reporting entities.
5. **Coordination:** Coordinate and strengthen collection and sharing of financial intelligence through an effective national, regional and global network to combat money laundering and related crimes.
6. **Research and Analysis:** Monitor and identify strategic key areas on money laundering trends, typologies and developments.

#### • Enforcement Directorate

The Directorate of Enforcement was established in the year 1956 with its Headquarters at New Delhi. It is responsible for enforcement of the Foreign Exchange Management Act, 1999 (FEMA) and certain provisions under the Prevention of Money Laundering Act. Work relating to investigation and prosecution of cases under the PML has been entrusted to Enforcement Directorate. The Directorate is under the administrative control of Department of Revenue for operational purposes; the policy aspects of the FEMA, its legislation and its amendments are within the purview of the Department of Economic Affairs. Policy issues pertaining to PML Act, however, are the responsibility of the Department of Revenue. Before FEMA became effective (1 June

2000), the Directorate enforced regulations under the Foreign Exchange Regulation Act, 1973.

#### **Functions:-**

1. To collect, develop and disseminate intelligence relating to violations of FEMA, 1999, the intelligence inputs are received from various sources such as Central and State Intelligence agencies, complaints etc.
2. To investigate suspected violations of the provisions of the FEMA, 1999 relating to activities such as "hawala" foreign exchange racketeering, non-realization of export proceeds, non-repatriation of foreign exchange and other forms of violations under FEMA, 1999.
3. To adjudicate cases of violations of the erstwhile FERA, 1973 and FEMA, 1999.
4. To realize penalties imposed on conclusion of adjudication proceedings.
5. To handle adjudication, appeals and prosecution cases under the erstwhile FERA, 1973
6. To process and recommend cases for preventive detention under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act (COFEPOSA)
7. To undertake survey, search, seizure, arrest, prosecution action etc. against offender of PMLA offence.
8. To provide and seek mutual legal assistance to/ from contracting states in respect of attachment/ confiscation of proceeds of crime as well as in respect of transfer of accused persons under PMLA.

#### **• Role of Reserve Bank of India**

The regulatory purview of the Reserve Bank extends to a large segment of financial institutions, including commercial banks, co-operative banks, non-banking financial

institutions and various financial markets<sup>168</sup>. The Board for Financial Supervision (BFS) continued to exercise its supervisory role over those segments of the financial institutions that are under the purview of the Reserve Bank.

Recently, the RBI has issued a series of master circulars to the banks, about the precautions to be exercised in handling their customers' transactions. Important amongst these is a guidance note issued about treatment of customer and key to knowing the customer. The identity, background and standing of the customer should be verified not only at the time of commencement of relationship, but also be updated from time to time, to reflect the changes in circumstances and the nature of operations of the account.

RBI plays a significant role in AML activities. RBI recently blocked the application of Swiss bank UBS for a banking license in India on the ground that it was involved in \$8 billion money-laundering racket. RBI investigators found the link between UBS and Khan, as the businessman had deposited \$8 billion at a Zurich branch of UBS. They cited it as direct evidence for blocking the license of the bank.

#### **• Role of Securities Exchange Board of India**

Vulnerability of securities market to money-laundering activities have been discussed in the earlier part of this paper. Indian securities market is also prone to money-laundering activities. Intermediaries registered under the SEBI are under reporting obligation of PMLA 02. FIU-IND has also issued certain guidelines relating to KYC to be followed by these intermediaries.

The main source of money-laundering would be the Participatory Notes Transaction and Overseas Direct Investment Routes.

The stock market regulator has undertaken various initiatives to additionally safeguard the existing Indian capital market regulatory system. Sebi plans to review and consolidate various initiatives undertaken by it and the government over the period of time. The initiative is

necessary to overcome new challenges in rapid technological and market advances.

All market intermediaries' i.e. mutual funds, brokers, depositories, merchant bankers, portfolio managers and investment advisors are required to adhere to specified client dealing procedures like know your customer (KYC) and mandatory requirement of PAN (Permanent Account Number).

The existing Sebi guideline is based on the Prevention of Money Laundering (PMLA) Act, of 2002, which was further amended in 2005 and in 2009. However, Sebi plans to review and consolidate it by taking into consideration the new financial action task force (FAFT) standards.

### **CONCLUSION**

Combating money laundering is a dynamic

process because the criminals who launder money are continuously seeking new ways to achieve their illegal ends. Many important financial centers have now adopted legislation to curb drug-related money laundering.

However UN data reveals that terror group financing accounts for just 0.2 per cent of the total \$856 billion money laundered worldwide. While this amounts to just \$1.72 billion, this segment of money laundering has the potency to cause havoc for the global economy.

In order to reduce the vulnerability of the international financial system to money laundering, governments must intensify their efforts to remove any detrimental rules and practices which obstruct international co-operation against money laundering for this sharing of information is necessary.

•••

## WORLD ECONOMY

There are seven continents in the world viz., Asia, Europe, Australia, Africa, North America, South America (or Latin America) and Antarctica. The countries of the world are passing through different levels of development. North America, Western Europe, some East Asian countries are developed countries whereas large number of countries in Asia, Africa and Latin America are developing countries, some of them falling under the category of least developed countries. The developing countries include 'eastern tigers', 'emerging market economies' and many countries of the 'G-20'. It is, therefore, important to know about them.

### *North and South*

The developed countries are concentrated in the northern hemisphere whereas the underdeveloped countries are concentrated in the southern hemisphere. It is because of this reason that the developed and underdeveloped regions are euphemistically mentioned in economic literature as "North" and "South" respectively. Though Asia, which contains many poor countries is in Northern hemisphere and Australia, which is rich, is in Southern Hemisphere, by and large this North-South categorization of developed and underdeveloped countries indicates geographical concentration.

### *Third world*

The notion of third world refers to underdeveloped or developing countries which remained aloof from two cold war camps- Soviet Union and the United States of America. The word ~~third world~~ refers to those countries that remained non-aligned or neutral with either capitalism and NATO (which along with its allies represented the First World) or communism and

the Soviet Union (which along with its allies represented the Second World).

### *Least developed country (LDC)*

Least developed country (LDC) is the name given to a country which, according to the United Nations, exhibits the lowest indicators of socioeconomic development, with the lowest Human Development Index ratings of all countries in the world. The concept of LDCs originated in the late 1960s and the first group of LDCs was listed by the UN in its resolution 2768 (XXVI) of 18 November 1971. A country is classified as a Least Developed Country if it meets three criteria:

- poverty (three-year average GNI per capita of less than US \$905, which must exceed \$1,086 to leave the list)
- human resource weakness (based on indicators of nutrition, health, education and adult literacy) and
- economic vulnerability (based on instability of agricultural production, instability of exports of goods and services, economic importance of non-traditional activities, merchandise export concentration, handicap of economic smallness, and the percentage of population displaced by natural disasters).

LDC criteria are reviewed every three years by the Committee for Development Policy (CDP) of the UN Economic and Social Council (ECOSOC). Countries may "graduate" out of the LDC classification when indicators exceed these criteria. The United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN

OHRLS) coordinates UN support and provides advocacy services for Least Developed Countries. The classification (as of 1 January 2011) applies to 48 countries.

Since the LDC category was initiated, only three countries have graduated to developing country status. The first country to graduate from LDC status was Botswana in 1994. The second country was Cape Verde, in 2007. Maldives became the third country to graduate to developing country status on 1 January 2011. In 2011 the UN suggested that Equatorial Guinea, Samoa, Tuvalu, and Vanuatu are among the candidates for promotion from LDC status. At the UN's fourth conference on LDCs held in May 2011, delegates endorsed a goal targeting the promotion of at least half the current LDC countries within the next ten years.

### **DEVELOPED AND DEVELOPING COUNTRIES**

#### *Developing country*

Developing country is a term generally used to describe a nation with a low level of material well being. These are countries with more advanced economies than other developing nations, but which have not yet fully demonstrated the signs of a developed country, are categorized under the term newly industrialized countries. A developing country, also known as a less-developed country (LDC), is a nation with a low living standard, undeveloped industrial base, and low Human Development Index (HDI) relative to other countries.

#### *Developed Nations*

There is no single internationally-recognized definition of developed country, and the levels of development may vary widely within so-called developing countries, with some developing countries having high average standards of living. Kofi Annan, former Secretary General of the United Nations, defined a developed country as follows. "A developed country is one that allows all its citizens to enjoy a free and healthy life in a safe environment."

Although, there are similar notions about developing and developed countries among the multilateral organizations, they differ in their methods of classification of developing and developed nations. While the UN does not give any quantitative specification, the World Bank and the IMF give some quantifiable basis of difference.

### **THE UN SYSTEM OF CLASSIFICATION**

The United Nations Statistics Division says that there is no established convention for the designation of "developed" and "developing" countries or areas in the United Nations system. According to the United Nations, the designations "developed" and "developing" are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Thus, in common practice, Japan and South Korea in Asia, Canada and the United States in northern America, Australia and New Zealand in Oceania, and Europe, are considered "developed" regions or areas. In international trade statistics, the Southern African Customs Union is also treated as a developed region and Israel as a developed country; countries emerging from the former Yugoslavia are treated as developing countries; and countries of eastern Europe and of the Commonwealth of Independent States (code 172) in Europe are not included under either developed or developing regions.

### **THE IMF SYSTEM OF CLASSIFICATION OF DEVELOPING AND DEVELOPED COUNTRIES**

The IMF uses a flexible classification system that considers "(1) per capita income level, (2) export diversification-so oil exporters that have high per capita GDP would not make the advanced classification because around 70% of its exports are oil, and (3) degree of integration into the global financial system." From the IMF criteria India, China, Brazil, Mexico, Indonesia, Malaysia, the Middle Eastern countries, almost all the African countries fall under the category

of developing countries whereas G7 countries, South Korea, Australia etc. are developed countries. Thus, according to the classification from International Monetary Fund (IMF) before April 2004, all the countries of Eastern Europe (including Central European countries which still belongs to "Eastern Europe Group" in the UN institutions) as well as the former Soviet Union (USSR) countries in Central Asia (Kazakhstan, Uzbekistan, Kyrgyzstan, Tajikistan and Turkmenistan) and Mongolia, were not included under either developed or developing regions, but rather were referred to as "countries in transition"; however they are now widely regarded (in the international reports) as "developing countries".

The World Bank System of classification of developing and developed countries.

The World Bank classifies countries into four income groups. These are set each year on July 1. Economies were divided according to 2008 GNI per capita using the following ranges of income:

- Low income countries had GNI per capita of US\$1,005 or less.
- Lower middle income countries had GNI per capita between US\$1,006 and US\$3,975.
- Upper middle income countries had GNI per capita between US\$3,976 and US\$12,275.
- High income countries had GNI above US\$12,276.

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

#### **Newly Industrialised Countries (NIC)**

NICs are countries whose economies have not yet reached First World status but have, in a macroeconomic sense, outpaced their devel-

oping counterparts. Another characterization of NICs is that of nations undergoing rapid economic growth (usually export-oriented). Incipient or ongoing industrialization is an important indicator of a NIC. In many NICs, social upheaval can occur as primarily rural, agricultural populations migrate to the cities, where the growth of manufacturing concerns and factories can draw many thousands of laborers.

#### ***Emerging Economies***

In the 2008 Emerging Economy Report the Center for Knowledge Societies defines Emerging Economies as those "regions of the world that are experiencing rapid informationalization under conditions of limited or partial industrialization." It appears that emerging markets lie at the intersection of non-traditional user behavior, the rise of new user groups and community adoption of products and services, and innovations in product technologies and platforms.

#### ***Emerging Markets***

The term emerging markets is used to describe a nation's social or business activity in the process of rapid growth and industrialization. Originally brought into fashion in the 1980s by then World Bank economist Antoine van Agtmael, the term is sometimes loosely used as a replacement for emerging economies, but really signifies a business phenomenon that is not fully described by or constrained to geography or economic strength; such countries are considered to be in a transitional phase between developing and developed status. Examples of emerging markets include China, India, some countries of Latin America (particularly Argentina, Brazil, Chile, and Mexico), some countries in Southeast Asia, most countries in Eastern Europe, Russia, some countries in the Middle East (particularly in the Persian Gulf Arab States), and parts of Africa (particularly South Africa). Emphasizing the fluid nature of the category, political scientist Ian Bremmer defines an emerging market as "a country where politics matters at least as much as economics to the markets."

**BRIC Countries**

In recent years, new terms have emerged to describe the largest developing countries such as BRIC that stands for Brazil, China, India and Russia, along with BRICS (BRIC + South Africa), BRICM (BRIC + Mexico) and BRICK (BRIC + South Korea). These countries do not share any common agenda, but some experts believe that they are enjoying an increasing role in the world economy and on political platforms. In economics, BRIC (typically rendered as the "BRICS" or "the BRIC countries") is an acronym that refers to the fast-growing developing economies of Brazil, Russia, India, China and South Africa. The acronym was first coined and prominently used by Goldman Sachs in 2001 before South Africa joined in 2011.

**THE WORLD BANK CLASSIFICATION OF ECONOMIES**

The World Bank classifies economies of the world on the basis of Gross National Income per capita for operational and analytical purposes. Based on its GNI per capita, every economy is classified as low income, middle income (subdivided into lower middle and upper middle), or high income. Other analytical groups based on geographic regions are also used. The World Bank has identified following groups of countries on the basis of GNI per capita:

**Income group:** Economies are divided according to 2008 GNI per capita, calculated using the World Bank Atlas method. The groups are: low income, \$975 or less; lower middle income, \$976 - \$3,855; upper middle income, \$3,856 - \$11,905; and high income, \$11,906 or more. The Bank's analytical income categories (low, middle, high income) are based on the Bank's operational lending categories (civil works preferences, IDA eligibility, etc.).

**Geographic region:** Classifications and data reported for geographic regions are for low-income and middle-income economies only. Low-income and middle-income economies are sometimes referred to as developing economies.

The use of the term is convenient; it is not intended to imply that all economies in the group are experiencing similar development or that other economies have reached a preferred or final stage of development. Classification by income does not necessarily reflect development status.

**Lending category:** IDA countries are those that had a per capita income in 2008 of less than \$1,135 and lack the financial ability to borrow from IBRD. IDA loans are deeply concessional-interest-free loans and grants for programs aimed at boosting economic growth and improving living conditions. IBRD loans are nonconcessional. Blend countries are eligible for IDA loans because of their low per capita incomes but are also eligible for IBRD loans because they are financially creditworthy.

**Euro Zone**

The eurozone, officially called the euro area, is an economic and monetary union (EMU) of 17 European Union (EU) member states that have adopted the euro (\*) as their common currency and sole legal tender. The eurozone currently consists of Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain. Most other EU states are obliged to join once they meet the criteria to do so. No state has left and there are no provisions to do so or to be expelled.

Monetary policy of the zone is the responsibility of the European Central Bank (ECB) which is governed by a President and a Board of the Heads of National Central Banks. The principal task of the ECB is to keep inflation under control. Though there is no common representation, governance or fiscal policy for the currency union, some co-operation does take place through the Euro Group, which makes political decisions regarding the eurozone and the euro. The Euro Group is composed of the Finance Ministers of eurozone states, however in emergencies, national leaders also form the Euro Group.

**European Central Bank (ECB)**

The European Central Bank (ECB) is the institution of the European Union (EU) that administers the monetary policy of the 17 EU Eurozone member states. It is thus one of the world's most important central banks. The bank was established by the Treaty of Amsterdam in 1998, and is headquartered in Frankfurt, Germany. The current President of the ECB is Mario Draghi, former Governor of the Bank of Italy.

The primary objective of the European Central Bank is to maintain price stability within the Eurozone, which is the same as keeping inflation low. The Governing Council defined price stability as inflation (Harmonised Index of Consumer Prices) of around 2%. Unlike, for example, the United States Federal Reserve Bank, the ECB has only one primary objective with other objectives subordinate to it.

The key tasks of the ECB are to define and implement the monetary policy for the Eurozone, to conduct foreign exchange operations, to take care of the foreign reserves of the European System of Central Banks and promote smooth operation of the financial market infrastructure under the TARGET2 payments system and the technical platform (currently being developed) for settlement of securities in Europe (TARGET2 Securities). Furthermore, it has the exclusive right to authorise the issuance of euro banknotes. Member states could issue euro coins, but the amount must be authorised by the ECB beforehand (upon the introduction of the euro, the ECB also had exclusive right to issue coins). On 9 May 2010, the 27 member states of the European Union agreed to incorporate the European Financial Stability Facility. The EFSF's mandate is to safeguard financial stability in Europe by providing financial assistance to Eurozone Member States.

**2007-2012 GLOBAL FINANCIAL CRISIS**

The 2007-2012 global financial crisis is considered by many economists to be the worst financial crisis since the Great Depression of

the 1930s. It resulted in the collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world. In many areas, the housing market also suffered, resulting in evictions, foreclosures and prolonged unemployment. The crisis played a significant role in the failure of key businesses, declines in consumer wealth estimated in trillions of US dollars, and a downturn in economic activity leading to the 2008-2012 global recession and contributing to the European sovereign-debt crisis.

**Sub Prime Crisis**

The U.S. subprime mortgage crisis was a set of events and conditions that led to the late-2000s financial crisis, characterized by a rise in subprime mortgage delinquencies and foreclosures, and the resulting decline of securities backed by said mortgages. The percentage of new lower-quality subprime mortgages rose from the historical 8% or lower range to approximately 20% from 2004 to 2006, with much higher ratios in some parts of the U.S. A high percentage of these subprime mortgages, over 90% in 2006 for example, were adjustable-rate mortgages. These two changes were part of a broader trend of lowered lending standards and higher-risk mortgage products. Further, U.S. households had become increasingly indebted, with the ratio of debt to disposable personal income rising from 77% in 1990 to 127% at the end of 2007, much of this increase mortgage-related. After U.S. house sales prices peaked in mid-2006 and began their steep decline forthwith, refinancing became more difficult. As adjustable-rate mortgages began to reset at higher interest rates (causing higher monthly payments), mortgage delinquencies soared. Securities backed with mortgages, including subprime mortgages, widely held by financial firms, lost most of their value. Global investors also drastically reduced purchases of mortgage-backed debt and other securities as part of a decline in the capacity and willingness of the private financial system to support lending. Concerns about the soundness of U.S. credit

and financial markets led to tightening credit around the world and slowing economic growth in the U.S. and Europe.

The immediate cause or trigger of the crisis was the bursting of the United States housing bubble which peaked in approximately 2005-2006. High default rates on "subprime" and adjustable rate mortgages (ARM), began to increase quickly thereafter. Lenders began originating large numbers of high risk mortgages from around 2004 to 2007, and loans from those vintage years exhibited higher default rates than loans made either before or after.

An increase in loan incentives such as easy initial terms and a long-term trend of rising housing prices had encouraged borrowers to assume difficult mortgages in the belief they would be able to quickly refinance at more favorable terms. Additionally, the increased market power of originators of subprime mortgages and the declining role of Government Sponsored Enterprises as gatekeepers increased the number of subprime mortgages provided to consumers who would have otherwise qualified for conforming loans.

The worst performing loans were securitized by private investment banks, who generally lacked the GSE's market power and influence over mortgage originators. Once interest rates began to rise and housing prices started to drop moderately in 2006-2007 in many parts of the U.S., refinancing became more difficult. Defaults and foreclosure activity increased dramatically as easy initial terms expired, home prices failed to go up as anticipated, and ARM interest rates reset higher. Falling prices also resulted in 23% of U.S. homes worth less than the mortgage loan by September 2010, providing a financial incentive for borrowers to enter foreclosure. The ongoing foreclosure epidemic, of which subprime loans are one part, that began in late 2006 in the U.S. continues to be a key factor in the global economic crisis, because it drains wealth from consumers and erodes the financial strength of banking institutions.

In the years leading up to the crisis, signifi-

cant amounts of foreign money flowed into the U.S. from fast-growing economies in Asia and oil-producing countries. This inflow of funds combined with low U.S. interest rates from 2002-2004 contributed to easy credit conditions, which fueled both housing and credit bubbles. Loans of various types (e.g., mortgage, credit card, and auto) were easy to obtain and consumers assumed an unprecedented debt load.

As part of the housing and credit booms, the amount of financial agreements called mortgage-backed securities (MBS), which derive their value from mortgage payments and housing prices, greatly increased. Such financial innovation enabled institutions and investors around the world to invest in the U.S. housing market. As housing prices declined, major global financial institutions that had borrowed and invested heavily in MBS reported significant losses. Defaults and losses on other loan types also increased significantly as the crisis expanded from the housing market to other parts of the economy. Total losses are estimated in the trillions of U.S. dollars globally.

While the housing and credit bubbles were growing, a series of factors caused the financial system to become increasingly fragile. Policymakers did not recognize the increasingly important role played by financial institutions such as investment banks and hedge funds, also known as the shadow banking system. Shadow banks were able to mask their leverage levels from investors and regulators through the use of complex, off-balance sheet derivatives and securitizations.

These instruments also made it virtually impossible to reorganize financial institutions in bankruptcy, and contributed to the need for government bailouts. Some experts believe these institutions had become as important as commercial (depository) banks in providing credit to the U.S. economy, but they were not subject to the same regulations. These institutions as well as certain regulated banks had also assumed significant debt burdens while providing the loans described above and did not have

a financial cushion sufficient to absorb large loan defaults or MBS losses.

These losses impacted the ability of financial institutions to lend, slowing economic activity. Concerns regarding the stability of key financial institutions drove central banks to take action to provide funds to encourage lending and to restore faith in the commercial paper markets, which are integral to funding business operations. Governments also bailed out key financial institutions, assuming significant additional financial commitments.

The risks to the broader economy created by the housing market downturn and subsequent financial market crisis were primary factors in several decisions by central banks around the world to cut interest rates and governments to implement economic stimulus packages. Effects on global stock markets due to the crisis have been dramatic. Between 1 January and 11 October 2008, owners of stocks in U.S. corporations had suffered about \$8 trillion in losses, as their holdings declined in value from \$20 trillion to \$12 trillion. Losses in other countries have averaged about 40%.

Losses in the stock markets and housing value declines place further downward pressure on consumer spending, a key economic engine. Leaders of the larger developed and emerging nations met in November 2008 and March 2009 to formulate strategies for addressing the crisis. A variety of solutions have been proposed by government officials, central bankers, economists, and business executives. In the U.S., the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010 to address some of the causes of the crisis.

The bursting of the U.S. housing bubble, which peaked in February 2007, caused the values of securities tied to U.S. real estate pricing to plummet, damaging financial institutions globally. The financial crisis was triggered by a complex interplay of valuation and liquidity problems in the United States banking system in 2008. Questions

regarding bank solvency, declines in credit availability and damaged investor confidence had an impact on global stock markets, where securities suffered large losses during 2008 and early 2009. Economies worldwide slowed during this period, as credit tightened and international trade declined. Governments and central banks responded with unprecedented fiscal stimulus, monetary policy expansion and institutional bailouts. Although there have been aftershocks, the financial crisis itself ended sometime between late-2008 and mid-2009. In the U.S., Congress passed the American Recovery and Reinvestment Act of 2009. In the E.U., the U.K. responded with austerity measures of spending cuts and tax increases without export growth and it has since slid into a double-dip recession.

Many causes for the financial crisis have been suggested, with varying weight assigned by experts. The U.S. Senate's Levin-Coburn Report asserted that the crisis was the result of "high risk, complex financial products; undisclosed conflicts of interest; the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of Wall Street." Two factors that have been frequently cited include the liberal use of the Gaussian Copula function and the failure to track data provenance.

The 1999 repeal of the Glass-Steagall Act effectively removed the separation between investment banks and depository banks in the United States. Critics argued that credit rating agencies and investors failed to accurately price the risk involved with mortgage-related financial products, and that governments did not adjust their regulatory practices to address 21st-century financial markets.

In response to the financial crisis, both market-based and regulatory solutions have been implemented or are under consideration. Paul Krugman, author of *End This Depression Now!* (2012), argues that while current solutions have stabilized the world economy, the world economy will not improve unless it receives further stimulus. Buchanan, Gjerstad, and

Smith argue that fiscal and monetary policy are ineffective, failing to reignite residential investment and construction as they have in past contractions. The current type of contraction requires balance sheet repair via currency depreciation and export-driven growth. Fiscal stimulus extends a current account deficit and retards export growth. If the world economy does not improve, many economists fear sovereign default is a real possibility in several European countries and even the United States.

### **EFFECTS ON FINANCIAL INSTITUTIONS**

Several major financial institutions either failed or were bailed-out by governments, or merged (voluntarily or otherwise) during the crisis. While the specific circumstances varied, in general the decline in the value of mortgage-backed securities held by these companies resulted in either their insolvency, the equivalent of bank runs as investors pulled funds from them, or inability to secure new funding in the credit markets. These firms had typically borrowed and invested large sums of money relative to their cash or equity capital, meaning they were highly leveraged and vulnerable to unanticipated credit market disruptions.

The five largest U.S. investment banks, with combined liabilities or debts of \$4 trillion, either went bankrupt (Lehman Brothers), were taken over by other companies (Bear Stearns and Merrill Lynch), or were bailed-out by the U.S. government (Goldman Sachs and Morgan Stanley) during 2008. Government-sponsored enterprises (GSE) Fannie Mae and Freddie Mac either directly owed or guaranteed nearly \$5 trillion in mortgage obligations, with a similarly weak capital base, when they were placed into receivership in September 2008. For scale, this \$9 trillion in obligations concentrated in seven highly leveraged institutions can be compared to the \$14 trillion size of the U.S. economy (GDP) or to the total national debt of \$10 trillion in September 2008.

Major depository banks around the world had also used financial innovations such as structured investment vehicles to circumvent capital ratio regulations. Notable global failures included Northern Rock, which was nationalized at an estimated cost of £87 billion (\$150 billion). In the U.S., Washington Mutual (WaMu) was seized in September 2008 by the USA Office of Thrift Supervision (OTS). This would be followed by the shotgun wedding of Wells Fargo & Wachovia after it was speculated that without the merger Wachovia was also going to fail. Dozens of U.S. banks received funds as part of the TARP or \$700 billion bailout. The TARP funds gained some controversy after PNC Financial Services received TARP money, only to turn around hours later and purchase the struggling National City Corp., which itself had become a victim of the subprime crisis. As a result of the financial crisis in 2008, twenty-five U.S. banks became insolvent and were taken over by the FDIC. As of August 14, 2009, an additional 77 banks became insolvent. This seven month tally surpasses the 50 banks that were seized in all of 1993, but is still much smaller than the number of failed banking institutions in 1992, 1991, and 1990. The United States has lost over 6 million jobs since the recession began in December 2007. The FDIC deposit insurance fund, supported by fees on insured banks, fell to \$13 billion in the first quarter of 2009. That is the lowest total since September, 1993.

#### ***Carl Levin and Tom Coburn committee***

The Permanent Subcommittee on Investigations (PSI) is the oldest subcommittee of the U.S. Senate Committee on Homeland Security and Governmental Affairs (formerly the Committee on Government Operations). The Permanent Subcommittee on Investigations was created at the same time as the Committee on Government Operations in 1952. On April 13, 2011 the Committee released its report on Wall Street and the Financial Crisis: Anatomy of a Financial Collapse. The 635-page bipartisan report was issued under the chairmanship of Carl Levin and Tom Coburn and also thus referred as the Levin-Coburn Report.

## **Mortgage-backed security (MBS)**

A mortgage-backed security (MBS) is an asset-backed security that represents a claim on the cash flows from mortgage loans through a process known as securitization. The process of securitization is complicated, and is highly dependent on the jurisdiction within which the process is conducted. The basics are:

1. Mortgage loans (mortgage notes) are purchased from banks and other lenders, and possibly assigned to a special purpose vehicle (SPV).
2. The purchaser or assignee assembles these loans into collections, or "pools".
3. The purchaser or assignee securitizes the pools by issuing mortgage-backed securities.

While a residential mortgage-backed security (RMBS) is secured by single-family or two to four family real estate, a commercial mortgage-backed security (CMBS) is secured by commercial and multifamily properties, such as apartment buildings, retail or office properties, hotels, schools, industrial properties and other commercial sites. A CMBS is usually structured as a different type of security than an RMBS.

These securitization trusts include government-sponsored enterprises and private entities which may offer credit enhancement features to mitigate the risk of prepayment and default associated with these mortgages. Since residential mortgages in the United States have the option to pay more than the required monthly payment (curtailment) or to pay off the loan in its entirety (prepayment), the monthly cash flow of an MBS is not known in advance, and therefore presents risk to MBS investors.

In the United States, the most common securitization trusts are Fannie Mae and Freddie Mac, U.S. government-sponsored enterprises. Ginnie Mae, a U.S. government-sponsored enterprise backed by the full faith and credit of the U.S. government, guarantees its investors receive timely payments, but buys limited numbers of mortgage notes. Some private institu-

tions also securitize mortgages, known as "private-label" mortgage securities. Issuances of private-label mortgage-backed securities increased dramatically from 2001 to 2007, and then ended abruptly in 2008 when real estate markets began to falter.

## **EUROPEAN SOVEREIGN DEBT CRISIS**

The European sovereign debt crisis is an ongoing financial crisis that has made it difficult or impossible for some countries in the euro area to refinance their government debt without the assistance of third parties. From late 2009, fears of a sovereign debt crisis developed among investors as a result of the rising private and government debt levels around the world together with a wave of downgrading of government debt in some European states.

Causes of the crisis varied countrywise. In several countries, private debts arising from a property bubble were transferred to sovereign debt as a result of banking system bailouts and government responses to slowing economies post-bubble. In Greece, unsustainable public sector wage and pension commitments drove the debt increase. The structure of the Eurozone as a monetary union (i.e., one currency) without fiscal union (e.g., different tax and public pension rules) contributed to the crisis and impacted the ability of European leaders to respond. European banks own a significant amount of sovereign debt, such that concerns regarding the solvency of banking systems or sovereigns are negatively reinforcing.

Concerns intensified in early 2010 and thereafter, leading Europe's finance ministers on 9 May 2010 to approve a rescue package worth €750 billion aimed at ensuring financial stability across Europe by creating the European Financial Stability Facility (EFSF).

In October 2011 and February 2012, the eurozone leaders agreed on more measures designed to prevent the collapse of member economies. This included an agreement whereby banks would accept a 53.5% write-off of Greek debt owed to private creditors, increasing the EFSF to about €1 trillion, and requiring

European banks to achieve 9% capitalisation. To restore confidence in Europe, EU leaders also agreed to create a European Fiscal Compact, including the commitment of each participating country to introduce a balanced budget amendment.

While sovereign debt has risen substantially in only a few eurozone countries, it has become a perceived problem for the area as a whole. Prior to May, 2012, the European currency remained stable. As of mid-November 2011, the euro was even trading slightly higher against the bloc's major trading partners than at the beginning of the crisis. Three countries significantly affected, Greece, Ireland and Portugal, collectively accounted for 6% of the eurozone's gross domestic product (GDP). During June 2012, the Spanish debt crisis became a prime concern for the Euro-zone. Interest rates on Spain's debt rose significantly and its ability to access capital markets was affected, leading to a bailout of its banks and other measures.

The European sovereign debt crisis resulted from a combination of complex factors, including the globalization of finance; easy credit conditions during the 2002-2008 period that encouraged high-risk lending and borrowing practices; the 2007-2012 global financial crisis; international trade imbalances; real-estate bubbles that have since burst; the 2008-2012 global re-

cession; fiscal policy choices related to government revenues and expenses; and approaches used by nations to bail out troubled banking industries and private bondholders, assuming private debt burdens or socializing losses.

Commentator and Financial Times journalist Martin Wolf has asserted that the root of the crisis was growing trade imbalances. He notes in the run-up to the crisis, from 1999 to 2007, Germany had a considerably better public debt and fiscal deficit relative to GDP than the most affected eurozone members. In the same period, these countries (Portugal, Ireland, Italy and Spain) had far worse balance of payments positions. Whereas German trade surpluses increased as a percentage of GDP after 1999, the deficits of Italy, France and Spain all worsened.

Paul Krugman wrote in 2009 that a trade deficit by definition requires a corresponding inflow of capital to fund it, which can drive down interest rates and stimulate the creation of bubbles: "For a while, the inrush of capital created the illusion of wealth in these countries, just as it did for American homeowners: asset prices were rising, currencies were strong, and everything looked fine. But bubbles always burst sooner or later, and yesterday's miracle economies have become today's basket cases, nations whose assets have evaporated but whose debts remain all too real."

# INTERNATIONAL TRADE AND FINANCE

## TRADE THEORIES AND INTERNATIONAL FINANCE

The term International trade refers to the exchange (exports and imports) of goods & services among nations. This process of exports and imports involves two or more nations with different national currencies. Therefore in order to make the exchange effective, some universally accepted currencies or precious metals are used (other than the barter trade to settle the transactions). The precious metals used are generally gold and bullion whereas the universally accepted currencies are the national currencies of a few developed nations who have substantial presence in the world trade and hence their currencies are easily accepted by trading nations. These currencies include U.S. Dollars, Japanese Yen and European Euro, etc. Since international trade worth billions of dollars takes place annually, it seems that there exists some obvious mutual benefits to the trading nations. Different theories have been put forward to explain their advantages which are listed below:-

- (1) **Mercantilism:** This was the first formal writing on international trade, originated during the seventeenth and eighteenth century. This line of thinking advocates that the way a nation could become rich and powerful was to export more and import less. The resulting export surplus would then be settled through inflow of gold and bullion. Therefore this way, one nation could gain only at the expense of the other. This theory was later discarded by other theories which stress that trade will benefit both the trading nations.
- (2) **Absolute advantage theory:** This theory was propounded by 'Adam Smith'. It says

that if a nation is more efficient than another in the production of a commodity but is less efficient in producing a second commodity, then both nations can gain by each specializing in production of the commodity of its absolute advantage and exchanging part of the output with other nation for another commodity. Thus in this theory both nations gain unlike mercantilist's view where in international trade one nation can gain only at the expense of the other.

- (3) **Comparative advantage theory:** This theory propounded by David Ricardo in 1817, is an improvement over absolute advantage theory and is also till date regarded as the most important and unchallenged law of economics. It says that even if a nation is less efficient (i.e. has an absolute disadvantage) than another in the production of both the commodities there is still a basis for mutually beneficial trade. The first nation should specialize in the production and export of the commodity in which its absolute disadvantage is smaller (i.e. its commodity of comparative advantage) and import the commodity in which its absolute disadvantage is larger (i.e. its commodity of comparative disadvantage). This can be shown with the help of an example:-

	Wheat (bushels/ Labor hour)	U.S	U.K.
	6	1	
Cloth (yards/ Labor hour)	4	2	

In the above table even though U.K is less efficient in the production of both the commodity, it can trade by exporting cloth (as its absolute disadvantage is smaller in cloth vis-à-vis wheat) and importing wheat and

still both the nations would gain.

- (4) **Opportunity Cost Theory:** Theory of comparative advantage has one weakness as it takes labor as the only factor of production in the production of both the commodities and difference in the labor productivity as the cause of trade. However, since labor is not the only factor of production, Haberler in 1936 propounded the opportunity cost theory. It says that cost of a commodity is the amount of a second commodity that a nation must give up to release just enough resources to produce an additional unit of the first commodity. Therefore for a 2 nation, 2-commodity world, the nation with a lower opportunity cost in the production of a commodity has a comparative advantage in that commodity whereas the other nation would have a comparative advantage in the other commodity. If we assume an increasing opportunity cost economy, then both the nations would specialize in the production of their respective commodities (based on lower opportunity cost) until the opportunity costs for both the commodities equalises in the two nations. Then two nations can trade at an exchange rate, which is mutually beneficial to the two nations.

### *Modern Theory of International Trade*

- (5) **Heckscher - Ohlin Theory:** Whereas other theories explained above assumed comparative advantage i.e. they do not explain why labor productivity differs (in case of Ricardo) or why opportunity costs differ (in case of Haberler). The Heckscher - Ohlin theory propounded originally by Eli Heckscher in 1899 (later developed by Ohlin) tries to identify the basis of comparative advantage i.e. what cause differences in opportunity costs (or relative commodity prices when expressed in monetary terms).

H-O theory states that a nation should specialize in the production and export of the

commodity, which is intensive in the use of its abundant factor. Thus in other words, this means that a nation will have its comparative advantage on the commodity which intensively uses its abundant factor. This will happen so because the relative factor price of the abundant factor will be lower in that nation and given the assumption of similar technology and similar consumer tastes and preferences, the relative commodity prices will also differ and this will form the basis of comparative advantage and international trade. Thus, the H-O theory identifies differences in factor endowments out of all other possible factors, as the basis of comparative advantage and international trade.

One more extension of the Heckscher - Ohlin theory is that International trade will equalize the relative and absolute returns to homogenous factor in the two nations. Thus international trade serves to bridge the gap in factor returns in different nations and acts as a substitute for International mobility of factors. This equalization will come through because differences in relative commodity prices will force trade among nations. As the nation with the abundant factor will produce more of the commodity which is intensive in the use of its abundant factor, then demand for the abundant factor will increase and hence its relative factor price will increase, opposite will happen with the other nation. This will bring in equality in the relative factor prices in the two nations and later on will lead to equality in absolute factor returns also.

### **BALANCE OF PAYMENT**

Till now our discussion has been largely focussed on real side of the international trade. We discussed about the comparative advantages of the nations in terms of relative commodity prices and explained how international trade brings about equalisation of relative commodity prices and relative factor prices. How-

ever, putting money values to these figures involves some complication as international trade involves more than one currency and hence we need to explain the concept of exchange rate, balance of trade, balance of payments, etc.

It is an accounting record of international money flows (current as well as capital) of a nation with the rest of the world. It records financial flows in a specific period such as one year. Financial in-

flows such as receipts for exports or when a foreigner invests in the stockmarket, are treated as credits or positive entries. Outflows such as payments for imports or the purchase of shares on a foreign stock market are debits or negative entries. The accounts are double entry and hence they are always equal. For eg. the export of goods involves the receipt of cash (credit) which represents a claim on another country (the debit). Thus by definition, the balance of payments must balance.



### ***Components of Balance of Payments***

The format of the balance of payments given below shows the important types of transactions that enter the balance of payments.

#### **Balance of trade (BOT)**

- = Net visibles
- = Export of visibles minus import of visibles
- = Export of goods - Import of goods

#### **Balance of payment**

- = BOT + Net Invisibles
- = BOT + (Export of Services - Import of Services)

### ***Current Accounts***

The current account consists of two major items, namely (a) merchandise (goods) exports and imports; and (b) invisible (services such as transport, shipping, Banking, insurance, rent, profit and interest etc.) exports and imports.

#### ***Capital Account***

The capital account consists of short-term and long-term capital transactions. Capital outflows represents debit and capital inflow represents credit. It must, however, be noted that payment and receipt on loans and dividend are recorded on current account since they are really payments for the services of capital during a particular period.

***Unilateral Transfer Account***

Unilateral transfers are another term for gifts, and include private remittances, government grants, repatriations and disaster relief. Unilateral payments received from abroad are credits and those made abroad are debits. These are often accounted for in the invisible accounts.

***Official Reserve Account***

Official reserves represent the holdings by the government in the form of foreign currency and securities and gold. The official reserves usually consist of such assets only which are accepted as a means of international payments.

Official reserves refer to the Gold and foreign currencies held by the government. It indicates a country's ultimate ability to pay for imports and signals pressures on the balance of payments. They are presented as a nominal value at the day, month and/or year end. A general yardstick is that a nation should have, on an average, official reserves sufficient to cover three months' imports. Changes in the level of official reserves suggest foreign exchange intervention and therefore indicated pressures on the currency. A fall in the reserves suggests that there was intervention to offset currency weakness whereas a rise suggests intervention to hold the currency down. The central bank intervention gave rise to a new term called sterilization:- It is defined as follows. When a central bank sells reserves and purchases its own currency, the domestic money supply is reduced in size by the amount of domestic currency swallowed up by the bank. On the other hand purchases of foreign currency boost the money supply. Such intervention is sterilized. Central Bank neutralizes the effect on the money supply with some other action, such as the purchase or sale of government bonds.

***Balance of Trade and Balance of Payment***

—Balance of Trade— takes into account only those transactions arising out of the exports and imports of the visible items, it does not consider the exchange of invisible items.

Visible items refer to merchandise or trade in goods only. Therefore balance of trade refers to net exports of goods.

Balance of trade = Export of goods - Import of goods.

Invisible items refer to trade in services plus various payments and receipts in the form of rents, interest, profits and dividends. Trade in services includes payments and receipts regarding Banking, shipping and insurance. Invisibles also include expenditure by tourists and gifts and unilateral remittances by the nationals of a country working abroad.

Balance of payments takes into account the exchange of both the visible and invisible items. So to say

Balance of payments = Balance of Trade + net invisibles.

This represents comprehensive picture of a country's economic and financial transactions with the economic and financial transactions of the rest of the world than the balance of trade.

***Balance of Payments Crisis***

As bills must be paid, ultimately a country's accounts must balance (although because real life is never that neat a balancing item is usually inserted to cover up the inconsistencies). "Balance of payments crisis" is a politically charged phrase. But a country can often sustain a current account deficit for many years without its economy suffering, because any deficit is likely to be tiny compared with the country's National Income and wealth. Indeed, if the deficit is due to firms importing technology and other capital goods from abroad, which will improve their productivity, the economy may benefit. A deficit that has to be financed by the public sector may be more problematic, particularly if the public sector faces limits on how much it can raise taxes or borrow or has few financial reserves. For instance, when the Russian government failed to pay the interest

on its foreign DEBT in August 1998 it found it impossible to borrow any more money in the international financial markets. Nor was it able to increase taxes in its collapsing economy or to find anybody within Russia willing to lend it money. That truly was a balance of payments crisis.

In the early years of the 21st century, economists started to worry that the United States would find itself in a balance of payments crisis. Its current account deficit grew to over 5% of its GDP, making its economy increasingly reliant on foreign CREDIT.

### *Terms of trade*

It refers to the ratio of export prices to import prices. It measures the volume of imports that can be bought with one unit of exports. It is presented as index numbers. An improvement in the nation's terms of trade indicates that export earnings will buy more imports but its effect on trade balance or BOP will depend on many other related factors. Terms of trade are said to improve if export prices rise more highly or fall more slowly than import prices. Typically, an exchange rate devaluation or depreciation increases import prices relative to export prices and causes the terms of trade to deteriorate.

## **EXCHANGE RATE**

Exchange rate is the amount of the national currency required by a nation to purchase one unit of foreign currency say US Dollar. Since most of the international trade that takes place today is in money terms exchange rates have an important influence on the flow of international trade. Two types of exchange rate regimes exist in the contemporary world today:-

- a) Fixed exchange rate.
- b) Floating/ Fluctuating exchange rate.

In the fixed exchange rate, the exchange rate of the national currency is fixed and tied to another universally accepted foreign currency say US Dollar. The Central Bank of the nation stands ready to purchase and sell the foreign

currency to keep the exchange rate fixed. In the case of fluctuating exchange rate, exchange rate is determined by the demand and supply of foreign exchange by the nationals of a country. The exchange rate appreciates or depreciates, depending on the market forces of demand and supply. This in turn has an impact on the competitive position of the economy. A devaluation/ depreciation of a nation's currency may decrease imports and increase exports to help improve the foreign exchange position of the nation. This is measured and reflected in Balance of Payments position of the nation.

### *Different Exchange Rate Regimes*

**Gold Standard:** Before 1914, exchange rates were fixed in terms of gold. Trade was mainly in physical goods and capital flows were limited. A country, which developed a deficit on its current account, would first consume its reserves of foreign currencies. Then it would have to pay for the imports by shipping gold. The transfer of gold would reduce the money supply in the deficit country since currencies were then backed by convertibility into gold. The contracting money supply in the deficit country would reduce prices and output and hence would lower its imports. The opposite will happen in the surplus country and thus the current account would automatically return to equilibrium. This system got out of balance in 1920's and was abandoned by early 1930's.

### *Flexible/Floating Exchange Rate*

After breaking down of gold standard and the end of World War II, an international conference was convened in America at Bretton Woods, New Hampshire in June 1944. The participants vowed to form the IMF and the World Bank and the major currencies were fixed in relation to the dollar (Pegging). Fluctuations were allowed to the extent of 1% on either side. In addition, the American Government agreed to buy gold on demand at \$35 per ounce. However, this pegged Bretton Woods system broke by the 1970's. Persistent American deficits had led to an international excess of dollars and

American gold reserves came under pressure. In 1971, Americans suspended the convertibility of the dollar into gold. Major currencies of the world were allowed to float against each other depending on the demand and supply. Since then exchange rates are largely floating and are determined by the market.

### **How exchange Rate is fixed in India**

The Exchange rate of Indian rupee is determined on the basis of a basket of currencies, which comprises currencies of its main trading partners as well as world economic powers such as the USA, the U.K., France, Japan, Germany, etc. In India foreign exchange rates are now completely market determined, i.e Indian exchange rate is floating exchange rate. Today Rupee is fully convertible on current account i.e. no prior approval of RBI is required to import goods and services except those in the negative list. However, capital account convertibility has till date remained a ticklish issue and it has not been permitted till now. The movement of capital is today regulated through Foreign Exchange Management Act (FEMA) 1999. The Tarapore Committee set up to study the procedure for the same recommended a phased programme over the three-year period and to achieve the preconditions for CAC. At present RBI intervenes only occasionally in the market to prevent any substantial diversion of the exchange rate from the fundamental levels.

As to what determines the exchange rate, no neat explanation can be given for the same, but two leading theories put forward are:-  
(i) Purchasing Power parity (ii) Investment Portfolios theory. Purchasing Power Parity is defined as the exchange rate, which equates the prices of a basket of goods and services in two countries. In the long run it is argued that currencies should move towards their PPP. Big Mac Index is one of the ways to ascertain PPP among nations. The portfolio approach suggests that exchange rates move to balance total returns (interest + expected exchange rate movements) among nations.

### ***Effective Exchange rate (EER) and Real Effective Exchange Rate (REER)***

There exist different versions of Exchange rates, including nominal exchange rate (which we have discussed so far).

EER is the average exchange rate against a basket of currencies, with which the nation trades. It is presented as index numbers.

REER measures the competitiveness of a national currency against the basket of currencies with which the nation trades.

Thus the exchange rate regime in India is a managed float with the nominal exchange rate(against a basket of currencies) targeted to achieving the real exchange rate which yields a sustainable current account deficit.

**Foreign Exchange Market:** It is a market where one country's currency can be exchanged for another country's. It is not a geographic location; instead it is an informal network of telephone, telex, facsimile and computer communications between banks, foreign exchange dealers - arbitrageurs and speculators. The market operates simultaneously at three tiers:-

- a) Individuals and corporations buy and sell foreign exchange through their commercial banks.
- b) Commercial banks trade in foreign exchange with other commercial banks in the same financial centre.
- c) Commercial banks trade in foreign exchange with commercial banks in other financial centres.

Foreign exchange market consists of a spot market and forward market. In the sport market, foreign currencies are sold and bought for delivery within two business days after the day of a trade. In the forward market, foreign currencies are sold or brought for future delivery. There are many types of participants in the foreign exchange market. They include exporters, governments, importers, multinational companies, tourists, commercial banks and central

banks. However large commercial banks and central banks are the two major participants in the foreign exchange market.

In the foreign exchange market, foreign exchange quotations are made in terms of number of units of local currency required to buy one unit of a foreign country. Hence India quotes its exchange rates in rupees, which can be exchanged for one unit of foreign exchange for example Rs. 46.50/ \$. This means that we require Rs. 46.50 to get one unit of US \$. Practically all-major newspapers in the world print a daily list of exchange rates.

**Cross rates:** Most currencies are traded against the US dollar, but at times exporters and importers need to know the exchange rate between two non-U.S. currencies. For example, the exchange rate between Indian Rupee and Korean Won. Because most currency pairs are not traded actively, their exchange rate is determined through their relationship to a widely traded third currency such as the U.S. dollars. The type of exchange rate desired here is known as the cross-rate.

The exchange rate quotations in the forward market are made either "outright" or in terms of the spread on the spot rate. For e.g. a trader may buy the 90-days outright forward quotation as Rs. 46.75/ \$ 1 or through spread on the spot rate in terms of basis points (one basis point - 0.01 per cent)

**Currency futures and options market:** Currency futures market is just like the currency forward market except that trade in the future market is done in standard units and only in the future market where forward market is an informal market in which contracting parties enter into a tailor made agreement for exchange rate.

**Currency options market:** Currency option is simply a contract that gives the holder the right to buy or sell any foreign currency at a specified price during a specified period. Whereas the currency options do not necessarily need to

be exercised at maturity, payment and delivery in futures contracts are required at maturity.

Different participants in the foreign exchange market enter into spot & forward/ futures contract for different reasons. The reasons include arbitrage, hedging or risk avoidance and speculation.

**Arbitrage:** Arbitrage is the purchase of an asset or a commodity in one market and its sale in another market to take advantage of a price differential. Professional arbitrageurs quickly transfer funds from one currency to another in order to profit from discrepancies between exchange rates in different markets. The process of arbitrage also works through the foreign exchange market to bring interest in national markets together.

**Hedgers:** They enter into forward/ future contracts to eliminate possible exchange losses on export and import orders denominated in foreign currencies. Hedgers mostly MNCs, engage in forward contract to protect the home currency value of foreign-currency denominated assets and liabilities. This way they insulate themselves from fluctuations in the foreign exchange market and are able to focus on the core areas of operation.

**Speculations:** Deliberately expose themselves to exchange risk by engaging in forward contracts in order to make a profit from exchange fluctuations.

## ECONOMIC INTEGRATION

The term economic integration refers to the kind of arrangement between two or more trading countries that remove artificial trade barriers such as tariff and quotas between them. In fact the term economic integration is a broad and general term, which covers several kinds of arrangement by which two or more countries mutually agree to draw their economies closer in terms of trade, investment and other kinds of economic cooperation. In a very developed kind of arrangement for economic integration, the countries may agree to integrate their social

and national policies as well. If we consider the level of integration in ascending order, there are various kinds of economic integration such as Free Trade Area, Customs Union, Common Market and Economic Union.

### **Forms of Economic Integration**

1. **Free Trade Area:** A Free Trade Area (FTA) is a grouping of the countries to bring about free trade between them. The FTA abolishes all restrictions on trade among the members but each member is left free to determine its own commercial policy with non-members. There are many examples of FTA, which are operational at present. North Atlantic Free Trade area (NAFTA) is one such arrangement among the USA, Mexico and Canada. There is an FTA between Singapore and Japan. India has also FTAs with Sri Lanka and Thailand.
2. **Customs Union:** A customs Union is a more advanced level of economic integration than the FTA. It not only eliminates all restrictions on trade among member countries, but also adopts a uniform commercial policy against the non-members. The European union started as a customs union.
3. **Common Market:** The Common market is a step ahead of the Customs Union. A common Market allows free movement of labour and capital within the Common Market, besides having the two characteristics of the Customs Union, namely, free trade among members and uniform tariff policy towards non-members. In its earlier stage European Union was like a Common Market.
4. **Economic Union:** It is the most advanced level of integration. This satisfies the conditions of the Common Market and additionally it also achieves some degree of harmonization of national economic policies. The European Union is a living example of this kind of arrangement, which requires all its members to abide by certain monetary and fiscal disciplines along with some harmonization in social and political arena.

### **What is Convertibility?**

When one currency is freely exchangeable with another in the market, this attribute is referred to as convertibility. In a convertible exchange rate regime we can purchase another currency by paying in with our currency at the market exchange rate.

Convertibility of a currency may be full or partial. Full float of a currency in the exchange market vis-à-vis other currencies for the determination of exchange rate is practiced by the developed nations. The developing countries like India usually adopt a policy of "managed float" or "partial float" (sometimes referred to as dirty float as well). India's exchange rate was determined through managed float till 1992. Before India adopted what we call Liberalised Exchange Rate Management System (LERMS) in 1992, the exchange rate of Rupee was determined by the Reserve Bank of India on the basis of a basket of currencies. In LERMS, or Partial Convertibility 60% of foreign currency holding was permitted to be converted on the market rate whereas remaining 40% on official rate.

### **Full Convertibility on Trade A/C**

A unified exchange rate was introduced in 1993 & 1994 budgets through the provision of full convertibility of rupee on trade account under the unified exchange rate regime; the 60:40 ratio was extended to 100 per cent conversion. This 100 per cent conversion was extended to almost the entire merchandise trade transactions (i.e. export and import of goods); and all receipts, whether on current or capital account of balance of payments (BOP), but not all payments.

### **Full Convertibility on Current Account**

In February 1994, the RBI undertook several steps towards achieving full convertibility of Current A/c. India achieved full convertibility on current A/c on 19th August, 1994, when the RBI further liberalized its exchange rate system of the IMF, under which India is committed to forsake the use of exchange restric-

tions on current international transactions as an instrument in managing the BOP. The transactions under current account may be one of the following:

- All payments due in connection with foreign trade, current business, including services and normal short-term banking and credit facilities.
- Payments due as interest on loans and as net income from other investments.
- Payments of moderate amount of amortisation of loans or for depreciation or direct investments, and
- Moderate remittance for family living expenses.

#### ***Full Convertibility on Capital Account***

Capital account convertibility refers to easy and free conversion of a currency, say rupee, in dollars for loan and investment purposes. India has so far not allowed full conversion on capital account because the health of financial sector in India is not considered strong enough for this. A committee called the Tarapore Committee was formed five years back at the behest of the international lending community and pro-reformists to suggest a roadmap for CAC. Transactions in the capital account may include giving and taking Loans and credits, investing for speculative purposes, etc. among others.

#### ***Main Advantages of capital account convertibility***

1. Smooth availability of funds to industries and traders.
2. A step forward towards globalisation by way of connecting domestic financial market with world financial market.

#### ***Apprehensions regarding capital account convertibility:***

1. Flight of capital.
2. Dominance of foreign financial institutions over domestic players.

#### ***Suggestions for moving over to capital account***

#### ***convertibility:***

1. First strengthen your own/ domestic market for Capital and improve financial fundamentals such as fiscal deficit and inflation.
2. Boost exports and then slowly open up.

#### ***Tarapore Committee on Capital Account Convertibility***

Tarapore Committee on Capital Account Convertibility suggested that notwithstanding advantages of Capital Account Convertibility, India should achieve certain preconditions and signpost before making any haste towards full convertibility. As long as the economy is not robust with regard to its fiscal management and external balance of payments, any measure to hasten full convertibility on the C/A would prove disastrous.

### **FOREIGN EXCHANGE MANAGEMENT ACT (FEMA), 1999**

The Foreign Exchange Management Act (FEMA) has replaced the Foreign Exchange Regulation Act (FERA). Main reason for making FEMA that relaxes control on foreign exchange is that India has made its currency, i.e. Rupee, convertible on current account. This is to facilitate the external trade and payments and promote the orderly development and main-

India.

#### **PRECONDITIONS AND SIGNPOSTS**

#### **FISCAL CONSOLIDATIONS**

- Reduction in Gross Fiscal Deficit as percentage of Gross Domestic Product from budgeted 4.5 in 1997-98 to 4.0 in 1998-99 and further to 3.5 in 1999-2000.
- Introduction of Consolidated Sinking Fund.
- Introduction of a system of fiscal transparency and accountability on the lines New Zealand Fiscal Responsibility Act.

## **MANDATED INFLATION RATE**

- The mandated rate of inflation for the 3 year should be an average of 3% to 5%.
- RBI should be given freedom to attain the tarred mandate of inflation approved by the Parliament.
- There should be clear and transparent guidelines on the circumstances under which the mandate could be changed.

## ***Some features of FEMA are as follows: -***

Foreign trade transactions could be done only with the persons authorized by R.B.I. No person can acquire, hold, own, possess or transfer any foreign exchange, foreign security or immovable property outside India, except in cases where the Act provides for this. Current account transactions are freely allowed. However, in the public interest, the union government, in consultation with the **RBI**, may impose reasonable restrictions on current account transactions. Foreign exchange can be drawn for all current account transactions, except those that are prohibited, while on the capital account forex outflow is allowed only for transactions that are permitted. The three schedules of FEMA (current account transactions Rules, 2000) specify the restrictions on current account transactions. The first schedule mentions the transactions that are prohibited, the second lists the transactions that need the government's permission and the third schedule contains the transactions that need the prior approval of the **RBI**.

**Prohibited Transactions:** In the **First Schedule** money earned from lottery winnings, racing/ riding or any other hobby is not allowed to be remitted. The **Second Schedule** lists transactions that need government's approval such as cultural tours and health insurance from a company abroad, to mention just two. The **Third Schedule** contains items, which require **RBI's** permission. Thus, if a current account transaction is not found in any of the above-mentioned schedules, **RBI** permission is not

required. Even on capital account transactions, the Central Bank has come out with twenty-five notifications, some of which cover these transactions as well as areas such as exports and insurance.

## **MONEY LAUNDERING ACT**

The Prevention of Money Laundering Act, which was recently amended to remove certain shortcomings, came into force on July 1, 2005. The Act, aimed at combating channelling of money into illegal activities, provides for attachment and seizure of property and records. It also provides for stringent punishment, including rigorous imprisonment of upto 10 years and fine of upto Rs. 5 lakh.

### **Main features:**

- FIs, including chit funds, cooperative banks, housing finance companies and non-banking financial entities, and intermediaries like stock-brokers, sub-brokers, share transfer agents, bankers and registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and others have to be registered with SEBI.
- Transactions include all cash of over Rs. 10 lakh or its equivalent in foreign currency, all series of cash transactions integrally connected to each other which have been valued below Rs 10 lakh or its equivalent in foreign currency where such transactions have taken place within one calendar month, and all suspicious transactions, whether or not made in cash.
- The financial intelligence unit has been set up as a multi-disciplinary unit for establishing links between suspicious or unusual financial transactions and underlying criminal activities.
- For better coordination and information sharing, FIU-IND would coordinate and support efforts of national and global intelligence, investigation and enforcement agencies in pursuing efforts against money laundering and related crimes.

- It would be the central nodal agency responsibility for receiving, processing, analysing and disseminating information relating to suspect financial transactions to these agencies who would protect it against misuse.
- Through its research and analysis function, FIU-IND would monitor and identify strategic key areas on money laundering trends, methods and developments.
- For the purpose of money-laundering, the Act has identified certain offences under the Indian Penal Code, Narcotics Drug and Psychotropic Substances Act, Arms Act, Wild Life (Protection) Act, Immoral Traffic (Prevention) Act and Prevention of Corruption Act.

The Act, in line with India's commitment to fight all forms of economic crimes, came into being in 2002 but could not be brought into force due to certain lacunae. It was accordingly in the Parliament's session to remove the shortcomings that it came into effect on 1 July, 2005. As per the Act, every banking company, financial institution and intermediary needs to maintain a record of all transactions, the nature and value of which is being prescribed in the rules. The Money Laundering (Amendment) Regulations, 2012, have come into force on 1st October 2012.

The Government has entrusted the work relating to investigation, attachment of property/ proceeds of crime relating to the scheduled offences under the Act and filing of complaints, etc. to the Directorate of Enforcement in the Finance Ministry. India is committed to fight all forms of economic crimes, including money laundering.

The government of India has enacted a number of special laws regulating customs, excise, taxes, foreign exchange, narcotic drugs, banking, insurance, trade and commerce to deal with economic crimes.

### **SEZ BILL**

The Lok Sabha passed the Special Economic

Zones Bill, 2005 after adopting an official amendment to drop the Bill's provision in granting flexibility in labour laws by the States in the proposed Central Act. The original Act had no direct Central role in laying down labour policy in the SEZs. The Central legislation proposed that the States may take suitable steps to grant exemption from labour laws (clause 18) appli-

Act, 2005 by dropping this clause.

### **INDIRECT TAX CHANGES**

7 pc additional customs duty would be applicable on Laptops as in case of computers.

4 pc countervailing duty removed on components used in the manufacture of mobile handsets.

Duty on molasses cut from Rs 1,000 per tonne to Rs 750 per tonne.

Excise duty anomaly on nylon tyre cord fabric removed.

### **Objectives of the Act**

- (1) Making available goods and services free of taxes and duties, bolstered by integrated infrastructure for export production.
- (2) A package of incentives to attract foreign and domestic investments for promoting export-led growth.
- (3) The Bill is silent on conferring powers to the Development Commissioners for allowing flexible labour policies in SEZ units.

### **Important Features of the Act**

- To attract investment, both domestic and foreign.
- To ensure employment generation since export activities hold the potential for job creation.
- Provides for a stable and long-term fiscal policy framework with minimum regulatory intervention for such zones.
- It also provides for a single-window clear-

ance mechanism for the establishment of SEZs.

- The Act provides that SEZs could also take the form of port, airport, inland container depot, land station and land customs stations, as the case may be, under Section 7 of the Customs Act.
- It empowers the Union Government to specify an officer or agency for carrying out surveys or inspections to verify or ensure compliance with the provisions of the Central Act by a developer or an entrepreneur.
- Under this dispensation, units would be eligible for 100 per cent tax exemption for 5 years, 50 per cent for the next five years and 50 per cent of the ploughed back export profits for the next five years (in all 15 years).
- The Bill also proposes to grant exemption of capital gains on transfer of assets in the case of shifting of industrial undertaking from urban area or any other area to a SEZ on the lines of Section 54G of the Income-Tax Act.

### ***Special Economic Zones (SEZs)***

A new scheme was introduced in Exim Policy from 1.4.2000 for establishment of Special Economic Zones (SEZs) in different parts of the country, with a view to providing an internationally competitive and hassle free environment for export production.

The units operating in those zones are to be deemed as outside the country's customs territory and will have full flexibility of operations. They would be able to import capital goods and raw materials duty free and would also be able to access the same from Domestic Tariff Area (DTA) without payment of excise duty.

Further no permission would be necessary for inter-unit Sales or transfer of goods. There would be no wastage norms or input output norms. They would be able to undertake job work for the DTA units and would also be able to get their goods processed in the DTA.

The only condition would be that the units in the zones would have to be a net foreign exchange earner. DTA sales would be on payment of full customs duties and in accordance with the import policy in force. The movement of goods between SEZs and ports will be unrestricted and without any hindrance.

The SEZs imply a qualitative transformation of the traditional Export Processing Zones (EPZs). The improvements include 100 per cent FDI investment through automatic route to manufacturing SEZ units (barring a handful of sensitive industries), no routine examination by customs of export and import cargo in SEZs, all imports on self-certification basis, duty free material to be utilized over five years, no pre-determined value addition, DTA sales on full duty payment and various procedural simplification for operations like record keeping, inter-unit transfers, subcontracting, disposal of obsolete materials, etc.

SEZs will be permitted to set up in the public, private, joint sector or by the State Governments with a minimum size of not less than 100 hectares. These units may be for manufacturing, trading or service activity. Package of incentives announced so far include exemption from industrial licensing for manufacture of items reserved for SSIs and removal of sectoral ceilings on FDI in SEZ units.

From November 1, 2000 Export Processing Zones at Kandla, Santa Cruz (Mumbai), Kochi and Surat have been converted into SEZs. Approval has also been given for setting up SEZs at Nawguner (Tamilnadu), Positra (Gujarat), Kulpi (West Bengal), Paradeep (Orissa), Bhadohi and Kanpur (Uttar Pradesh), Kakinada (Andhra Pradesh), Dronagiri (Maharashtra) and Indore (Madhya Pradesh).

The performance of SEZs largely depends on comprehensive liberalisation and freedom, as inherent in the Chinese SEZ model. However, Chinese zones are many times larger than those currently planned in India. The extent of success of SEZs in India would, therefore, cru-

cially depend upon the degree to which domestic regulations; restrictions and infrastructure inadequacies are eliminated in those zones.

### **Export Processing Zones, Special Economic Zones & Export Houses**

FTZs/ EPZs are industrial estates, which form enclaves within the national customs territory and are usually situated near international port and/or airport. The entire production of such Zones is normally exported. Imports of raw materials, intermediate products, equipment & machinery required for export production are not subject to the payment of customs duty. A characteristic feature of EPZs is the speed and simplicity of import and export transactions. Time-consuming customs procedures on import into the Zones and exports from the zones are kept to minimum.

Export Processing Zones in India—

***Seven Export Processing Zones operating in the country are:***

1. Kandla Free Trade Zone (KFTZ), Kandla, Gujarat.
2. Santa Cruz Electronics Export Processing Zone (SEEPZ), Santa Cruz, Mumbai
3. Noida Export Processing Zones, Noida, UP.
4. Madras Export Processing Zones, Chennai.
5. Cochin Export Processing Zones, Cochin, Kerala.
6. Falta Export Processing Zones, Falta, West Bengal.
7. Visakhapatnam Export Processing Zone, Visakhapatnam.



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# POVERTY & UNEMPLOYMENT

## WHAT IS POVERTY?

Poverty refers to the inability to get the minimum consumption requirement for life, health and efficiency. Poverty is painful and it leads to discontentment. If people are left to live amidst poverty for a long time it may have serious political repercussions. The people's discontentment may lead to social tension as seen in Bihar, Andhra and M.P. (Naxalite movements).

**The word 'Poverty' is used in two senses:**

1. Absolute Poverty
2. Relative Poverty

**1. Absolute Poverty:** This approach defines minimum level of income required to sustain life: for example, estimating minimum dietary needs and how these can be most cheaply met. In the official estimates of poverty by the Planning Commission in India, the concept of 'absolute poverty' has been adopted. The concept of absolute poverty in India is based on 'nutritional criteria' expressed in terms of 'consumption expenditure'. There is one 'consumption expenditure level' above which the people are well-off and below which people are poor. This consumption expenditure level is known as 'poverty line'.

**2. Relative Poverty:** This approach defines poverty relative to appropriate comparator groups. Thus while an individual may have more than enough income to sustain life, if it is very low compared to the rest of the community, the individual would be viewed as being in poverty. As society grows richer so the income level defining poverty rises. On this basis we have various economic categories in society (1) Higher Income Groups (2) Middle Income

Groups and (3) Lower Income Groups.

### *Poverty Ratios by URP and MRP*

S.No	Category	1993-94	2004-05
	By Uniform Recall		
	Period (URP)		
	Method		
1.	Rural	37.3	28.3
2.	Urban	32.4	25.7
3.	All India	36.0	27.5
	By mixed Recall		
	Period (MRP)		
	Method		
4.	Rural	27.1	21.8
5.	Urban	23.6	21.7
6.	All India	26.1	21.8

**Table 1:**

Source: Planning Commission

### *Poverty Estimates 2004-05*

1. The Planning Commission as the Nodal agency in the Government of India for estimation of poverty has been estimating the number and percentage of poor at national and state levels. Since, March 1997 it has been using the Expert Group Method (Expert Group on Estimation of Proportion and Number of Poor) to estimate poverty. According to this method the estimates of poverty are made from the large sample survey data on household consumer expenditure conducted by the National Sample Survey Organization (NSSO) of the Ministry of Statistics and Programme Imple-

- mentation. Using this methodology the Planning Commission, in the past, has released poverty estimates for the year 1973-74, 1977-78, 1983, 1987-88 and 1993-94 by the Government of India on 11th March 1997. Subsequently, the poverty estimates for 1999-2000 were released by the Government of India on 22nd February 2001. While releasing the estimates of poverty for 1999-2000, it had been noted that these estimates were not strictly comparable with the estimates for the previous years.
2. The state-wise rural and urban poverty lines for the year 2004-05 are given in Table-1. These are estimated using the original state-specific poverty lines identified by the Expert Group and updating them to 2004-05 prices using the Consumer Price Index of Agricultural Labourers (CPIAL) for rural poverty lines and Consumer Price Index for Industrial Workers (CPIIW) for urban poverty lines.
  3. The NSSO released the result of the latest large sample survey data on household consumer expenditure (NSS 61st Round), covering the period July 2004 to June 2005 [Report No.508 (61/ 1.0/ 1)]. From this data, two different consumption distributions for the year 2004-05 have been obtained. The first one from the consumption data collected using 30-day recall period (also known as reference period) for all the items. The other distribution is obtained from the consumer expenditure data collected using 365-day recall period for five infrequently purchased non-food items, namely, clothing, footwear, durable goods, education and institutional medical expenses and 30-day recall period for the remaining items. These two consumption distributions have been termed as Uniform Recall Period (URP) consumption distribution and Mixed Recall Period (MRP) consumption distribution respectively. The Planning Commission, using the Expert Group methodology has estimated poverty in 2004-05 using both the distri-

butions.

4. The state specific percentage and number of poor in rural and urban areas estimated from URP consumption distribution gives the state specific percentage and number of poor in rural and urban areas estimated from MRP consumption distribution.
5. The percentage and number of poor in 2004-05 estimated from URP consumption distribution of NSS 61st Round of consumer expenditure data are comparable with the poverty estimates of 1993-94. The percentage and number of poor in 2004-05 estimated from MRP consumption distribution of NSS 61st Round of consumer expenditure data are roughly (but not strictly) comparable with the poverty estimates of 1999-2000.
6. The URP-consumption distribution data of the 61st Round yields a poverty ratio of 28.3 per cent in the rural areas, 25.7 per cent in the urban areas and 27.5 per cent for the country as a whole in 2004-05. The corresponding figures obtained from the MRP-consumption distribution data of the 61st Round are 21.8 percent in the rural areas, 21.7 per cent in the urban areas and 21.8 per cent for the country as a whole.
7. The poverty estimates in 2004-05 based on URP consumption distribution (27.5 percent) is comparable with the poverty estimates of 1993-94, which was 36 per cent. The poverty estimates in 2004-05 based on MRP consumption (21.8 per cent) is roughly (but not strictly) comparable with the poverty estimates of 1999-2000, which was 26.1 per cent.

#### *Expert Committee/Lakadawala Committee's Recommendations*

In view of the criticism of the official method of estimation of poverty, the Planning Commission Constituted an Expert Group in 1992 under the chairmanship of Prof. Lakadawala to examine the methodology and computational aspects of poverty ratio. Following are the main

features of the expert committee's recommendation -

- (1) The expert group retained the concept of poverty line as defined by the earlier official method.
- (2) It suggested changes in the price deflator to update the poverty line for use in later years.
- (3) It suggested the use of state-specific price indices so that the changes in the cost of consumption basket of the people below the poverty line may be reflected realistically.

It recommended the use of NSS data on consumption expenditure without adjusting it to the National Accounts estimates of consumption expenditure for estimation of ratio of people below poverty line.

## TYPES OF UNEMPLOYMENT

**Frictional Unemployment:** This kind of unemployment arises because of the continuous movement of people between regions, jobs or shifting through different stages of the life cycle. Even if an economy were at full employment there would remain some unemployment as there exists a time gap in coincidence of those looking for a job and those who are ready to employ. This kind of unemployment may also be called as voluntary unemployment as workers are willingly selecting between Jobs and regions.

**Structural Unemployment:** This kind of unemployment arises because of a mismatch between the supply of and demand for workers (depending on level of investment and capital formation). Mismatches may occur because the demand for one kind of labor is rising while the demand for another kind is falling and supplies do not adjust quickly. This may happens as certain sectors grow while others decline.

**Cyclical Unemployment:** This kind of unemployment exists when the overall demands for labor is low. As total spending and output fall,

unemployment rises everywhere. The simultaneous increase in unemployment in many markets tends to cyclical unemployment. This kind of unemployment occurs during recessions when employment falls as a result of an imbalance between aggregate supply and demand. Our study of simple demand and supply curves in microeconomics suggest that true exists a market clearing price at which demand and supply equals. The commodities market in perfect competition gets cleared at this equilibrium price. Since unemployment servants all the time it seems that there is something which prevents labor markets from getting cleared away. This means to say that there exists inflexibility in wage rates, which prevents them to adjust downward and hence unemployment prevents. In this context, we now study the terms Voluntary & Involuntary unemployment.

**Voluntary unemployment:** This refers to those workers who are not willing to work at the going wage rate even if they could get one. This suggests that voluntarily unemployed workers might prefer leisure to jobs at the going wage rate. The existence of voluntary unemployment suggest that an economy may be performing at the peak of efficiency even though it generates a certain amount of unemployment.

**Involuntary unemployment:** It refers to those workers currently unemployed even though they are ready to join at the market wage rate. The resultant over supply of labor at the enjoying wage rate does not lead to downward movements in wage rates because of the inflexibility of wage rates to move downward. This happens due to imperfections in the labor market in the form of labor unions (which prevents downward movements of wage rates) or minimum-wage rate stipulation by the government.

### Unemployment in India

India is predominantly an agrarian economy. The industrial sector in India has not grown sufficiently to absorb the labour force (15-60 age group), which is increasing with an increase

in population. In an agrarian society where assured source of irrigation is available only to one-third of the cultivated area, agriculture turns out to be only a seasonal activity. Therefore our farmers and labourers are faced with seasonal unemployment. Another remarkable feature about agriculture is the existence of disguised unemployment in this sector. Since India is a country where about 65 per cent of the masses depend on agriculture for livelihood, the land-man ratio is very adverse. This implies that there is a huge burden on land. Disguised unemployment refers to employment of a farmer (or labourer) in agricultural activity even if his/her marginal productivity is close to zero. For example if a farm unit is producing 100 quintals with the help of 10 labourers and now if a unit of labour is increased (total labourers become 11 in number) but production still remains only 100 quintals, the marginal product of one additional unit of labour is zero. This is disguised unemployment, which is peculiar to agriculture sector. Prof. Arthur Lewis had suggested the method for capital formation through surplus of labour. In such a model disguisedly unemployed labourers in the agriculture sector were to be shifted to a more productive sector while sticking to the same consumption level, these labourers produce capital.

India is a country characterized by inequality of income and wealth as well as massive poverty with around 36 per cent of the population (1993) living below the poverty line. Here there are people who have no tangible resources to fall back upon. They remain unemployed for a large part of the year. This is known as open-unemployment or chronic unemployment. Then there are people who are partially employed in terms of their skill and qualification as well as time in employment. Such cases are referred to as under employment.

#### **Labor Force and Unemployment**

The official definition of "labour force" (Persons in the age group of 15-60) leaves out a large number of people who would work if

they had some prospect of a job. The total population of working age is far larger than the officially defined labour force. In the year 2000, when employment was 337 million, and the official figure of the labour force was 363 million, the working age population was 578 million. By March 2004, when employment would be 349 million, the working age population would have risen to 662 million. In other words, 313 million, or almost half the population in the working age group, are unable to engage in any 'gainful activity' because of the existing economic order and the policies it has adopted.

#### **The three concepts of unemployment developed by the NSSO**

The three concepts of unemployment developed by the NSSO primarily refer to chronic unemployment and underemployment. The three concepts are as follows:-

- (a) **Usual Status unemployment** - This concept is meant to determine the usual Activity Status - employed or unemployed or outside the labour force - of those covered by the survey (N.S.S.O). The activity status is determined with reference to a longer period; say a year preceding to the time of survey. The persons covered by the survey may be classified into those working and/or available for work in their principal activity sector, and those working and/or available for work in subsidiary sector, that is, a sector other than their principal activity sector. Hence, within the usual status concept, the estimates are now derived on the usual principle status as well as usual principal and subsidiary status basis.
- (i) **The Current Weekly Status** - This concept determines the activity status of a person with reference to a period of preceding seven days. If in this period a person seeking employment fails to get work for even one hour on any day, he (or she) is deemed to be unemployed.
- (ii) **The Current Daily Status** - This concept considers the activity status of a person for

each day of the proceeding seven days. A person who works for one hour but less than four hours is considered having worked for half a day. If he works for four hours or more during a day, he is considered as employed for the whole day. The current Daily Status unemployment rate is a time rate.

It is the most appropriate and comprehensive measure of unemployment.

#### ***Employment and Unemployment in India***

Agricultural and allied sectors accounted for about 60% of the total workforce in 2003 same as in 1993-94. At present agriculture contributes 52 percent of total employment. While agriculture has faced stagnation in growth, services have seen a steady growth. Of the total workforce, 8% is in the organised sector, two-thirds of which are in the public sector. The NSSO survey estimated that in 1999-2000, 106 million, nearly 10% of the population were unemployed and the overall unemployment rate was 7.3%, with rural areas doing marginally better (7.2%) than urban areas (7.7%). India's labor force is growing by 2.5% annually, but employment only at 2.3% a year.

Unemployment in India is characterized by chronic underemployment or disguised unem-

ployment. Government schemes that target eradication of both poverty and unemployment (which in recent decades has sent millions of poor and unskilled people into urban areas in search of livelihoods) attempt to solve the problem, by providing financial assistance for setting up businesses, skill honing, setting up public sector enterprises, reservations in governments, etc. The decreased role of the public sector after liberalization has further underlined the need for focusing on better education and has also put political pressure on further reforms.

Child labor is a complex problem that is basically rooted in poverty. The Indian government is implementing the world's largest child labor elimination program, with primary education targeted for 250 million. Numerous non-governmental and voluntary organizations are also involved. Special investigation cells have been set up in states to enforce existing laws banning employment of children (under 14) in hazardous industries. The allocation of the Government of India for the eradication of child labor was \$10 million in 1995-96 and \$16 million in 1996-97. The allocation for 2007 is \$21 million.

#### ***Employment***

The estimates of employment and unemploy-

#### ***Employment and Unemployment in Million Persons Years (by CDS basis)***

	Million 1983	Million 1993-94	Million 1999-00	Million 2004-05	% Growth 1983 to 1993-94	1993-94 to 1999-00	1999-00 to 2004-05
Population	718.10	893.68	10050.5	1092.83	2.11	1.98	1.69
Labour Force	263.82	334.20	364.88	419.65	2.28	1.47	2.84
Work Force	239.49	313.93	338.19	384.91	2.61	1.25	2.62
Unemployment	9.22	6.06	7.31	8.28			
Rate (Percent)							
No of Unemployed	24.34	20.27	26.68	34.74			

**Source:** Various Rounds of NSSO Survey on employment and unemployment, Planning Commission.

ment on Usual Principal Status (UPS) basis from various rounds of NSSO survey are available. In the meantime, the Eleventh Five year Plan has largely used the Current Daily Status (CDS) basis of estimation of employment and unemployment in the country. It has also been observed that the estimates based on daily status are the most inclusive rate of 'unemployment' giving the average level of unemployment on a day during the survey year. It captures the unemployed days of the chronically unemployed, the unemployed days of usually employed who become intermittently unemployed during the reference week and unemployed days of those classified as employed according to the criterion of current weekly status. The estimates presented earlier also need revisiting so as to be based on population projections released by National Commission on Population.

Estimates on employment and unemployment on CDS basis indicate that employment growth during 1999-2000 to 2004-05 has accelerated significantly as compared to the growth witnessed during 1993-94 to 1999-2000. During 1999-2000 to 2004-05, about 47 million work opportunities were created compared to only 24 million in the period between 1993-94 and 1999-00. Employment growth accelerated from 1.25 per cent per annum to 2.62 per cent per annum. However, since the labour force grew at a faster rate of 2.84 per cent than the workforce, unemployment rate also rose. The incidence of unemployment on CDS basis increased from 7.31 per cent in 1999-00 to 8.28 per cent in 2004-05.

The decline in overall growth of employment during 1993-94 to 1999-00 was largely due to the lower absorption in agriculture. The share of agriculture in total employment dropped from 61 per cent to 57 per cent. This trend continued and the share of agriculture in total 2004-05. While the manufacturing sector's share increased marginally during this period, trade, hotel and restaurant sector contributed significantly in earlier years. The other important sectors whose shares in employment have increased are transport, storage and communica-

tions apart from financial, insurance, real estate, business and community, social and personal services.

## LATEST IN POVERTY AND UNEMPLOYMENT

### Poverty

The Planning Commission, the nodal agency for estimating the number and proportion of people living below the poverty line at national and state levels, separately for rural and urban areas, makes poverty estimates based on a large sample survey of household consumption expenditure carried out by the National Sample Survey Office (NSSO) approximately every five years. The methodology for estimation of poverty has been reviewed from time to time. The Planning Commission constituted an Expert Group under the Chairmanship of Professor Suresh D. Tendulkar in December 2005, which submitted its report in December 2009. The recomputed poverty estimates for the years 1993-94 and 2004-05 as recommended by the Tendulkar Committee have been accepted by the Planning Commission. As per the Tendulkar Committee Report, the national poverty line at 2004-05 prices was a monthly per capita consumption expenditure of Rs. 446.68 in rural and ~ 578.80 in urban areas in 2004-05. The above poverty lines which refer to the national average, vary from state to state because of price differentials.

The Tendulkar Committee has mentioned in its report that the proposed poverty lines have been validated by checking the adequacy of actual private expenditure per capita near the poverty lines on food, education, and health by comparing them with normative expenditures consistent with nutritional, educational, and health outcomes. In order to have a two-point comparison of changes in head count ratio, the Expert Group has re-estimated poverty for 1993-94. The head-count ratios for 1993-94 and 2004-05 as released earlier by the Planning Commission. Even though the Tendulkar methodology gives higher estimates of headcount ratios for both 1993-94 and 2004-05, the extent of poverty reduction is 8.1 percentage points which is not

very different from the reduction of 8.5 percentage points during the same period as per Lakdawala Methodology.

### ***Inequality***

According to HDR 2011, inequality in India for the period 2000-11 in terms of the income Gini coefficient was 36.8. India's Gini index was more favourable than those of comparable countries like South Africa (57.8), Brazil (53.9), Thailand (53.6), Turkey (39.7), China (41.5), Sri Lanka (40.3), Malaysia (46.2), Vietnam (37.6), and even the USA (40.8), Hong Kong (43.4), Argentina (45.8), Israel (39.2), and Bulgaria (45.3).

### ***Employment***

The Eleventh Five Year Plan (2007-12) aimed at generation of 58 million work opportunities. The NSSO quinquennial survey has reported an increase in work opportunities to the tune of 18 million under the current daily status (CDS) between 2004-05 and 2009-10. However, the overall labour force expanded by only 11.7 million. This was considerably lower than in comparable periods earlier, and can be attributed to the much larger retention of youth in education and also because of lower labour force participation among working-age women. As a result, unemployment in absolute terms came down by 6.3 million. The lower growth in the labour force is not expected to continue as educated youth are expected to join the labour force in increasing numbers during the Twelfth Plan and in the years beyond. This means that the pace of job/ livelihood creation must be greatly accelerated. The Twelfth Plan Approach Paper therefore lays greater stress on skill building which can be viewed as an instrument for improving the effectiveness and contribution of labour to overall production. This will push the production possibility frontier outward and take the economy on to a higher growth trajectory and can also be viewed as a means of empowerment.

### ***Employment in the Organised sector***

Employment growth in the organized sector, public and private combined, has increased

by 1.9 per cent in 2010, which is lower than the annual growth for the previous year. The annual growth rate for the private sector was much higher than that for the public sector. However, in respect of both sectors, annual increase in employment had slowed down in 2010 vis-à-vis 2009. The share of women in organized-sector employment was 20.4 per cent in 2010 March end and has remained nearly constant in recent years.

### ***Unemployment***

A comparison between different estimates of unemployment in 2009-10 indicates that the CDS estimate of unemployment is the highest. The higher unemployment rates according to the CDS approach compared to the weekly status and usual status approaches indicate a high degree of intermittent unemployment. Interestingly urban v unemployment was higher under both the UPSS and CWS but rural unemployment was higher under the CDS approach. This possibly indicates higher intermittent or seasonal unemployment in rural than urban areas, something that employment generation schemes like the MGNREGA need to pay attention to. However, overall unemployment rates were lower in 2009-10 under each approach vis-a-vis 2004-05. Labour force participation rates (LFPR) under all three approaches declined in 2009-10 compared to 2004-05. However, the decline in female LFPRs was larger under each measure in comparison with male LFPRs which either declined marginally (UPSS), remained constant (CWS), or increased marginally (CDS).

### ***Unemployment Rates all India (2009-10)- 66th round NSSO***

Rural	Urban	Total
UPSS- 1.6	UPSS-3.4	UPSS-2.0 (de clined from 2.3 in 2004-05)
CWS-3.3	CWS-4.2	CWS-3.6 (de clined from 4.4 in 2004-05)
CDS-6.8	CDS-5.8	CDS-6.6 (in creased from 6.2)

## **EMPLOYMENT PROGRAMMES**

### **(i) MGNREGA**

This flagship programme of the Government of India aims at enhancing livelihood security of households in rural areas of the country by providing at least one hundred days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. It also mandates 1/3 participation for women. The primary objective of the scheme is to augment wage employment. This is to be done while also focusing on strengthening natural resource management through works that address causes of chronic poverty like drought, deforestation, and soil erosion and thus encourage sustainable development. The MGNREGA was notified in 200 districts in the first phase with effect from 2 February 2006 and then extended to additional 130 districts in the financial year 2007-08. The remaining districts with rural areas were brought under the Act with effect from 1 April 2008. Out of total outlay of ` 40,000 crore approved for 2011-12, Rs. 21,471.92 crore has been released to the states/ union territories and the total funds available with states including the opening balance of Rs. 18,185.23 crores (on 1 April 2011) are Rs. 41,615.05 crore. Of these Rs. 21,124.74 crore has been utilized as reported on 19 January 2012. About 3.80 crore households have been provided employment under the programme. During the same period, 122.37 crore persondays employment has been generated across the country out of which 60.45 crore were women (49.40 per cent), 27.27 crore (22.62 per cent) SCs, and 20.97 crore (17.13 per cent) STs. At national level, the average wage paid under the MGNREGA has increased from Rs. 65 in FY 2006-7 to Rs. 120 in FY 2011-12 (up to November 2011).

### **(ii) Swarnjayanti Gram Swarozgar Yojana**

The Swarnjayanti Gram Swarozgar Yojana (SGSY) is a self-employment programme with the objective of helping poor rural families cross

the poverty line by assisting them to take up incomegenerating economic activities through a mix of bank credit and government subsidy. The SGSY specially basic banking services to all poor households, SHGs, and their federations on both the demand and supply sides of financial inclusion; in order to ensure affordable credit, the NRLM has a provision for subsidy on interest rates above 7 per cent per annum for all eligible SHGs who have to look at stabilizing and enhancing existing livelihoods and subsequently diversifying them; to develop backward and forward linkages and support business plans; to pursue skill upgradation and placement projects through partnership mode, with the National Skill Development Corporation (NSDC) being one of the leading partners in this effort and 15 per cent of the central allocation under the NRLM earmarked for this purpose; and 5 per cent of the central allocation to be earmarked for innovations.

### **(iii) Swarna Jayanti Shahari Rozgar Yojana**

The Swarna Jayanti Shahari Rozgar Yojana (SJSRY) was launched by the Government of India on 1 December 1997 to provide gainful employment to the urban unemployed and underemployed by encouraging the setting up of self-employment ventures or provision of wage employment. This scheme subsumed the earlier three urban poverty alleviation programmes and was also revamped with effect from April 2009 to include the Urban Self Employment Programme (USEP), Urban Women Self-help Programme (UWSP), Skill Training for Employment Promotion amongst Urban Poor (STEPUP), Urban Wage Employment Programme (UWEP), and Urban Community Development Network (UCDN). The annual budgetary provision for the SJSRY for the year 2011-12 is Rs. 813.00 crore and Rs. 676.80 crore has been released by 16 February 2012. A total of 3,63,794 beneficiaries have been assisted in the year 2011-12.

### **Social Sector in India**

Social sector comprises of education, health,

housing and all welfare programmes for the poor, unemployed, women, children, minorities, farmers and certain programmes for rural development. The development in social sector in India lags behind because of paucity of funds, lack of focus of the government, leakages through corruption and absence of good governance.

#### **Social Sector Spending**

Central government expenditure on social services and rural development (Plan and non-Plan) has consistently gone up over the years. It has increased from 13.38 per cent in 2006-07 to 18.47 per cent in 2011-12. Central support for social programmes has continued to expand in various forms although most social-sector subjects fall within the purview of the states. Major programme-specific funding is available to states through centrally sponsored schemes. Expenditure on social services (which include education, sports, art and culture, medical and public health, family welfare, water supply and sanitation, housing, urban development, welfare of SCs, STs and OBCs, labour and labour welfare, social security, nutrition, and relief for natural calamities,) by the general government (centre and states combined) has also shown increase in recent years reflecting the higher priority given to this sector. Expenditure on social services as a proportion of total expenditure increased from 21.6 per cent in 2006-07 to 24.1 per cent in 2009-10 and further to 25 per cent in 2011-12 (BE). As a proportion of the gross domestic product (GDP), its share increased from 5.57 per cent in 2006-07 to 6.76 per cent, 6.91 per cent, and 7.34 per cent in 2008-09, 2009-10, and 2010-11 respectively, helping India face the global crisis without much adverse impact on the social sector. In 2011-12 it is expected to be 6.74 per cent as per the BE. While expenditure on education as a proportion of GDP has increased from 2.72 per cent in 2006-7 to 3.11 per cent in 2011-12 (BE), that on health has increased from 1.25 per cent in 2006-7 to 1.30 per cent in 2011-12 (BE). Of total social services expenditure, that on 'Oth-

ers' has fallen in 2011-12 (BE).

#### **SOCIAL PROTECTION PROGRAMMES**

**Aam Admi Bima Yojana (AABY):** Under this scheme launched on 2 October 2007, insurance is provided against natural as well as accidental and partial / permanent disability of the head of the family of rural landless households in the country. Under the scheme, the head of the family or an earning member is eligible for receiving the benefit of Rs. 30,000 in case of natural death, Rs.75,000 for accidental death, Rs. 75,000 for total permanent disability, and Rs. 37,500 for partial permanent disability. The scheme has provided insurance coverage to 1.97 crore lives in the country up to 31 January 2012.

**Janashree Bima Yojana (JBY):** The JBY was launched on 10 August 2000 to provide life insurance protection to rural and urban persons living below and marginally above the poverty line. Persons between ages 18 and 59 years and who are the members of the 45 identified occupational groups are eligible for participation in this policy. The scheme provides coverage of Rs.30,000 in case of natural death, Rs. 75,000 in case of death or total permanent disability due to accident, and Rs. 37,500 in case of partial permanent disability. During 2010-11, a total of 2.09 crore lives has been covered under the JBY.

**Rashtriya Swasthya Bima Yojana (RSBY):** The RSBY was launched on 01 October 2007 to provide smart card-based cashless health insurance cover of Rs. 30,000 per family per annum on a family floater basis to BPL families (a unit of five) in the unorganized sector. The scheme became operational from 01 April 2008. The premium is shared on 75:25 basis by the centre and state governments. In the case of the north-eastern states and Jammu and Kashmir, the premium is shared in a 90:10 ratio. The scheme provides for portability of smart cards by splitting the card value for migrant workers. As on 20 December 2011, the scheme is being implemented in 23 states / UTs, namely Arunachal

Pradesh, Assam, Bihar, Chhattisgarh, Delhi, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Maharashtra, Manipur, Meghalaya, Mizoram, Nagaland, Orissa, Punjab, Tripura, Uttar Pradesh, Uttarakhand, West Bengal, and Chandigarh Administration. More than 2.55 crore smart cards have been issued.

**The Unorganized Workers Social Security Act 2008:** The Act came into force from 16 May 2009 with the objective of providing social security to unorganized workers. The Unorganized Workers' Social Security Rules 2009 have also been framed. Constitution of the National Social Security Board in 2009 was another significant step. The Board recommended that social security schemes, namely the RSBY providing health insurance, JBY providing death and disability cover and Indira Gandhi National Old Age Pension Scheme (IGNOAPS) providing old age pension be extended to building and other construction workers, MGNREGA workers, Asha workers, Anganwadi workers and helpers, porters/ coolies/ gangmen, and casual and daily wagers.

**National Social Security Fund:** A National Social Security Fund for Unorganized Sector Workers with initial allocation of Rs 1000 crore has been set up. This Fund will support schemes for weavers, toddy tappers, rickshaw pullers, bidi workers, etc.

**Bilateral Social Security Agreements:** Bilateral social security agreements have been signed with Belgium, Switzerland, the Netherlands, Denmark, and Norway to protect the interests of expatriate workers and companies on a reciprocal basis. These agreements help workers by providing exemption from social security contribution in case of posting, totalization of contribution period, and exportability of pension in case of relocation to the home country or any third country.

## **RURAL INFRASTRUCTURE AND DEVELOPMENT**

**Bharat Nirman:** This programme, launched in

2005-06 for building infrastructure and basic amenities in rural areas, has six components, namely rural housing, irrigation potential, drinking water, rural roads, electrification, and rural telephony. A goal has been set to provide connectivity to all villages with a population of 1000 (500 in hilly or tribal areas) with all-weather roads. New connectivity is proposed to a total of 63,940 habitations under Bharat Nirman. This will involve construction of 189,897 km of rural roads. In addition, Bharat Nirman envisages upgradation / renewal of 194,130 km of existing rural roads. Under the rural roads component of Bharat Nirman, 42,249 habitations have been provided allweather road connectivity up to December 2011 and projects for connecting 16,126 habitations are at different stages of implementation. Under the PMGSY, over 19,443 km of all-weather roads have been completed, including upgradation during 2011-12 (up to December 2011). New connectivity has been provided to 3710 habitations at an expenditure of Rs. 7514 crore.

**IAY :** The IAY is one of the six components of the Bharat Nirman programme. During 2010-11, as against the target of 29.09 lakh houses, 27.15 lakh houses were constructed. (Also see state-wise performance in Table 13.10.) During financial year 2011-12, against the physical target of 27.26 lakh houses, 21.18 lakh houses were sanctioned and 7.26 lakh constructed as on 31 October 2011. Since the inception of the scheme, 271 lakh houses have been completed till September 2011. The unit assistance provided to rural BPL households for construction of a dwelling unit under the IAY has been revised with effect from 1 April 2010 from Rs 35,000 to Rs. 45,000 for plain areas and from Rs. 38,500 to Rs. 48,500 for hilly/ difficult areas. In addition, construction of IAY houses have been included in the differential rate of interest (DRI) scheme for lending up to ` 20,000 per housing unit at an interest rate of 4 per cent. Sixty left wing extremism (LWE) affected districts have been made eligible for a higher rate of unit assistance of Rs. 48,500. Under this scheme a homestead site of 100-250 sq.m will

be provided to those rural BPL households who have neither land nor a house site. For this purpose, Rs. 10,000 per beneficiary, to be shared by the centre and states in a 50 : 50 ratio, will be provided to the District Rural Development Agencies (DRDAs).

**Rural drinking water:** Drinking water supply is one of the components of Bharat Nirman. The present status of provision of safe drinking water in rural areas as measured by habitations where the population is fully covered, as per information reported by the states is that about 72 per cent of rural habitations are fully covered. The rest are either partially covered or have chemically contaminated drinking water sources. As against the target of 653,798 habitations during the Eleventh Five year Plan, the coverage up to 31 March 2011 was 526,667 (80.56 per cent). The States of Jharkhand, Chhattisgarh, Nagaland, Madhya Pradesh, Odisha, Himachal Pradesh, Tamil Nadu, Kerala, and Uttarakhand have exceeded their targets whereas Sikkim, Punjab, Assam, Rajasthan, Arunachal Pradesh, and Jammu and Kashmir have reported low (less than 50 per cent) achievement against targets. Expenditure for drinking water supply during the Bharat Nirman period increased considerably from Rs. 4098 crore in 2005-06 to Rs. 8500 crore in 2011-12. All uncovered habitations have been reported covered as on 1 April 2011. In order to give effect to the policy initiatives mentioned in the Eleventh Five Year Plan document, the guidelines for the Rural Water Supply Programme were revised in 2009 and renamed the National Rural Drinking Water Programme (NRDWP). The Jalmani programme, a scheme to provide 100 per cent assistance to states for installing stand-alone water purification systems in schools in rural areas was launched in 2008-09. In pursuance of the same, Rs. 200 crore was released to states in 2008-09 and 2009-10 to cover 1 lakh schools. So far about 65,503 schools have been covered under this scheme.

**Rural Sanitation-Total Sanitation Campaign (TSC):** The TSC is one of the flagship programmes of the government. As of Decem-

ber 28, 2011, TSC projects have been sanctioned in 607 rural districts of the country at a total outlay of Rs. 22,022 crore, with a central share of Rs. 14,425 crore. The approved central outlay for the TSC in the Eleventh Plan is Rs. 7816 crore. The annual budgetary support was gradually increased from Rs. 202 crore in 2003-4 to Rs. 1500 crore in 2011-12. The TSC follows a community-led and people-centric approach, laying emphasis on information, education, and communication (IEC) for demand generation for sanitation facilities. To motivate the community towards creating sustainable sanitation facilities and their usage, the incentive for Individual household latrines for BPL households has been increased from Rs. 2200 (Rs. 2700 for hilly and difficult areas) to Rs. 3200 (Rs. 3700 for hilly and difficult areas) with effect from 1 June 2011. With the scaling up of the TSC, combined with higher resource allocation, programme implementation has improved substantially. As per Census 2001 data, only 21.9 per cent rural households had access to latrines. Since 1999, over 8.30 crore toilets have been provided for rural households under the TSC. A significant achievement has also been the construction of 11.64 lakh school toilet units and 3.94 lakh Anganwadi toilets. This has led to substantial increase in rural sanitation coverage from 21.9 per cent in 2001 to about 85.95 per cent as of January 2012 as per the progress reported by states. With increasing budgetary allocations and focus on rural areas, the number of households being provided with toilets annually has increased from only 6.21 lakh in 2002-3 to 122 lakh in 2010-11. In the year 2011-12 (up to January 2012), more than 63 lakh toilets have been provided to rural households. The active participation of women and adolescent girls in the sanitation programme has been encouraged with special components for them. The Nirmal Gram Puraskar (NGP) incentive scheme has been launched to encourage PRIs to take up sanitation promotion. The award is given to those PRIs that attain a 100 per cent open defecation-free environment. A total of 25,145 gram panchayats, 166 intermediate panchayats, and 10 district panchayats have

received the award in the last six years. Sikkim has become the first state to receive the award.

## SKILL DEVELOPMENT

In addition to constituting a three-tier institutional structure on Coordinated Action on Skill Development consisting of (i) the Prime Minister's National Council on Skill Development(NCSD), (ii) National Skill Development Coordination Board (NSDCB), and (iii) National Skill Development Corporation (NSDC), the NCSD appointed an adviser to the Prime Minister in the NCSD in January 2011. As on 31 October 2011, the NSDC has approved 34 training projects spread across 177 districts in 20 sectors. The NSDC has also approved eight sector skill councils (SSCs). A new strategic framework for skill development for early school leavers and existing workers has been developed since May 2007 in close consultation with industry, state governments, and experts. At present, 1386 modules for employable skills covering 60 sectors have been developed, 36 assessing bodies empanelled for conducting assessment, 6753 vocational training providers (VTPs) registered, and more than 12.19 lakh persons trained / tested (since inception).

## UIDAI

Implementation of the Unique Identification (UID) project has progressed and about 13 crore Aadhaar numbers (UID numbers) have already been generated. The Unique Identification Authority of India (UIDAI) has scaled up enrolments and has also established infrastructure capabilities to generate 10 lakh Aadhaar numbers every day. The UIDAI is on the verge of commencing Phase III of the scheme, which apart from enrolling residents and issuing Aadhaar numbers extends to providing updation services, a robust authentication process as a means of enhancing service delivery of various social schemes, and facilitating financial inclusion and development of Aadhaar-enabled applications to leverage Aadhaar.

## EDUCATION

The Twelfth Plan Approach Paper focuses on teacher training and evaluation and measures to enforce accountability. It also stresses the need to build capacity in secondary schools to absorb the passouts from expanded primary enrolments. The GER in higher education must be targeted to increase from nearly 18 per cent.

### *Initiatives for primary education*

(RTE): Free education for all children between the ages of 6 and 14 years has been made a fundamental right under the RTE Act 2009. While the RTE Act was notified on 27 August 2009 for general information, the notification for enforcing the provisions of the Act with effect from 1 April 2010 was issued on 16 February 2010. It mandates that every child has a right to elementary education of satisfactory and equitable quality in a formal school which satisfies certain essential norms and standards. The reform processes initiated in 2010-11 continued during the year 2011-12.

**Rashtriya Madhyamik Shiksha Abhiyan (RMSA):** The RMSA was launched in March 2009 with the objective of enhancing access to secondary education and improving its quality. In addition to ensuring access, the quality interventions include ensuring all secondary schools conform to prescribed norms, removing gender, socio-economic and disability barriers, providing universal access to secondary level education by 2017, i.e. by the end of the Twelfth Five Year Plan, and achieving universal retention by 2020. The central and state governments bear 75 per cent and 25 per cent of the project expenditure respectively during the Eleventh Five Year Plan. The funding pattern is in the ratio of 90:10 for the north-eastern states. The RMSA Annual Plan 2011-12 proposals received from all 35 states/ UTs were considered by the Project Approval Board (PAB) of the scheme and major interventions such as opening of 4032 new schools, strengthening of 15,567 existing schools, 832 residential quarters for teachers, and 52,352 additional teachers have been approved.

**Model Schools Scheme:** A scheme for setting up 6000 model schools as benchmarks of excellence at block level with one school per block was launched in November 2008 with a view to providing quality education to talented rural children. The scheme has two modes of implementation: (i) 3500 schools are to be set up in as many Educationally Backward Blocks(EBBs) through state/ UT governments and (ii) the remaining 2500 schools are to be set up under PPP mode in blocks that are not educationally backward. At present, only the first component is being implemented. The implementation of the PPP component will start from Twelfth Five Year Plan. Since the inception of the scheme, approval has been granted for setting up 1942 model schools in 22 states. Financial sanctions have been accorded for setting up 1538 schools in 20 States and Rs. 1697.95 crore has been released as central share to these states. During 2010-11, (140 schools) had become functional in Punjab (21 schools), Karnataka (74 schools), Chhattisgarh (15 schools), Tamil Nadu (18 schools), and Gujarat (12 schools) and Rs. 9.55 crore as recurring grants was released to these states. In 2011-12, the number of functional schools has increased to 438 in seven states.

**Inclusive Education for the Disabled at Secondary Stage (IEDSS):** The IEDSS scheme was launched in 2009-10 replacing the earlier Integrated Education for Disabled Children (IEDC) scheme. While inclusive education for disabled children at elementary level is being provided under the SSA, this scheme provides 100 per cent central assistance for inclusive education of disabled children studying in Classes IX-XII in mainstream government, local body, and government-aided schools. The aim of the scheme is to facilitate continuation of education of children with special needs up to higher secondary level.

**Vocational Education:** The revised centrally sponsored Vocationalisation of Secondary Education scheme aims to address the weaknesses of the earlier scheme to strengthen vocational

education in Classes XI-XII. The components approved for implementation in the remaining period of the Eleventh Plan, i.e. 2011-12, include (a) strengthening of 1000 existing vocational schools and establishment of 100 new ones through state governments, (b) assistance to 500 vocational schools under the PPP mode, (c) in-service training of seven days for 2000 existing vocational teachers and induction training of 30 days for 1000 new ones, (d) development of 250 competency based modules for each individual vocational course, (e) establishment of a vocational education cell within the Central Board of Secondary Education (CBSE), (f) assistance to 150 reputed NGOs to run shortduration innovative vocational education programmes, and (g) pilot programme under the National Vocational Education Qualifications Framework(NVEQF) in Class IX in Haryana and West Bengal.

**Saakshar Bharat (SB)/Adult Education:** The National Literacy Mission, recast as Saakshar Bharat (SB) launched by the Prime Minister on 8 September 2009, reflects the enhanced focus on female literacy. The literacy rate according to the 2001 census was 64.83 per cent, improving to 74.04 per cent in 2011. The literacy rate improved sharply among females as compared to males. While the literacy rate for males rose by 6.9 per cent from 75.26 per cent to 82.14 per cent, it increased by 11.8 per cent for females from 53.67 per cent to 65.46 per cent. The target of the Eleventh Five Year Plan is to achieve 80 per cent literacy. With just one year to go for the Twelfth Five Year Plan, 74 per cent literacy has been achieved. Literacy levels remain uneven across states, districts, social groups, and minorities. The government has taken positive measures to reduce the disparities by focusing on backward areas and target groups. By March 2010, the programme had reached 167 districts in 19 states covering over 81,000 gram panchayats.

## **Higher Education**

Higher education is of vital importance for the country, as it is a powerful tool for building

a knowledge-based twenty-first-century society. The Indian higher education system is one of the largest in the world. At the time of Independence, there were only 20 universities and 500 colleges with 0.1 million students; these have increased to 611 universities and university-level institutions and 31,324 colleges as on August 2011. To prepare for the challenges of the twenty-first century, the government has taken a number of initiatives during the Eleventh Plan period focusing on improvement of access along with equity and excellence, adoption of state-specific strategies, enhancement of the relevance of higher education through curriculum reforms, vocationalization, networking, and use of information technology and distance education along with reforms in governance in higher education. A large-scale expansion in university education has been initiated during the Eleventh Five Year Plan by setting up new educational institutions comprising 30 central universities, 8 new Indian Institutes of Technology (IITs), 8 new Indian Institutes of Management (IIMs), 10 new National Institutes of Technology (NITs), 20 new Indian Institutes of Information Technology (IIITs), 3 new Indian Institutes of Science Education and Research (IISERs), 2 new Schools of Planning and Architecture (SPAs), 374 model colleges, and 1000 polytechnics. Other important initiatives include upgradation of state engineering institutions, expansion of research fellowships and provision of hostels for girls, reservation for SCs, STs and OBCs, focus on backward, hilly and remote locations including the north-east, facilitating greater participation of students belonging to minorities, girls, and persons with disabilities, scholarships, provision of education loans with interest free subsidies, setting up of polytechnics in unserved areas, and degree colleges in low GER districts. The National Mission in Education through ICT, which aims at providing high speed broadband connectivity to universities and colleges and development of e-content in various disciplines, is under implementation. Open and distance learning is encouraged for increasing access to and making quality education available at any time, any place.

## **HEALTH**

### **National Health Policy**

The National Health Policy of 2002 and the priorities set in the successive Five Year Plans provide the framework for the implementation of policies and programmes for health care. The National Health Policy seeks to provide prophylactic and curative health-care services and aims at achieving an acceptable standard of good health amongst the general population in the country by increasing access to the decentralized public health system. Access to the decentralized public health system is sought to be increased through establishment of new infrastructure in deficient areas and upgrading of existing infrastructure. Success in eliminating or controlling diseases such as small pox, leprosy, polio, and TB is indicative of the progress made in some areas of health. Overall sex ratio in the country has increased from 933 in 2001 to 940 as per census 2011 (prov.). In 2011-12, the Plan outlay for health is Rs. 26760 crore. This outlay constitutes among others Rs. 17,840 crore under the NRHM and Rs. 2356 crore for schemes/ projects in the north-eastern region and Sikkim. A provision of Rs. 1616.57 crore has been earmarked for the Pradhan Mantri Swasthya Suraksha Yojana (PMSSY) aimed at strengthening the tertiary sector. The National Programme for Prevention and Control of Cancer, Diabetes, Cardiovascular Diseases and Stroke (NPCDCS) has been allocated Rs. 125 crore in 2011-12. During 2011- 12, Rs. 1700 crore has been earmarked for the National Aids Control Programme with the objective of halting and reversing the HIV epidemic in the country by integrating programmes for prevention, care, support, and treatment. The government also seeks to develop and promote the Indian system of medicines in an organized and scientific manner by involvement/ integration of AYUSH (Ayurveda, Yoga, Unani, Siddha, and Homeopathy) systems in national health-care delivery and has allocated Rs. 900 crore plan outlay for it in 2011-12.

## **Health Programmes**

The government has launched a large number of programmes and schemes to address major concerns and bridge the gaps in existing health infrastructure and provide accessible, affordable, equitable health care. These include the NRHM, National Programme for Health Care of the Elderly (NPHCE), National Mental Health Programme, NPCDCS, Pradhan Mantri Swasthya Suraksha Yojana (PMSSY), upgradation/ strengthening of state government medical colleges, development of paramedical services and the Programmes of AYUSH. The details of major programmes are as follows:

**NRHM:** The NRHM launched in 2005 aims to improve accessibility to quality health care for the rural population, bridge gaps in health care, facilitate decentralized planning in the health sector and bring about inter-sectoral convergence. The NRHM provided an overarching umbrella to the existing health and family welfare programmes including Reproductive and Child Health (RCH-II) and various programmes for control of diseases, including tuberculosis, leprosy, vector-borne diseases and blindness. The effort is to integrate all vertical programmes. All the programmes have now been brought under the District Health Society at district level and State Health Society at state level. Under the NRHM, over 1.4 lakh health human resources have been added to the health system across the country (up to September 2011) which include 11,712 doctors/ specialists, 10,851 AYUSH doctors, 66,784 auxiliary nurse midwives (ANMs), 32,860 staff nurses, and 14,434 paramedics including AYUSH paramedics. Accredited social health activists (ASHAs) are engaged in each village / large habitation in the ratio of one per 1000 population.

**Reproductive and Child Health (RCH):** The RCH Programme was launched in 1997-8 as a separate entity up to the year 2004-5 as a part of the Family Welfare Programme and was brought under the ambit of the NRHM during the Eleventh Plan. It has components such as pulse polio immunization and routine immuni-

zation for protection of children from life threatening conditions that are preventable such as tuberculosis, diphtheria, pertussis, tetanus, polio, and measles.

**Janani Suraksha Yojana (JSY):** The JSY was launched with focus on demand promotion for institutional deliveries in states and regions where these are low. It integrates cash assistance with delivery and post-delivery care. It targets lowering of MMR by ensuring that deliveries are conducted by skilled birth attendants. The JSY scheme has shown rapid growth in the last three years, with 90.37 lakh beneficiaries in 2008-9 to 106.96 lakh beneficiaries in 2010-11. The issues of governance, transparency, and grievance redressal mechanisms are now the thrust areas for the JSY.

**Janani Shishu Suraksha Karyakram (JSSK):** The JSSK is a new initiative launched on 1 June 2011 to give free entitlements to pregnant women and sick new borns for cashless delivery, C-Section, drugs and consumables, diagnostics, diet during stay in the health institutions, provision of blood, exemption from user charges, transport from home to health institutions, transport between facilities in case of referral, and drop back from Institutions to home. A sum of Rs. 1437 crore has been allocated to the states during 2011-12 under the JSSK. In order to reach out to difficult, inaccessible, backward and underserved areas with poor health indicators, 264 high focus districts in 21 states have been identified based on concentration of SC/ ST population and presence of left wing extremism for focused attention.

**National Vector Borne Disease Control Programme:** This Programme is being implemented for prevention and control of vector-borne diseases such as malaria, filariasis, kala-azar, Japanese encephalitis, dengue, and chikungunya. The government has taken various steps for tackling of vector-borne diseases including dengue and chikungunya by the states. There are 250 filaria endemic districts in 20 states / UTs in the country. The National Health Policy (2002) aims at elimination of lym-

phatic filariasis in country by 2015. Kala-azar is endemic in four states, namely Bihar, West Bengal, Jharkhand, and Uttar Pradesh. During 2011, 31,322 cases and 78 deaths have been reported.

**Revised National Tuberculosis Control Programme (RNTCP) :** The RNTCP, a centrally sponsored ongoing scheme, is an application in India of the WHO-recommended directly observed treatment short course popularly known as DOTS. Under the programme, quality diagnosis and treatment facilities including a supply of anti-TB drugs are provided free of cost to all TB patients. More than 13,000 microscopy centres have been established in the country. During 2010-11, the programme has achieved new sputum positive case detection rate of 71 per cent and treatment success rate of 87 per cent.

**National Leprosy Eradication Programme (NLEP):** The NLEP was started in 1983 with the objective of eradication of the disease. In 2005, the dreaded disease after 22 years recorded a case load less than 1 per 10,000 population at national level. The recorded prevalence further came down to 0.69 per 10,000 in March 2011.

**National Programme for Control of Blindness (NPCB):** The NPCB, launched in the year 1976 as a 100 per cent centrally sponsored scheme with the goal of reducing the prevalence of blindness to 0.3 per cent by 2020, showed reduction in the prevalence rate of blindness from 1.1 per cent (2001-2) to 1 per cent (2006-7).

**National Programme for Health Care of the Elderly (NPHCE):** The NPHCE aims to provide separate and specialized comprehensive health care to senior citizens at various levels of the state healthcare delivery system including outreach services. Some of the strategies include preventive and promotive care, management of illness, health manpower development for geriatric services, medical Information Education and Communication(IEC) activities. The major components of the NPHCE are establishment of 30 bedded departments of geriatrics in

8 identified regional medical institutions, and provision of dedicated health-care facilities at district, CHC, PHC and sub-centres levels in 100 identified districts of 21 states of the country.

**NPCDCS:** The NPCDCS was launched during the Eleventh Five year plan. It envisages health promotion and health education advocacy, early detection of persons with high levels of risk factors through opportunistic screening and strengthening of health systems at all levels to tackle Non Communicable Disease (NCDs), and improvement of quality of care. At present the programme is being implemented in 100 districts covering 21 states.

**Human Resources and Infrastructure Development in Tertiary Health Care:** The Eleventh Plan also witnessed a number of initiatives to improve the availability of human resources in the health sector. With a view to strengthening government medical colleges, the land requirement norms and infrastructural requirements for opening new medical colleges have been revised. The faculty requirements have also been revised. Besides, increased intake at MBBS level has been enabled especially in the under-served states.

**PMSSY:** The PMSSY has been launched with the objectives of correcting regional imbalances in the availability of affordable/ reliable tertiary health-care services and augmenting facilities for quality medical education in the country. These are sought to be achieved through establishing AIIMS-like Institutions and upgrading existing medical college institutions. The PMSSY aims at (i) construction of 6 AIIMS like institutions in the first phase at Bhopal, Bhubaneswar, Jodhpur, Patna, Raipur, and Rishikesh and in the second phase in West Bengal and Uttar Pradesh, ii) upgradation of 13 medical college institutions in the first phase and 6 in the second phase. The upgradation programmes broadly envisages improving health infrastructure through construction of super speciality blocks/ trauma centres, etc. and procurement of medical equipment for existing as well as new facilities. Seven more medical colleges are

proposed to be upgraded, one each in Kerala, Karnataka and Madhya Pradesh and two each in Bihar and Uttar Pradesh in the third phase.

**Ayurveda, Yoga & Naturopathy, Unani, Siddha and Homeopathy (AYUSH):** Mainstreaming of AYUSH in national health care delivery is an important goal under the NRHM for which the government has sanctioned Rs. 42.19 crore upto December 31, during the current financial year. A new component of upgradation of AYUSH dispensaries has been incorporated in the centrally sponsored scheme of Development of AYUSH Hospitals and Dispensaries in July 2010. Besides, a component of setting up of 50/ 10 bedded integrated AYUSH hospitals for North Eastern and other hilly states has been introduced in 2011. The States of Himachal Pradesh, Jammu and Kashmir, Mizoram, Manipur, Tripura, have been financially assisted for setting up of 50 bedded hospitals while Assam and Sikkim for 10 bedded hospitals upto December 31, 2011.

## CHILD AND WOMEN DEVELOPMENT

**Integrated Child Development Services (ICDS):** The scheme was launched in 1975 for holistic development of children below 6 years of age and proper nutritional and health education of pregnant and lactating mothers with 33 projects and 4,891 anganwadi centres (AWCs). It has now been universalized with the government cumulatively approving 7,076 projects and 14 lakh AWCs including 20,000 anganwadis 'on demand'.

**Rajiv Gandhi Scheme for Empowerment of Adolescent Girls (RGSEAG):** This scheme was launched on 19 November 2010 with the objective of empowering adolescent girls in the age group 11-18 years by bringing improvement in their nutritional and health status and upgrading various skills like home skills, life skills, and vocational skills. To start with, it is being implemented in 200 selected districts across the country on a pilot basis. The RGSEAG is being implemented through state governments/ UT administrations with 100 per cent financial assistance

from the central government for all inputs other than nutrition provision for which 50 per cent central assistance is provided. AWCs are the focal points for delivery of services.

**The Rajiv Gandhi National Creche Scheme for Children of Working Mothers:** This scheme provides for day-care facilities to 0-6 year-old children of working mothers by opening crèches and development services, i.e. supplementary nutrition, health-care inputs like immunization, polio drops, basic health monitoring, and recreation. The combined monthly income of both the parents should not exceed Rs. 12,000 for availing of the facilities. The number of crèches functional at present are 23,785 and beneficiary children are 594,625. The approved outlay for 2011-12 for the scheme was Rs. 85 crore.

**Integrated Child Protection Scheme (ICPS):** This centrally sponsored scheme implemented through states was launched in 2009-10 with the objective of providing a safe and secure environment for comprehensive development of children in the country who are in need of care and protection as well as children in conflict with the law. The ICPS provides preventive and statutory care and rehabilitation services to any vulnerable child including, but not limited to, children of potentially vulnerable families and families at risk, children of socially excluded groups like migrant families, families living in extreme poverty, families subjected to or affected by discrimination and minority families, children infected and / or affected by HIV / AIDS, orphans, child drug abusers, children of substance abusers, child beggars, trafficked or sexually exploited children, children of prisoners, and street and working children.

**Support to Training and Employment Programme for Women (STEP) Scheme :** This scheme seeks to provide updated skills and new knowledge to poor women in 10 traditional sectors of agriculture, animal husbandry, dairy, fisheries, handlooms, handicrafts, khadi and village industries, sericulture, social forestry, and wasteland development so as to enhance their

productivity and income generation. For expanding the reach of the programme and further strengthening it, implementation of the scheme was revised in November 2009. The scheme aims at introduction of locally appropriate sectors.

**Rashtriya Mahila Kosh (RMK):** The RMK (National Credit Fund for Women) was created in 1993 with a corpus fund of Rs. 31 crore. The initial corpus has now grown to over Rs. 180 crore including reserves and surplus due to credit, investment and recovery management,

and an additional budgetary allocation of Rs. 69 crore. Since its creation, the RMK has established itself as a premier advocacy organization for the development of the micro-finance sector at national and international levels to enhance the flow of micro credit in the unorganized sector for poor women. It focuses on poor women and their empowerment through the provision of credit for livelihood-related activities. The RMK provides microcredit in a quasi-informal manner, lending to intermediate micro-credit organizations (IMOs) across states.

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# POPULATION OF INDIA

## (India's Census)

### SOME IMPORTANT CENSUS CONCEPTS

#### *Rural-Urban Areas*

The data in the table on Final Population Totals census 2011 are presented separately for rural and urban areas. The unit of classification in this regard is 'town' for urban areas and 'village' for rural areas. In the Census of India 2011, the definition of urban area adopted is as follows: (a) All statutory places with a municipality, corporation, cantonment board or notified town area committee, etc. (b) All other places satisfying the following three criteria simultaneously:

- i) a minimum population of 5,000;
- ii) at least 75 per cent of male working population engaged in non-agricultural pursuits; and
- iii) a density of population of at least 400 per sq. km. (1,000 per sq. mile).

For identification of places which would qualify to be classified as 'urban' all villages, which, as per the 2001 Census had a population of 4,000 and above, a population density of 400 persons per sq. km. and having at least 75 per cent of male working population engaged in non-agricultural activity were considered. To work out the proportion of male working population referred to above against b)(ii), the data relating to main workers were taken into account.

An Urban Agglomeration is a continuous urban spread constituting a town and its adjoining urban outgrowths (OGs) or two or more physically contiguous towns together and any adjoining urban outgrowths of such towns.

Examples of OGs are railway colonies, university campuses, port areas, etc., that may come up near a city or statutory town outside its statutory limits but within the revenue limits of a village or villages contiguous to the town or city. Each such individual area by itself may not satisfy the minimum population limit to qualify it to be treated as an independent urban unit but may deserve to be clubbed with the town as a continuous urban spread.

For the purpose of delineation of Urban Agglomerations during Census of India 2011, following criteria are taken as pre-requisites: (a) The core town or at least one of the constituent towns of an urban agglomeration should necessarily be a statutory town; and (b) The total population of all the constituents (i.e. towns and outgrowths) of an Urban Agglomeration should not be less than 20,000 (as per the 2001 Census). With these two basic criteria having been met, the following are the possible different situations in which Urban Agglomerations would be constituted: (i) a city or town with one or more contiguous outgrowths; (ii) two or more adjoining towns with their outgrowths; and (iii) a city and one or more adjoining towns with their outgrowths all of which form a continuous spread.

#### *City*

Towns with population of 1,00,000 and above are called cities.

#### *Scheduled Castes & Scheduled Tribes*

Article 341 of the Constitution provides that the President may, with respect to any State or Union territory, specify the castes, races or tribes

or parts of or groups within castes, races or tribes which shall for the purposes of the Constitution be deemed to be Scheduled Castes in relation to that State or Union territory. Similarly, Article 342 provides for specification of tribes or tribal communities or parts of or groups within tribes or tribal communities which are deemed to be for the purposes of the Constitution the Scheduled Tribes in relation to that State or Union territory. In pursuance of these provisions, the list of Scheduled Castes and / or Scheduled Tribes are notified for each State and Union territory and are valid only within the jurisdiction of that State or Union territory and not outside.

It is important to mention here that under the Constitution (Scheduled Castes) Order, 1950, no person who professed a religion different from Hinduism was deemed to be a member of a Scheduled Caste in addition to every member of the Ramdasi, Kabirpanthi, Majhabi or Sikligar caste resident in Punjab or Patiala and East Punjab States Union were in relation to that State whether they professed the Hindu or the Sikh religion. Subsequently, in September, 1956, by an amendment, the Presidential Order of 1950 and in all subsequent Presidential Orders relating to Scheduled Castes, the population professing the Hindu and the Sikh religions were placed on the same footing with regard to their inclusion as Scheduled Castes. Later on, as per the amendment made in the Constitution (Scheduled Castes) Order 1990, the Hindu, the Sikh and the Buddhist professing population were placed on the same footing with regard to the recognition of the Scheduled Castes.

For finalizing the list of Schedule Castes/Scheduled Tribes notified in each state/union territory, all the constitutional amendments that have taken place prior to the conduct of 2011 census were taken into account. Since there is no Scheduled Castes list for the state of Nagaland and the Union territories of Andaman & Nicobar Islands and Lakshadweep; and no Scheduled Tribes list for the States of Delhi, Haryana and

Punjab and the Union territories of Chandigarh and Puducherry, the Scheduled Castes and Scheduled Tribes population figures are furnished for only the relevant category in respect of these States and Union territories.

### Literates

A person aged 7 years and above who can both read and write with understanding in any language has been taken as literate. It is not necessary for a person to have received any formal education or passed any minimum educational standard for being treated as literate. People who were blind and could read in Braille are treated to be literates.

A person, who can neither read nor write or can only read but cannot write in any language, is treated as illiterate. All children of age 6 years or less, even if going to school and have picked up reading and writing, are treated as illiterate.

### Sex Ratio

Sex ratio has been defined as the number of females per 1000 males in the population. It is expressed as 'number of females per 1000 males'.

$$\text{Sex-ratio} = \frac{\text{Number of females}}{\text{Number of males}} \times 1000$$

### Literacy Rate

Literacy rate of population is defined as the percentage of literates to the total population of age 7 years and above.

$$\text{Literacy rate} = \frac{\text{Number of Literates}}{\text{Population aged 7+}} \times 1000$$

### Work Participation Rate

Work participation rate is defined as the percentage of total workers (main and marginal) to total population.

$$\text{Work participation rate}$$

$$= \frac{\text{Total Workers (Main+Marginal)}}{\text{Total Population}} \times 100$$

**Definition of Slum**

Slums have come to form an integral part of the phenomena of urbanization in India. Comprehensive information on the slums being essential for formulation of effective and coordinated policy for their improvement. Formation and identification of slum enumeration blocks prior to the conduct of 2011 Census has made it possible to compile and repare special tables for slums. It is for the first time in the history of census in the country that the slum demography is being presented on the basis of the actual count. The systematic delineation of slums for collection of primary data on their population characteristics during population enumeration itself may perhaps be the first of its type in the world.

*For the purpose of Census of India, 2011, the slum areas broadly constitute of :-*

- (i) All specified areas in a town or city notified as 'Slum' by State/ Local Government and UT Administration under any Act including a 'Slum Act'.
- (ii) All areas recognized as 'Slum' by State/ Local Government and UT Administration, Housing and Slum Boards, which may have not been formally notified as slum under any act;

- (iii) A compact area of at least 300 population or about 60-70 households of poorly built congested tenements, in unhygienic environment usually with inadequate infrastructure and lacking in proper sanitary and drinking water facilities.

**Variation in Population Since 1901**

Year	Total	Rural	Urban
1901	238,396,327	212,544,454	25,851,873
1911	252,093,390	226,151,757	25,941,633
1921	251,321,213	223,235,043	28,086,170
1931	278,977,238	245,521,249	33,455,989
1941	318,660,580	274,507,283	44,153,297
1951	361,088,090	298,644,381	62,443,709
1961	439,234,771	360,298,168	78,936,603
1971	548,159,652	439,045,675	109,113,977
1981	683,329,097	523,866,550	159,462,547
1991	846,302,688	628,691,676	217,611,012
2001	1,028,737,436	742,490,639	286,119,689
2011	1,210,569,573	833,463,448	377,106,125

**INDIA, STATES AND UNION TERRITORIES BY POPULATION, PERCENTAGE DECADAL GROWTH, AREA, DENSITY, SEX RATIO, AND LITERACY-2011**

Sr. No.	State	Population	Growth Rate	Area Sq.km	Density/ Sq.km.	Sex Ratio	Literacy Rate
-	India	1,21,05,69,573	17.7	32,87,240	382	943	73.0
1.	Uttar Pradesh	19,98,12,341	20.2	2,40,928	829	912	67.7
2	Maharashtra	11,23,74,333	16.0	3,07,713	365	929	82.3
3	Bihar	10,40,99,452	25.4	94,163	1,106	918	61.8
4	West Bengal	9,12,76,115	13.8	88,752	1,028	950	76.3
5	Andhra Pradesh	8,45,80,777	11.0	2,75,045	308	993	67.0
6	Madhya Pradesh	7,26,26,809	20.3	3,08,245	236	931	69.3

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7	Tamil Nadu	7,21,47,030	15.6	1,30,058	555	996	80.1
8	Rajasthan	6,85,48,437	21.3	3,42,239	200	928	66.1
9	Karnataka	6,10,95,297	15.6	1,91,791	319	973	75.4
10	Gujarat	6,04,39,692	19.3	1,96,024	308	919	78.0
11	Odisha	4,19,74,218	14.0	1,55,707	270	979	72.9
12	Kerala	3,34,06,061	4.9	38,863	860	1,084	94.0
13	Jharkhand	3,29,88,134	22.4	79,714	414	949	66.4
14	Assam	3,12,05,576	17.1	78,438	398	958	72.2
15	Punjab	2,77,43,338	13.9	50,362	551	895	75.8
16	Chhattisgarh	2,55,45,198	22.6	1,35,191	189	991	70.3
17	Haryana	2,53,51,462	19.9	44,212	573	879	75.6
18	NCT of Delhi	1,67,87,941	21.2	1,483	11,320	868	86.2
19	Jammu & Kashmir	1,25,41,302	23.6	2,22,236	124	889	67.2
20	Uttarakhand	1,00,86,292	18.8	53,483	189	963	78.8
21	Himachal Pradesh	6,86,41,602	12.9	55,673	123	972	82.8
22	Tripura	36,73,917	14.8	10,486	350	960	87.2
23	Meghalaya	29,66,889	27.9	22,429	132	989	74.4
24	Manipur	25,70,390	18.6	22,327	115	992	79.2
25	Nagaland	19,78,502	-0.6	16,579	119	931	79.6
26	Goa	14,58,545	8.2	3,702	394	973	88.7
27	Arunachal Pradesh	13,83,727	26.0	83,743	17	938	65.4
28	Puducherry	12,47,953	28.1	479	2,547	1,037	85.8
29	Mizoram	10,97,206	23.5	21,081	52	976	91.3
30	Chandigarh	10,55,540	17.2	114	9,258	818	86.0
31	Sikkim	6,10,577	12.9	7,096	86	890	81.4
32	Andaman and Nicobar Islands	3,80,581	6.9	8,249	46	876	86.6
33	Dadra and Nagar Haveli	3,43,709	55.9	491	700	774	76.2
34	Daman and Diu	2,43,247	53.8	112	2,191	618	87.1
35	Lakshadweep	64,473	6.3	32	2,149	947	91.8

***Population :***

Persons	1,21,05,69,573
Males	62,31,21,843
Females	58,74,47,730

***Highest / Lowest Population :***

State with Highest Population	Uttar Pradesh	199,8,12,341
State with Lowest Population	Sikkim	6,10,577
UT with Highest Population	NCT of Delhi	167,87,941
UT with Lowest Population	Lakshadweep	64,473

***Literacy Rate***

		<b>Persons</b>	<b>Males</b>	<b>Females</b>
Total	Literacy rate	73.0%	80.9%	64.6%
Rural	Literacy rate	67.8%	77.2%	57.9%
Urban	Literacy rate	84.1%	88.8%	79.1%
		<b>Persons (%)</b>	<b>Males (%)</b>	<b>Females (%)</b>
State with Highest Literacy Rate		Kerala (94.0)	Kerala (96.1)	Kerala (92.1)
State with Lowest Literacy Rate		Bihar (61.8)	Bihar (71.2)	Bihar (51.5)
UT with Highest Literacy Rate	Lakshadweep (95.6)	Lakshadweep (95.6)	Lakshadweep (87.9)	
UT with Lowest Literacy Rate	Dadra & Nagar Haveli (85.2)	Dadra & Nagar Haveli (85.2)	Dadra & Nagar Haveli (64.3)	

**Population Density**

		<b>Persons / Sq. Km</b>
	India	382
State with Highest Population Density	Bihar	1106
State with Lowest Population Density	Arunachal Pradesh	17
UT with Highest Population Density	Delhi	11,320
UT with Lowest Population Density	Andaman & Nicobar Islands	46
District with Highest Population Density	North East (Delhi)	36,155
District with Lowest Population Density	Dibang Valley	1

**Rural - Urban Distribution**

		<b>Population</b>	<b>(%)</b>
	Rural	83,3463,448	68.8%
	Urban	37,71,6,125	31.2%
State with highest proportion of Urban Population	Goa		62.2
State with lowest proportion of Urban Population	Himachal Pradesh		10.0
UT with highest proportion of Urban Population	NCT of Delhi		97.5
UT with lowest proportion of Urban Population	A. & Nicobar Islands		37.7

**Sex Ratio (females per thousand males)**

	<b>India</b>	943
	<b>Rural</b>	949
	<b>Urban</b>	929
State with Highest Female Sex Ratio	Kerala	1,084
State with Lowest Female Sex Ratio	Haryana	879
UT with Highest Female Sex Ratio	Puducherry	1,037
UT with Lowest Female Sex Ratio	Daman & Diu	618
District with Highest Female Sex Ratio	Mahe (Puducherry)	1,147
District with Lowest Female Sex Ratio	Daman (Daman & Diu)	534

**Work Participation Rate : 2011 Census**

<b>Total Workers</b>	<b>Number</b>	<b>Rate (%)</b>
Persons	48,17,43,311	39.8
Males	33,18,65,930	53.3
Females	14,98,77,381	25.5
<b>Main Workers</b>	<b>Percentage of Main Workers</b>	
Persons	36,24,46,420	75.2
Males	27,31,49,359	82.3
Females	8,92,97,061	59.6
<b>Marginal Workers</b>	<b>Percentage of Marginal Workers</b>	
Persons	11,92,96,891	24.8
Males	5,87,16,571	17.7
Females	6,05,80,320	40.4

<b>Population Composition (2001 Census)</b>	<b>Population</b>	<b>(%)</b>
Hindus	827,578,868	80.5
Muslims	138,188,240	13.4
Christians	24,080,016	2.3
Sikhs	19,215,730	1.9
Buddhists	7,955,207	0.8
Jains	4,225,053	0.4
Other Religions & Persuasions	6,639,626	0.6
Religion not stated	727,588	0.1
<b>Total</b>	<b>1,028,610,328</b>	<b>100.0</b>

**Scheduled Castes & Scheduled Tribes Population - (2011 Census)**

Scheduled Castes : 20,13,78,086 16.6%

Scheduled Tribes : 10,42,81,034 8.6%

**Scheduled Castes**

State with highest proportion of Scheduled Castes Punjab ( 31.9%)

State with lowest proportion of Scheduled Castes Mizoram ( 0.1%)

UT with highest proportion of Scheduled Castes Chandigarh (18.9%)

UT with lowest proportion of Scheduled Castes D & N Haveli (1.8% )

**Scheduled Tribes**

State with highest proportion of Scheduled Tribes Mizoram ( 94.4%)

State with lowest proportion of Scheduled Tribes Uttar Pradesh (0.06%)

UT with highest proportion of Scheduled Tribes Lakshadweep (94.8%)

UT with lowest proportion of Scheduled Tribes Daman & Diu (6.3%)

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## MULTILATERAL AGENCIES

### INTERNATIONAL MONETARY FUND

The International Monetary Fund (IMF) is an international organization that oversees the global financial system by following the macroeconomic policies of its member countries, in particular those with an impact on exchange rates and the balance of payments. It is an organization formed to stabilize international exchange rates and facilitate development. It also offers financial and technical assistance to its members, making it an international lender of last resort. Its headquarters are located in Washington, D.C., USA. The International Monetary Fund was created in July of 1944, with a goal to stabilize exchange rates and assist the reconstruction of the world's international payment system. Countries contributed to a pool which could be borrowed from, on a temporary basis, by countries with payment imbalances.

The IMF currently has a near-global membership of 188 countries. To become a member, a country must apply and then be accepted by a majority of the existing members. In April 2012, Republic of South Sudan joined the IMF, becoming the institution's 188th member.

Upon joining, each member country of the IMF is assigned a quota, based broadly on its relative size in the world economy. The IMF's membership agreed in November 2010 on a major overhaul of its quota system to reflect the changing global economic realities, especially the increased weight of major emerging markets in the global economy.

A member country's quota defines its financial and organizational relationship with the IMF.  
**Members Quota in the IMF**

A member's quota in the IMF determines the

amount of its subscription, its voting weight, its access to IMF financing, and its allocation of Special Drawing Rights (SDRs). A member state cannot unilaterally increase its quota - increases must be approved by the Executive Board and are linked to formulas that include many variables such as the size of a country in the world economy. For example, in 2001, China was prevented from increasing its quota as high as it wished, ensuring it remained at the level of the smallest G7 economy (Canada). In September 2006, the IMF's member countries agreed to the first round of ad hoc quota increases for four countries, including China.

The percentage of quotas of the individual member-countries decides not just their voting rights but also determines their access to the Fund resources. Besides, the size of a country's quota is a decisive factor in its level of representation in the Fund, as for example, the post of a Director or his alternate on the Executive Board of the Fund.

Industrial countries also attach great importance to their ranking in the Fund membership, which is strictly in accordance with their quota size. At present the largest member of the IMF is the US, with a quota of SDR 42,122.4 million and the smallest is Palau (SDR 3.1 million).

The quota largely determines the voting power. Each member has 250 basic votes plus one additional vote for each SDR 100,000 of quota. Accordingly, the US has 421,961 votes (16.75 per cent of the total) and Palau 768 votes (0.03 per cent).

The amount of financing a member could obtain from the IMF (its access limit) is based on its quota. Under Stand-By and Extended Arrangements, a member can borrow up to 100

per cent of its quota annually and 300 per cent cumulatively.

However, access may be higher in exceptional circumstances. Further, a member's share of general SDR allocations is established in proportion to its quota.

### **IMF Financial Facilities**

The IMF makes its financial resources available to member countries through a variety of financial facilities. Except for the ESAF members avail themselves of the IMF's financial resources by purchasing (drawing) other members' currencies or SDRs with an equivalent amount of their own currency. The IMF levies charges on these drawings and requires that members repurchase (repay) their own currency from the IMF over a specified time.

### **IMF Financial Policies**

IMF financial policies govern the modalities for the use of its financial resources under existing IMF facilities. These include:

- **Reserve Tranche Policies:** A member has a reserve tranche position in the IMF to the extent that its quota exceeds the IMF's holdings of its currency, excluding credits extended to it by the IMF. Subject only to balance of payments need, a member may draw up to the full amount of its reserve tranche position at any time. This drawing does not constitute a use of IMF credit, as its reserve position is considered part of the member's foreign reserves, and is not subject to an obligation to repay.
- **Credit Tranche Policies:** Credits under regular facilities are made available to members in tranches (segments) of 25 percent of quota. For first credit tranche drawings, members must demonstrate reasonable efforts to overcome their balance of payments difficulties, and no phasing applies. Upper credit tranche drawings (over 25 per cent) are normally phased in relation to certain conditions or "performance criteria."

• **Policy on Emergency Assistance:** The IMF provides emergency assistance by allowing members to make drawings to meet balance of payments needs arising from sudden and unforeseeable natural disasters and in postconflict situations. Normally this takes the form of an outright purchase of up to 25 percent of quota provided that the member is cooperating with the IMF. It does not entail performance criteria or a phasing of drawings.

• **Debt and Debt-Service Reduction Policies:** Part of a credit extended to a member by the IMF under regular facilities can be set aside to finance operations involving debt principal and debt service reduction. The exact amount of the set-aside is determined on a case-by-case basis; its availability is generally tied to program performance.

### **Regular IMF Facilities**

- **Stand-by arrangements (SBA):** It is designed to provide short-term balance of payments assistance for deficits of a temporary or cyclical nature, such arrangements are typically for 12 to 18 months. Drawings are phased on a quarterly basis, with their release made conditional on meeting performance criteria and the completion of periodic program reviews. Repurchases are made 3½ to 5 years after each purchase.
- **Extended Fund Facility (EFF):** It is designed to support medium-term programs that generally run for three years, the EFF aims at overcoming balance of payments difficulties stemming from macroeconomic and structural problems. Performance criteria are applied, similar to those in stand-by arrangements, and repurchases are made in 4½ to 10 years.

### **Concessional IMF Facility**

- **Enhanced Structural Adjustment Facility (ESAF):** It was established in 1987, and enlarged and extended in 1994. Designed for low-income member countries with pro-

tracted balance of payments problems, ESAF drawings are loans and not purchases of other members' currencies. They are made in support of three-year programs and carry an annual interest rate of 0.5 percent, with a 5½-year grace period and a 10-year maturity. Quarterly benchmarks and semiannual performance criteria apply; 80 low-income countries are currently eligible to use the ESAF.

#### ***Special IMF Facilities***

- **Systemic Transformation Facility (STF):** It is in effect from April 1993 to April 1995. The STF was designed to extend financial assistance to transition economies experiencing severe disruption in their trade and payments arrangements. Repurchases are made over 4½ to 10 years.
- **Compensatory and Contingency Financing Facility (CCFF):** It provides compensatory financing for members experiencing temporary export shortfalls or excesses in cereal import costs, as well as financial assistance for external contingencies in Fund arrangements. Repurchases are made over 3¼ to 5 years.
- **Supplemental Reserve Facility (SRF):** It provides financial assistance for exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence. Repurchases are expected to be made within 1 to 1½ years, but can be extended, with IMF Board approval, to 2 to 2½ years.

#### ***Special Drawing Rights***

SDRs were originally created to replace Gold and Silver in large international transactions. Being that under a strict (international) gold standard, the quantity of gold worldwide is relatively fixed, and the economies of all participating IMF members as an aggregate are growing, a perceived need arose to increase the supply of the basic unit or standard proportionately. Thus SDRs, or "paper gold", are cred-

its that nations with balance of trade surpluses can 'draw' upon nations with balance of trade deficits. So-called "paper gold" is little more than an accounting transaction within a ledger of accounts, which eliminates the logistical and security problems of shipping gold back and forth across borders to settle national accounts. It has also been suggested that having holders of US dollars convert those dollars into SDRs would allow diversification away from the dollar without accelerating the decline of the value of the dollar. SDRs are defined in terms of a basket of major currencies used in international trade and finance. At present, the currencies in the basket are, by weight, the United States dollar, the euro, the Japanese yen, and the pound sterling. Before the introduction of the euro in 1999, the Deutsche Mark and the French Franc were included in the basket. The amounts of each currency making up one SDR are chosen in accordance with the relative importance of the currency in international trade and finance. The determination of the currencies in the SDR basket and their amounts is made by the IMF Executive Board every five years.

#### **THE WORLD BANK**

The World Bank is one of two major financial institutions created as a result of the Bretton Woods Conference in 1944. The United Nations Monetary and Financial Conference, commonly known as Bretton Woods conference, was a gathering of 730 delegates from all 44 Allied nations at the Mount Washington Hotel, situated in Bretton Woods, New Hampshire to regulate the international monetary and financial order after the conclusion of World War II. The conference was held from 1 July to 22 July 1944 when the agreements were signed to set up the International Bank for Reconstruction and Development (IBRD), the General Agreement on Tariffs and Trade (GATT), and the International Monetary Fund (IMF).

The World Bank Group (WBG) is a family of five international organizations makes leveraged loans, generally to poor countries. The Bank

came into formal existence on 27 December 1945 following international ratification of the Bretton Woods agreements, which emerged from the United Nations Monetary and Financial Conference (1 July - 22 July 1944). It also provided the foundation of the Osiander-Committee in 1951, responsible for the preparation and evaluation of the World Development Report. Commencing operations on 25 June 1946, it approved its first loan on 9 May 1947 (\$250M to France for postwar reconstruction, in real terms the largest loan issued by the Bank to date). Its five agencies are:

- International Bank for Reconstruction and Development (IBRD)
- International Development Association (IDA)
- International Finance Corporation (IFC)
- Multilateral Investment Guarantee Agency (MIGA)
- International Centre for Settlement of Investment Disputes (ICSID)

The term "World Bank" generally refers to the IBRD and IDA, whereas the World Bank Group is used to refer to the institutions collectively.

The World Bank differs from the World Bank Group, in that the World Bank comprises only two institutions:

- International Bank for Reconstruction and Development (IBRD)
- International Development Association (IDA)

Whereas the latter incorporates these two in addition to three more:

- International Finance Corporation (IFC)
- Multilateral Investment Guarantee Agency (MIGA)
- International Centre for Settlement of Investment Disputes (ICSID)

The World Bank is not a "bank" in the common sense. It is one of the United Nations' specialized agencies, and is made up of 188 member countries. These countries are jointly responsible for how the institution is financed and

how its money is spent. Along with the rest of the developing community, the World Bank centers its efforts on reaching the Millennium Development Goals, agreed to by UN members in 2000 and aimed at sustainable poverty reduction. The "World Bank" is the name that has come to be used for the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Together these organizations provide low-interest loans, interest-free credit, and grants to developing countries. Some 10,000 development professionals from nearly every country in the world work in the World Bank's Washington DC headquarters or in its 109 country offices. Interest-free credit and grant financing comes from IDA, the world's largest source of concessional assistance. Some 40 rich countries provide the money for this funding by making contributions every four years. IDA credits make up about one-quarter of the Bank's financial assistance. Aside from IDA funds, very little of the Bank's income is provided by its member countries.

### ***Current President of World Bank***

An indirect presidential election was held on 16 April 2012 to choose a new president of the World Bank to replace Robert Zoellick, whose term expired in June. Although the organization has always had presidents from, and nominated by, the United States, this election featured the nomination of two non-United States candidates for the first time, originating, respectively, from Nigeria and Colombia. Though the Colombian Jose Antonio Ocampo withdrew his candidacy in the final stages, the Nigerian Finance Minister Ngozi Okonjo-Iweala remained in the race. Eventually, and amid controversy, the U.S. nominee Jim Yong Kim was announced as the new president on 16 April.

### **WTO AND INDIAN ECONOMY**

The world trade organization (WTO) is an international trade institution. The WTO superseded and replaced the GATT. The GATT was a provisional, multilateral agreement governing

international trade from 1947 until January 1, 1995, the creation of the WTO was negotiated in the final GATT round, the Uruguay Round. The WTO inherited a number of core principles from the GATT. These principles include:

- Non-discrimination, which in practice means two things. The first principle is MFN—most favoured nation treatment. Any trade concession a nation offers to one member, it must offer to all. The second principle is national treatment. This means that imported products must be treated the same as domestic goods.
- Reciprocity of Trade Concessions.
- Trade Liberalization.
- Transparency and predictability in import and export rules and regulations.
- Favourable treatment to less developed countries.

Although built on the GATT legacy, the Uruguay Round and WTO added many new issues and features. To begin with, many older agreements were replaced by new, stronger agreements. For example, the Agreement on Textiles and Clothing established a time-table to liberalize textile trade, while the Agreement on Sanitary and Phytosanitary Measures established a more transparent regime for trade in agricultural goods and ensures plant and animal health standards are followed. The WTO also broke new ground, adding a number of trade sectors and issues not addressed by the GATT:

- The General Agreement on Trade in Services (GATS) adds services.
- Trade in Intellectual Property Rights (TRIPs) adds copyrights, trademarks and patents.
- Trade Related Investment Measures (TRIMs) sets rules for Foreign Direct Investment.
- The Agreement on Government Procurement (GPA) & the Information Technology Agreement (ITA) are also international rules on new product areas.

These new agreements are ambitious additions to the rule governing the world trading system. However, at this stage there are significant enforcement problems and numerous loopholes that countries use to evade their obligations.

The WTO differs from the GATT not only in scope, but in institutional functioning. The WTO has two significant functions that the GATT did not. First, the WTO has a Trade Policy Review Mechanism. This process periodically assesses a country's trade policies and notes any changes. It is a non-judgmental, non-confrontational process.

More controversial is the Dispute Settlement Body and its dispute settlement panels. These panels, composed of economists, hand down binding judgments in trade disputes.

The WTO has 153 members, representing more than 97% of total world trade and 30 observers, most seeking membership. The WTO is governed by a ministerial conference, meeting every two years; a general council, which implements the conference's policy decisions and is responsible for day-to-day administration; and a director-general, who is appointed by the ministerial conference. The WTO's headquarters is at the Centre William Rappard, Geneva, Switzerland.

### **Main Provisions of WTO**

#### **General Agreement on Trade in Services (GATS)**

The GATS applies in principle to all service sectors except "services supplied in the exercise of governmental authority". These are services that are supplied neither on a commercial basis nor in competition with other suppliers viz social security schemes and central banking.

#### **Modes of supply**

The GATS sets out four modes of supplying services:

Mode 1: Cross-border trade

Mode 2: Consumption abroad

Mode 3: Commercial presence

Mode 4: Presence of natural persons

#### **Mode 1**

Cross-border trade corresponds with the normal form of trade in goods and maintains a clear geographical separation between seller and buyer. In this case services flow from the territory of one member into the territory of another member crossing national frontiers. (e.g., banking or architectural services transmitted via telecommunications or mail).

#### **Mode 2**

Consumption abroad refers to situations where a service consumer moves into another member's territory to obtain a service (e.g., consumer travelling for tourism, medical treatment, to attend educational establishment).

#### **Mode 3**

Commercial presence is the supply of a service through the commercial presence of the foreign supplier in the territory of another WTO member. In this case a service supplier of one member establishes a territorial presence, including through ownership or lease of premises, in another member's territory to provide a service. (e.g., the establishment of branch offices or agencies to deliver such services as banking, legal advice or communications).

#### **Mode 4**

Presence of natural persons involves the admission of foreign nationals to another country to provide services there. An Annex to the GATS makes it clear, however, that the agreement has nothing to do with individuals looking for employment in another country, or with citizenship, or residence requirements. The members still have a right to regulate the entry and stay of the persons concerned, for instance by requiring visas.

#### **General Principles**

These are basic rules that apply to all members and to all services.

#### **MFN Treatment**

Under Article II of the GATS, "Each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than it accords to like services and service suppliers of any other country". However, a member is permitted to maintain a measure inconsistent with the general MFN requirement if it has established an exception.

However, all exemptions are subject to review and they should in principle, not last longer than 10 years.

#### **Transparency**

The GATS requires each member to publish promptly "all relevant measures of general application" that affect operation of the agreement. Members must also notify the Council for Trade in Services of new or changed laws, regulations or administrative guidelines that affect trade in services covered by their specific commitments under the agreement. Each member is required to establish an enquiry point, to respond to requests from other members for information.

#### **Specific Obligations**

Obligations, which apply on the basis of commitments, laid down in individual country schedules concerning market access and national treatment in specifically designated sectors. These requirements apply only to scheduled sectors.

#### **Market Access**

Market access is a negotiated commitment in specified sectors. The GATS also sets out different forms of measure affecting free market access that should not be applied to the foreign service or its supplier unless their use is clearly provided for in the schedule. They are:

- Limitations on the number of service suppliers
- Limitations on the total value of services transactions or assets

- Limitations on the total number of service operations or the total quantity of service output
- Limitations on the number of persons that may be employed in a particular sector or by a particular supplier
- Measures that restrict or require supply of the service through specific types of legal entity or joint venture
- Percentage limitations on the participation of foreign capital, or limitations on the total value of foreign investment

### National Treatment

A commitment to national treatment means that in the sectors covered by its schedule, subjected to any conditions and qualifications set out in the schedule, each member shall give treatment to foreign services and service suppliers treatment, in measures affecting supply of services, no less favourable than it gives to its own services and suppliers. Again, the extension of national treatment in any particular sector may be made subject to conditions and qualifications. Members are free to tailor the sector coverage and substantive content of such commitments as they see fit. The commitments thus tend to reflect national policy objectives and constraints, overall and in individual sectors. While some Members have scheduled less than a handful of services, others have assumed market access and national treatment disciplines in over 120 out of a total of 160-odd services.

### Exemptions

Members in specified circumstances are allowed to introduce or maintain measures in contravention of their obligations under the Agreement, including the MFN requirement or specific commitments. These circumstance cover measures necessary to protect public morals or maintain public order, protect human, animal or plant life or health or secure compliance with laws or regulations not inconsistent with the Agreement including, among others, measures

necessary to prevent deceptive or fraudulent practices.

Also, in the event of serious balance-of-payments difficulties, members are allowed to temporarily restrict trade, on a non-discriminatory basis, despite the existence of specific commitments.

### *Indian Concerns*

Services exports account for 40% of India's total exports of goods and services, and stood at \$86 billion in 2007-08. The contribution of Services to India's GDP is more than 55%. The sector (domestic and exports) provides employment to around 142 million people, comprising 28% of the work force of the country. India's exports are mainly in the IT and IT enabled sectors, Travel and Transport, and Financial sectors.

The main destinations are the US (33%), the EU (15%) and other developed countries. India has an obvious interest in the liberalisation of services trade and wants commercially meaningful access to be provided by the developed countries to fulfil the Development Agenda of this Round. Since the Uruguay Round, India has autonomously liberalised its Services trade regime across the board, with significant market access provided in core areas of interest to the India's interest in services lies in the large pool of trained, qualified experienced manpower providing services by temporarily moving to provide services and then returning to India (Mode 4). Trade in Mode 4 accounts for only a minuscule 1% of global trade at the moment. India has asked for a commitment from the developed countries in Mode 4, inter alia in LT and IT Enabled Services, Engineering Services, Health Services, Education Services, etc. The other manner in which India can deliver services is by way of remote supply of services with improved connectivity and vast pool of professionals in various services sectors (Mode 1). It includes outsourcing, BPO, etc. Global trade in Mode 1 accounts for only 18% of total trade. In Mode 1, India wants developed

countries to take binding commitments in various services sectors—Health Services, R&D Services, Engineering & Integrated Engineering Services, Construction and Related Services, Computer Related Services, Professional Services, Other Business Services like credit reporting services, collection agency services, telephone-based support services, data processing services, etc. The major concern for India in the area of services is that the markets for services in the larger economies are not sufficiently open, particularly in respect of labour and labour-related services. Furthermore, in order to realise effective access in the larger markets, there is a need to ensure that predictable and transparent disciplines are put in place for Domestic Regulations so that they are not abused to deny access or to create barriers.

#### ***Trade-Related Investment Measures (TRIMs)***

In the late 1980s, there was a significant increase in foreign direct investment throughout the world. However, some of the countries receiving foreign investment, imposed numerous restrictions on that investment designed to protect and foster domestic industries, and to prevent the outflow of foreign exchange reserves. Examples of these restrictions include local content requirements (which require that locally-produced goods be purchased or used), manufacturing requirements (which require the domestic manufacturing of certain components), trade balancing requirements, domestic sales requirements, technology transfer requirements, export performance requirements (which require the export of a specified percentage of production volume), local equity restrictions, foreign exchange restrictions, remittance restrictions, licensing requirements, and employment restrictions. These measures can also be used in connection with fiscal incentives as opposed to requirement. Some of these investment measures distort trade in violation of GATT Article III and XI, and are therefore prohibited. Until the completion of the Uruguay Round negotiations, which produced

a well-rounded Agreement on Trade-Related Investment Measures (hereinafter the "TRIMs Agreement"), the few international agreements providing disciplines for measures restricting foreign investment provided only limited guidance in terms of content and country coverage. The OECD Code on Liberalization of Capital Movements, for example, requires members to liberalize restrictions on direct investment in a broad range of areas. The OECD Code's efficacy, however, is limited by the numerous reservations made by each of the members. In addition, there are other international treaties, bilateral and multilateral, under which signatories extend most-favoured-nation treatment to direct investment. Only a few such treaties, however, provide national treatment for direct investment. Moreover, although the APEC Investment Principles adopted in November 1994 provide rules for investment as a whole, including non-discrimination and national treatment, they have no binding force.

#### **Legal Framework**

GATT 1947 prohibited investment measures that violated the principles of national treatment and the general elimination of quantitative restrictions, but the extent of the prohibitions was never clear. The TRIMs Agreement, however, contains statements prohibiting any TRIMs that are inconsistent with the provisions of Articles III or XI of GATT 1994. In addition, it provides an illustrative list that explicitly prohibits local content requirements, trade balancing requirements, foreign exchange restrictions and export restrictions (domestic sales requirements) that would violate Article III:4 or XI:1 of GATT 1994. TRIMs prohibited by the Agreement include those that are mandatory or enforceable under domestic law or administrative rulings, or those with which compliance is necessary to obtain an advantage (such as subsidies or tax breaks). The following table contains a list of measures specifically prohibited by the TRIMs Agreement. Note that this table is not exhaustive, but simply illustrates TRIMs that are prohibited by the TRIMs

Agreement. The table, therefore, calls particular attention to several common types of TRIMs. We would add that this table identifies measures that were also inconsistent with Article

III:4 and XI:1 of GATT 1947. Indeed, the TRIMs Agreement is not intended to impose new obligations, but to clarify the pre-existing GATT 1947 obligations. Under the WTO TRIMs

### **Examples of TRIMs Explicitly Prohibited by the TRIMs Agreement**

<b>Local Content Requirement</b>	<b>Trade Balancing Requirements</b>	<b>Foreign Exchange Restrictions</b>	<b>Export Restrictions (Domestic Sales Requirements)</b>
Measures requiring the purchase or use by an enterprise of domestic products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. (Violation of GATT Article III:4)	1. Measures requiring that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local exports. products that it (Violation of GATT Article III:4) 2. Measures restricting the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports. (Violation of GATT Article XI:1)	Measures restricting the importation by an enterprise of products (parts and other goods) used in or related to its local Production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise. (Violation of GATT Article XI:1)	Measures restricting the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production. (Violation of GATT Article XI:1)

### **Exceptional Provisions of the TRIMs Agreement**

<b>Transitional period</b>	<b>Exceptions for developing countries</b>	<b>Equitable provisions</b>
Measures specifically prohibited by the TRIMs Agreement need not be eliminated immediately, although such measures must be notified to the WTO within 90 days after the entry into force of the TRIMs Agreement. Developed countries will have a period of two years in which to abolish such measures; in principle, developing countries will have five years and least-developed countries will have seven years.	Developing countries are permitted to retain TRIMs that constitute a violation of GATT Article III or XI, provided the measures meet the conditions of GATT Article XVIII which allows specified derogation from the GATT provisions, by virtue of the economic development needs of developing countries	To avoid damaging the competitiveness to companies already subject to TRIMs, governments are allowed to apply the same TRIMs to new foreign direct investment during the transitional period described.

Name	Start	Duration	Countries	Subjects Covered	Achievements
Geneva	April 1947	7 months	23	Tariffs	Signing of GATT, 45,000 tariff concessions affecting \$10 billion of trade
Annecy	April 1949	5 months	13	Tariffs	Countries exchanged some 5,000 tariff concessions
Torquay	September 1950	8 months	38	Tariffs	Countries exchanged some 8,700 tariff concessions, cutting the 1948 tariff levels by 25%
Geneva II	January 1956	5 months	26	Tariffs, admission of Japan	\$2.5 billion in tariff reductions
Dillon	September 1960	11 months	26	Tariffs	Tariff concessions worth \$4.9 billion of world trade
Kennedy	May 1964	37 months	62	Tariffs, Anti-dumping	Tariff concessions worth \$40 billion of world trade
Tokyo	September 1973	74 months	102	Tariffs, non-tariff measures, "framework" agreements	Tariff reductions worth more than \$300 billion dollars achieved
Uruguay	September 1986	87 months	123	Tariffs, non-tariff, measures, rules services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc	The round led to the creation of WTO, and extended the range of trade negotiations, leading to major reductions in tariffs (about 40%) and agricultural subsidies, an agreement to allow full access for textiles and clothing from developing countries, and an extension of intellectual property rights.
Doha	November 2001	?	141	Tariffs, non-tariff measures, agriculture, labor standards, environment, competition, investment, transparency, patents, etc	The round is not yet concluded

Agreement, countries are required to rectify any measures inconsistent with the Agreement, within a set period of time, with a few exceptions the second table.

### ***Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS)***

TRIPS contains requirements that nations' laws must meet for copyright rights, including the rights of performers, producers of sound recordings and broadcasting organizations; geographical indications, including appellations of origin; industrial designs; integrated circuit layout-designs; patents; monopolies for the developers of new plant varieties; trademarks; trade dress; and undisclosed or confidential information. TRIPS also specify enforcement procedures, remedies, and dispute resolution procedures. Protection and enforcement of all intellectual property rights shall meet the objectives to contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.

The TRIPS agreement introduced intellectual property law into the international trading system for the first time and remains the most comprehensive international agreement on intellectual property to date. In 2001, developing countries, concerned that developed countries were insisting on an overly narrow reading of TRIPS, initiated a round of talks that resulted in the Doha Declaration. The Doha declaration is a WTO statement that clarifies the scope of TRIPS, stating for example that TRIPS can and should be interpreted in light of the goal "to promote access to medicines for all."

### ***Impact of WTO on Indian Agriculture***

For the last two decades, the concept of WTO is highlighted in every newspaper, electronic media, agriculture and commerce ministries, states and central government forums, farmer's union, academicians, policy

makers, researchers, etc.

Especially in the Doha Development Round of trade talks, agriculture has emerged as one of the most important issues for negotiations. Developing countries are particularly concerned about the widespread use of domestic farm subsidies by developed countries. Estimates suggest that domestic farm support in developed countries amounts to about 300 billion US dollars. Such huge subsidies not only create distortion in the domestic markets of these countries, they also distort trade by artificially influencing commodity prices. One of the priorities of the current round of WTO negotiations is to bring substantial reduction in trade distorting domestic support.

### **Background**

The Agreement on Agriculture forms a part of the Final Act of the Uruguay Round of Multilateral Trade Negotiations, which was signed by the member countries in April 1994 at Marrakesh, Morocco and came into force on 1st January, 1995. The Uruguay Round marked a significant turning point in world trade in agriculture. For the first time, agriculture featured in a major way in the GATT round of multilateral trade negotiations. Although the original GATT – the predecessor of the World Trade Organisation (WTO) – applied to trade in agriculture, various exceptions to the disciplines on the use of non-tariff measures and subsidy meant that it did not do so effectively. The Uruguay Round agreement sought to bring order and fair competition to this highly distorted sector of world trade by establishment of a fair and market oriented agricultural trading sector. The root cause of distortion of international trade in agriculture has been the massive domestic subsidies given by the industrialised countries to their agricultural sector over many years. This in turn led to excessive production and its dumping in international markets as well as import restrictions to keep out foreign agricultural products from their domestic markets. Hence, the starting point for the establishment of a fair

agricultural trade regime has to be the reduction of domestic production subsidies given by industrialised countries, reduction in the volume of subsidized exports and minimum market access opportunities for agricultural producers world-wide.

The obligations and disciplines incorporated in the Agreement on Agriculture, therefore, relate to (a) market access; (b) domestic subsidy or domestic support; and (c) export subsidy.

#### **Salient Features**

The Agreement on Agriculture contains provisions in the following three broad areas of agriculture and trade policy:

**(a) Market Access:** On market access, the Agreement has two basic elements:

(i) Tarification of all non-tariff barriers. That is to say, non-tariff barriers such as quantitative restrictions and export and import licensing, etc. are to be replaced by tariffs to provide the same level of protection. Tariffs, resulting from this "tarification" process together with other tariffs on agricultural products, are to be reduced by a simple average of 36% over 6 years in the case of developed countries and 24% over 10 years in the case of developing countries. With India being under balance of payments cover (which is a GATT-consistent measure), we had not undertaken any commitments with regard to market access and this has been clearly stated in our schedule filed under GATT. The only commitment India has undertaken is to bind its tariffs on primary agricultural products at 100%; processed foods at 150%; and edible oils at 300%.

(ii) The second element relates to setting up of a minimum level for imports of agricultural products by member countries as a share of domestic consumption. Countries are required to maintain current levels (1986-88) of access for each individual product. Where the current level of import is

negligible, the minimum access should not be less than 3% of the domestic consumption, during the base period and tariff quotas are to be established when imports constitute less than 3% of domestic consumption. This minimum level is to rise to 5% by the year 2000 in the case of developed countries and by 2004 in the case of developing countries. However, special Safeguards Provisions allow for the application of additional duties when shipments are made at prices below certain reference levels or when there is a sudden import surge. The market access provision, however, does not apply when the commodity in question is a 'traditional staple' of a developing country.

**(b) Domestic support:** Provisions of the Agreement regarding domestic support have two main objectives— first to identify acceptable measures that support farmers and second, to deny unacceptable, trade distorting support to the farmers. These provisions are aimed largely at the developed countries where the levels of domestic agricultural support have risen to extremely high levels in recent decades.

All domestic support is quantified through the mechanism of total Aggregate Measurement of Support (AMS). AMS is a means of quantifying the aggregate value of domestic support or subsidy given to each category of agricultural product. Each WTO member country has made calculations to determine its AMS wherever applicable. Commitment made requires a 20% reduction in total AMS for developed countries over 6 years. For developing countries, this percentage is 13% and no reduction is required for the least developed countries. The base period external reference price on which the reductions were calculated was 1986-88.

AMS consists of two parts—product-specific subsidies and non-product specific subsidies. Product-specific subsidy refers to the total level of support provided for each individual

agricultural commodity, essentially signified by procurement price in India. Non-product specific subsidy, on the other hand, refers to the total level of support for the agricultural sector as a whole, i.e., subsidies on inputs such as fertilisers, electricity, irrigation, seeds, credit, etc.

There are three categories of support measures that are not subject to reduction under the Agreement, and support within specified de minimis level is allowed. These three categories of exempt support measures are:

1. Measures which have a minimum impact on trade and which meet the basic and policy specific criteria set out in the Agreement (the so-called Green Box measures in the terminology of WTO). These measures include Government assistance on general services like (i) research, pest and disease control, training, extension, and advisory services; (ii) public stock holding for food security purposes; (iii) domestic food aid; and (iv) direct payment to producers like governmental financial participation in income insurance and safety nets, relief from natural disasters, and payments under environmental assistance programmes.
2. Developing country measures otherwise subject to reduction which meet the criteria set out in paragraph 2 of Article 6 of the Agreement (the so-called 'Special and Differential Treatment' or the S&D Box). Examples of these are (i) investment subsidies which are generally available to agriculture in developing countries; and (ii) agricultural input services generally available to low-income and resource-poor producers in developing countries.
3. Direct payments under production limiting programme which conform to the requirement set out in paragraph 5 of Article 6 of the Agreement (the so-called Blue Box measures). These are relevant from the developed countries point of view only.

Under the de minimis provision of Article 6.4 of the Agreement, there is no requirement to reduce support in this residual category whose value in any year, in the case of product specific support does not exceed 10% for developing countries of the total value of production of the basic agricultural product in question or of the value of total agricultural production in the case of non-product specific support. Where the support is below 10 per cent, as in the case of India, product-specific and non-specific de minimis ceiling may be raised to those levels.

**(c) Export subsidies:** The Agreement on Agriculture lists several types of subsidies to which reduction commitments apply. However, such subsidies are virtually non-existent in India as exporters of agricultural commodities do not get direct subsidy. Even exemption of export profits from income tax under Section 80-tHHC of the Income Tax Act is not among the listed subsidies. It is also worth noting that developing countries are free to provide three of the listed subsidies, namely, reduction of export marketing costs, internal and international transport and freight charges. In general, it may be noted that the virtual explosion of export subsidies in the industrialised countries in the years leading to the Uruguay Round was one of the key issues addressed in the agricultural negotiations. While under GATT 1947, prohibition of export subsidies for industrial products has been effective since 1956, in the case of agricultural primary products, such subsidies were only subject to limited disciplines which, moreover, did not prove to be operational or effective. As a result, in the 1970s and 1980s, success in international markets for agricultural products was increasingly determined by the financial power and largesse of national treasuries rather than the efficiency and marketing skills of agricultural producers and exporters. Export subsidies also became a major factor in depressing or destabilising

world market prices for many agricultural commodities. The Uruguay Round marked a radical departure from the earlier GATT disciplines in the areas of agricultural export subsidies. Members are required to reduce the value of direct export subsidies to a level of 36% below the 1986-90 base period level over a six year implementation period. The quantity of subsidized export is to be reduced by 21% over the same period. In the case of developing countries, the reductions are two-thirds those of the developed countries over a ten-year period and there are no reductions for least developed countries. Under the Agreement, export subsidies are defined as "subsidies contingent on export performance" and the list covers export subsidy practices such as direct export subsidies contingent on export performance; sales of noncommercial stocks of agricultural products for export at prices lower than comparable prices for such goods in the domestic markets; producer-financed subsidies such as government programmes which require a levy on production which is then used to subsidise the export of the product; cost-reduction measures such as subsidies to reduce marketing costs for exports including handling costs and costs of international freight; internal transport subsidies applying only to exports; subsidies on incorporated products i.e., subsidies on agricultural products such as wheat contingent on their incorporation in export products made of wheat, etc. All such export subsidies are subject to reduction commitments in terms of both the volume of subsidised export and budgetary outlays for such subsidies. As indicated earlier, such measures are virtually non-existent in India and, hence, the issue of reduction of export subsidy on agricultural products is not of particular relevance for India.

#### **Product Coverage**

The Agreement defines agricultural products

by reference to the harmonised system of product classification. The definition covers not only basic agricultural products such as wheat, milk and live animals, but the products derived from them such as bread, butter, other dairy products and meat, as well as all processed agricultural products such as chocolates and sausages. The coverage includes wines, spirits and tobacco products, fibres such as cotton, wool and silk, and raw animal skins destined for leather production. Fish and fish products are not included nor are forestry products.

#### **Implementation Period**

The implementation period for the country-specific commitments is the six-year period commencing in 1995. However, developing countries have the flexibility to implement their reduction and other specific commitments over a period of up to 10 years. Members had the choice of implementing their concessions and commitments on the basis of calendar, marketing (crop) or fiscal years. A WTO Member's implementation year for tariff reduction may thus differ from the one applied to export subsidy reductions. For the purpose of the 'peace clause' the implementation period is the nine-year period commencing in 1995.

#### **Implications of the Agreement**

Implications of the Agreement would differ from country to country and would depend largely on the overall agricultural scenario in the country. Indian agriculture is characterised by a preponderant majority of small and marginal farmers holding less than two hectares of land, less than 35.7% of the land, is under any assured irrigation system and for the large majority of farmers, the gains from the application of the science & technology in agriculture are yet to be realised. Farmers, therefore, require support in terms of development of infrastructure as well as extension of improved technologies and provisions of requisite inputs at reasonable cost. India's share of world's agricultural trade is of

the order of 1%. There is no doubt that during the last 30 years, Indian agriculture has grown at a reasonable pace, but with stagnant and declining net cropped area it is indeed going to be a formidable task to maintain the growth in agricultural production. The implications of the Agreement would thus have to be examined in the light of the food demand and supply situation. The size of the country, the level of overall development, balance of payments position, realistic future outlook for agricultural development, structure of land holdings, etc. are the other relevant factors that would have a bearing on India's trade policy in agriculture.

Implications of the Agreement on Agriculture for India should thus be gauged from the impact it will have on the following:

- i) Whether the Agreement has opened up markets and facilitated exports of our products;
- ii) Whether we would be able to continue with our domestic policy aimed at improving infrastructure and provision of inputs at subsidised prices for achieving increased agricultural production.

### **Implications—Short Term**

As far as opening of markets and impact on trade in agriculture is concerned, it may be noted that the share of developing countries in world exports of food remained at 44% and of agricultural raw materials increased insignificantly from 32% in 1994 to 34% in 1996 that is the post-Agreement period. The average growth of developed countries imports of agricultural products increased by just 1% during 1994-96. Nearer home, agricultural exports of ten Asian developing countries increased from US \$ 49252 million in 1994 to US \$ 55902 million in 1996. India's share in total agricultural exports from developing Asia is 8%, behind China's 19%, Thailand's 17%, Malaysia's 14% and Indonesia's 10%. India's exports of agricultural products have increased from US \$ 4151 million in 1993-94 to US \$

7054 million in 1997-98. No tangible opening up of the markets has thus been noticed in the post-Agreement period so far. However, it may be premature on this basis to assess the long-term impact of the Agreement on opening up of markets.

Regarding freedom to pursue our domestic policies, it is quite evident that in the short term India will not be affected by the WTO Agreement on Agriculture. The safeguards provided for developing countries give enough manoeuvres to insulate ourselves from any major impact of trade liberalisation in agricultural commodities.

India has been maintaining quantitative restrictions (QRs) on import of 825 agricultural products as on 1.4.97. QRs are proposed to be eliminated within the overall time frame of six years in three phases – 1.4.97 to 31.3.2003. (All our trading partners barring the US have agreed to this phase-out plan and dispute with the US is pending with Dispute Settlement Body of WTO for adjudication). Within the provisions of the GATT Agreement India has bound tariffs at high levels of 100%, 150% and 300% for primary products, processed products and edible oils respectively.

Therefore, the QRs can be replaced with high import tariff in case we want to restrict imports of these commodities.

In India, for the present, the minimum support price provided to commodities is less than the fixed external reference price determined under the Agreement. Therefore, the AMS is negative. Theoretically, therefore, we could increase the product-specific support up to 10%, the only restraint being the fiscal sustainability in the country's context.

### **Implications—Long Term**

As mentioned earlier, for a large majority of farmers in different parts of the country, the gains from the application of science and technology in agriculture are yet to be realised which would require infrastructural support,

improved technologies and provision of inputs at reasonable cost. The Agreement on Agriculture thus recognised this and developing countries have been given the freedom to implement such policies under Article 6 relating to differential treatment, but any attempt in future to dilute provisions relating to differential treatment for developing countries could affect us adversely.

Regarding the impact of liberalisation of trade in agriculture in the long term, Indian agriculture enjoys the advantage of cheap labour. Therefore, despite the lower productivity, a comparison with world prices of agricultural commodities would reveal that domestic prices in India are considerably less with the exceptions of a few commodities (notably oilseeds). Hence, imports to India would not be attractive in the case of rice, tea, sunflower oil and cotton. On the whole, large scale import of agricultural commodities as a result of trade liberalisation is ruled out. Even the exports of those foodgrains which are cheaper in the domestic market, but are sensitive from the point of view of consumption by the economically weaker sections are not likely to rise to unacceptable levels because of high inland transportation cost and inadequate export infrastructure in India. Through proper tariffication, however, we will have to strike a balance between the competing interest of 10% farmers who generate marketable surpluses and consumers belonging to the economically poor sections of the society.

It is also argued that because of increasing price of domestic agricultural commodities following improved export prospects, farmers would get benefits which in turn would encourage investment in the resource scarce agricultural sector. With the decrease in production subsidies as well as export subsidies, the international prices of agricultural commodities will rise and this will help in making our exports more competitive in world market. Given our agro diversity, we have the potential to increase our agro exports in a substantial way. In the words of Shri A.V.

Ganesan, "There will be growing pressure from the farmers to realise higher prices for their produce and to narrow the gap between the domestic and external prices. Our industrialists are pressing for a 'level playing field' vis-a-vis foreign enterprises; our farmers will press for a 'level playing field' for the prices of their products vis-a-vis international prices. Both the pattern of production and price expectations will increasingly be influenced by the demands and trends in world markets. On the one hand, the price incentive could be the best incentive and could give a strong boost to investment in agriculture as well as adoption of modern technologies and thereby to the raising of agricultural production and productivity. On the other hand, the rise in domestic prices would put pressure on the public distribution system and accentuate the problem of food subsidy. Furthermore, freedom to export agricultural products without restrictions will also need shedding the long-nurtured inhibition against their imports. The nature and character of State intervention and State support will have to undergo qualitative changes in order not only to realise the opportunities for exports, but also to cope with the implications of our agriculture coming into increasing alignment with the international market place".

#### **Doha Round**

Non Tariff Measures (NTMs) are all measures on international trade that are not in the form of a tariff or a tax. These measures include trade related procedures such as documentation, certification and inspections; technical regulations; standards; import related measures such as restrictions, prohibitions, seasonal duties, tariff rate quotas; foreign exchange controls including artificial exchange rates; public procurement practices, etc. Certain NTMs such as imposition of anti-dumping and safeguard duties have the effect of tariffs. On the other hand, some measures are intended to protect human, animal and plant, life and health, and are known as sanitary and phytosanitary (SPS) measures.

Non Tariff Barriers (NTBs) are a sub-set of NTMs which violate the obligations under the Agreements of the WTO. Therefore, NTBs are unfair measures which serve to discriminate against imports.

The NAMA negotiations focussed on the listing of NTBs by countries. Subsequently, the Negotiating Group went into text based negotiations on various proposals.

### Last Status

In the draft NAMA modalities of 6 December, 2008, there were 13 NTB textual proposals listed in Annex 5. These could be categorised as:

#### ***Horizontal proposals (those related across sectors)***

- Ministerial Decision on Procedures for the Facilitation of Solutions to Non-Tariff Barriers (known as the Horizontal Mechanism)
- Decision on the elimination of Non-Tariff Barriers imposed as unilateral trade measures
- Ministerial Decision on Trade in Remanufactured Goods

#### ***Vertical proposals (related to specific sectors)***

##### **(A) Export related proposals**

- Revised submission on Export Taxes
- Protocol on Transparency in Export Licensing to the General Agreement on Tariffs and Trade 1994

##### **(B) TBT (Technical Barriers to Trade) related proposals**

- Understanding on the Interpretation of the Agreement on Technical Barriers to Trade as Applied to Trade in Fireworks
- Understanding on the Interpretation of the Agreement on Technical Barriers to Trade as Applied to Trade in Lighter Products
- Understanding on the Interpretation of the Agreement on Technical Barriers to Trade as Applied to Trade in Electronics

- Decision on non-tariff barriers affecting forestry products used in building construction
- Agreement on Non-Tariff Barriers Pertaining to the Electrical Safety and Electromagnetic Compatibility (EMC) of Electronic Goods
- Negotiating Proposal on Non-Tariff Barriers in the Chemical Products and Substances Sector
- Understanding on the Interpretation of the Agreement on Technical Barriers to Trade with respect to the Labelling of Textiles, Clothing, Footwear, and Travel Goods
- Agreement on NTBs pertaining to standards, technical regulations and conformity assessment procedures for automotive products.

While listing these 13 proposals, the NAMA text states that 7 of the proposals merit particular attention which includes the proposals on the horizontal mechanism; remanufactured goods; TBT proposals on electronics (2 in number); vertical proposals on automotives; labelling in textiles, clothing, footwear and travel goods; and chemical products. Subsequently, the EC came out with its proposal on automobiles thereby putting 14 NTB proposals on the table.

While most proposals have little support and are unlikely to achieve consensus, the three key proposals under discussion are:

- “Ministerial Decision on Procedures for the Facilitation of Solutions to NTBs” known as the Horizontal Mechanism

This Horizontal Mechanism was originally mooted by the NAMA 11 (of which India is a Member) and European Communities (EC) with the support of more than 100 Members namely the African Group, Canada, LDCs, New Zealand, Norway, Pakistan and Switzerland. The Mechanism is an informal dispute resolution

mechanism that explores trade solutions without affecting the rights and obligations under the WTO Agreements. It operates through the existing WTO Committee's, takes the help of an expert in the respective field and enables faster and more economical resolution of NTBs especially those on products of export interest for developing countries.

The Procedures have the following salient features:

- The procedures are intended to explore trade solutions to the NTB without getting into the rights and obligations under the WTO Agreement.
- The first stage is of information exchange between the requesting and responding Member which seeks to ensure transparency. This is non confidential and is circulated to the WTO Committee.
- The Chairman or Vice Chairman get associated at this stage since they call a meeting for addressing any outstanding issues and explore possible steps forward.
- Third parties can join in based on consent of the two parties and on terms and conditions decided upon by them.
- The second stage is purely mandatory at the consent of both parties. It involves the appointment of a facilitator which is by mutual consent or else selected by the Chairman of the Council of Trade in Goods (CTG) after consulting the parties.
- This stage has flexible procedures in terms of the venue, means of communication, exploration of possible solutions, etc. The emphasis is on reaching a mutually agreed solution. The entire proceedings and content of the discussions in this stage are confidential.
- If a mutually agreed solution is reached, the facilitator will submit a draft report on the NTB, procedures followed and the

solution arrived at. This has to be vetted by the parties and then submitted to the Committee.

- While the solution may be trade related, it should not impinge on the rights and obligations of Members under the WTO Agreements.
- The procedures would be useful especially for developing countries in the context of the economical and expeditious nature of the decision making. It would also strengthen the WTO Committees especially in the context of their decision making.
- Ministerial Decision on Trade in Remanufactured Goods

The salient features of the proposal driven by the US are that it seeks to enhance market access opportunities for remanufactured goods, it seeks a review of the non tariff measures on importation of remanufactured goods so that they are in compliance with multilateral obligations and putting in place an institutional framework for consultations as well as discussing progress in reduction or elimination of non tariff barriers on remanufactured goods.

#### **Some of the concerns on this proposal are:**

- There is no conceptual clarity on remanufacturing and the suggested definition in the textual NTB proposal does not capture the concept of remanufacturing across various sectors.
- Re-manufactured imports would adversely affect the domestic manufacturing sector especially the unorganised sector and SMEs.
- It could serve as a conduit for dumping of waste (including e waste) into developing countries due to stringent standards elsewhere.
- Without any extended producer liability (EPL) for re-manufactured products, there could be grave environmental implications

- Issues of customs valuation, misclassification and intellectual property protection on imports of re-manufactured products would crop up.
- Remanufacturing cannot generate the same level of employment or value addition as manufacture of the new goods.
- In the absence of standards, technical regulations and conformity assessment procedures (both domestic and global) for remanufactured goods, there is a possibility of environmental norms being flouted.
- One needs to look at a Work Programme wherein all these issues are discussed and thereby generates greater clarity.
- TBT Related Proposals

9 out of the 14 NTB proposals are vertical in nature relating to specific NAMA sectors. They would also have a legal relationship with the Agreement on Technical Barriers to Trade (TBT Agreement) and would affect some of the provisions of the latter. It was in this context that India took a decision to seek a horizontal solution to specific NTB in NAMA sectors while retaining some elements of the vertical solutions wherever it was applicable. This was to ensure that specific carve outs for sectors did not create a cobweb of provisions that could otherwise be addressed through a horizontal treatment. The EC later joined India and a joint submission on a "Framework for Industry Specific proposals" was made in September, 2009. Work is now going on to convert this into a negotiating text.

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# INTERIM UNION BUDGET 2014-2015

## INTERIM UNION BUDGET 2014-2015

In an election year, Finance Minister presented an Interim Budget short of rhetoric and stuck to highlighting the Government's achievements of the last 10 years. Faced with a massive economic slowdown the Finance Minister tinkered with excise duty to make cars, two-wheelers and mobiles cheaper, announced the implementation of the long standing One Rank, One Pension for defence forces and expressed hope that the worst of the slowdown is over.

### Key Features of Budget

#### 1. The Current economic situation and the challenges:

- ❖ The state of world economy has been the most decisive factor affecting the fortunes of every developing country.
- ❖ The world economy has been witnessing a sliding trend in growth, from 3.9 percent in 2011 to 3.1 per cent in 2012 and 3 per cent in 2013.
- ❖ The economic situation of major trading partners of India, who are also the major source of our foreign capital inflows, continues to be under stress. United States has just recovered from long recession, Euro zone, as a whole, is reporting a growth of 0.2 per cent, and China's growth has also slowed down.
- ❖ The economic challenges faced by our country are common to all emerging economies. Despite these challenges, we have successfully navigated through this period of crisis.

- ❖ Apart from embarking on the path of fiscal consolidation, the objectives of price stability, self sufficiency in food, reviving the growth cycle, enhancing investments, promoting manufacturing, encouraging exports, quickening the phase of implementation of projects and reducing a stress on important sectors were the goals set in 2012-13.

#### 2. State of economy

##### (a) Deficit and Inflation

- ❖ The fiscal deficit for 2013-14 contained at 4.6 per cent.
- ❖ The current account deficit projected to be at USD 45 billion in 2013-14 down from USD 88 billion in 2012-13.
- ❖ Foreign exchange reserve to grow by USD 15 billion in this Financial Year
- ❖ No more talk of down grade of Indian Economy by Rating Agencies.
- ❖ Fiscal stability at the top of the Agenda.
- ❖ Government and RBI have acted in tandem to bring down inflation.
- ❖ WPI inflation down to 5.05 per cent and core inflation down to 3.0 per cent in January 2014.
- ❖ Food inflation down to 6.2 per cent from a high of 13.8 per cent.

##### (b) Agriculture

- ❖ Agricultural sector has performed remarkably well.
- ❖ Food grain production estimated for the

current year is 263 million tonnes compared to 255.36 million tonnes in 2012-13.

- ❖ Agriculture export likely to cross USD 45 billion higher from USD 41 billion in 2012-13.
- ❖ Agricultural credit to exceed the target of Rs 7 lakh crore.
- ❖ Agricultural GDP growth for the current year estimated at 4.6 per cent compared to 4.0 per cent in the last four years.

#### **(c) Investment**

- ❖ Savings rate at 30.1 per cent and investment rate of 34.8 per cent in 2012-13.
- ❖ Government set up a Cabinet Committee on investment and the Project Monitoring Group to boost investment. By end of January 2014, Projects numbering 296 with an estimated project cost of Rs 660,000 crore cleared.

#### **(d) Foreign Trade**

- ❖ Despite a decline in growth of global trade, our export have recovered sharply.
- ❖ The estimated merchandise export is estimated to reach USD 326 billion indicating a growth rate of 6.3 per cent in comparison to the previous year.

#### **(e) Manufacturing**

- ❖ The sluggish import is a matter of concern for manufacturing and domestic trade sector.
- ❖ Due to deceleration in investment, the manufacturing sector has witnessed a sluggish growth.
- ❖ The National Manufacturing Policy has set the goal of increasing the share of manufacturing in GDP to 25 per cent and to create 100 million jobs over a decade.

❖ 8 National Investment and Manufacturing Zones (NIMZ) along Delhi Mumbai Industrial Corridor (DMIC) have been announced. 9 Projects had been approved by the DMIC trust.

- ❖ 3 more Industrial Corridors connecting Chennai and Bengaluru, Bengaluru and Mumbai & Amritsar and Kolkata are under different stages of preparatory works.
- ❖ Additional capacities are being installed in major manufacturing industries.

❖ Notification of a public procurement policy, establishing technology and common facility centres, and launching the Khadi Mark are steps taken to promote Micro Small and Medium Enterprises.

#### **(f) Infrastructure**

In 2012-13 and in nine months of the current financial year, 29, 350 MW of power capacity, 3, 928 kms of National Highways, 39, 144 kms of Rural Roads, 3,343 kms of New Railway track and 217.5 million tonnes of capacity per annum in our ports have been created to give a big boost to infrastructure industries.

- ❖ 19 Oil and Gas blocks were given out for exploration and 7 new airports are under construction.
- ❖ Infrastructure debt funds have been promoted to provide finances for infrastructure Projects.

#### **(g) Exchange Rates**

- ❖ Rupee came under pressure following indications by US Federal Reserve of reduction in asset purchases in May 2013.
- ❖ Government, RBI and SEBI undertook a number of measures to facilitate capital inflows and stabilize the foreign exchange markets. As a result among emerging economy currencies rupee was least affected when actual reduction took place in December 2013.

**(h) GDP Growth**

- ❖ The GDP slow-down which began in 2011-12 reaching 4.4 per cent in Q1 of 2013-14 from 7.5 per cent in the corresponding period in 2011-12 has been controlled by numerous measures taken by the Government. Growth in the third and fourth quarter of the current year is expected to be 5.2 per cent and that for the whole year has been estimated at 4.9 per cent.
- ❖ The declining fiscal deficit, stable Exchange Rate and reducing Current Account Deficit, moderation in inflation, increasing exports are reflection of a more stable economy today

**3. Report Card of 2013-14**

- ❖ De-controlling sugar, gradual correction of diesel prices, rationalization of railway fares, were some of the courageous and long over due decisions taken by the government.
- ❖ Applications were invited for issue of new bank licences.
- ❖ DISCOMS, mostly sick are being restructured with generous central assistance.
- ❖ 12.8 lakhs land titles covering 18.80 lakh hectare were distributed under the Scheduled Tribes and Other traditional Forest Dwellers Act.
- ❖ The oppressive colonial law of 1894 was substituted with the Right to Fair Compensation and Transparency in Land Acquisition Rehabilitation and Resettlement Act.
- ❖ National Food Security Act was passed assuring food to 67 per cent of the population/ households.
- ❖ The new companies Act replaced a law of 1956 vintage.
- ❖ The PFRDA Act was passed to establish a statutory regulator for the New Pension Scheme.

**4. Economic Initiative**

- ❖ Centrally Sponsored Schemes were restructured into 66 Programs for greater Synergy.
- ❖ Funds under these programs will be released as Central assistance to State Plan, thus giving greater authority and responsibility. As a result, Central assistance to plans of States & UTs will rise substantially from Rs 136,254 crore in BE 2013-14 to Rs 338,562 crore in 2014-15.
- ❖ Record Capital expenditure of Rs 257,641 crores in 2013-14 by public sector enterprises.
- ❖ About 50,000 MW of Thermal and Hydel Power capacity is under construction after receiving all clearances and approvals. 78,000 MW of power capacity have been assured coal supply.
- ❖ Liberalised FDI policy in telecommunication, pharmaceuticals, civil aviation, power trading exchange, and multi brand retail to attract large investment.
- ❖ Approval to establish 2 semi conductor wafer fab units.
- ❖ Approval of IT modernization project of Department of Post.
- ❖ Kudankulam Nuclear Power Plant Unit-I achieved criticality and is generating 180 million Units of power.
- ❖ Fast breeder Reactor at Kalpakkam and 7 Nuclear Power Reactors under construction.
- ❖ National Solar Mission to add 4 Ultra Mega Solar Power Projects each with the capacity of over 500 MW in 2014-15.
- ❖ Ministry of MSME will create the 'India Inclusive Innovation Fund' to promote grass root innovations with social returns to support enterprises in the MSME sector with an initial contribution of Rs 100 crore to the corpus of the fund.

**5. Social Sector Initiative**

- ❖ A Venture Capital Fund to provide concessional finance to Scheduled Caste will be set up by IFCI with an initial capital of 200 crore which can be supplemented every year.
- ❖ The restructured ICDS, under implementation in 400 districts, will be rolled out in remaining districts from 1.4.2014.
- ❖ A National Agro-Forestry Policy 2014 has been approved.
- ❖ A mechanism for marketing minor Forest produce has been introduced and an allocation of Rs 444.59 crore has been made to continue the Scheme in 2014-15.
- ❖ A new Plan Scheme with an allocation of Rs 100 crore has been approved to promote community radio station.
- ❖ New technologies such as JE vaccine, a diagnostic test for Thalassaemia and Magnivisualizer for detection of Cervical cancer have been delivered to people. Additional Central Assistance to some States
- ❖ A sum of Rs 1200 crore as additional central assistance to North Eastern states, Himachal Pradesh and Uttarakhand in this financial year.
- ❖ Space India joined a handful of countries when it launched the Mars Orbiter Mission.
- ❖ The Country has acquired capability in launch vehicle technology, cryogenics and navigation ,meteorological and communication satellites.
- ❖ Several flight tests, navigational satellites and space missions are planned for 2014-15.
- ❖ A Corpus has been created for 'Nirbhaya Fund' with a non lapsable grant of Rs 1000 crore. 2 Proposals to ensure the dignity and

safety of women have been approved which will be funded from the Nirbhaya Fund . A sum of Rs 1000 crore has again been provided in FY 2014-15

- ❖ The National Skill Certification and monetary reward schemes launched in August 2013 with an allocation of Rs 1000 crore has been widely hailed as a success. A sum of Rs 1000 crore is proposed to be transferred to the NSD Trust to scale up its programme rapidly.
- ❖ Government remains fully committed to Aadhar under which 57 crore Unique Numbers have been issued so far and to opening bank accounts for all Aadhar holders to promote financial inclusion.
- ❖ Through the Direct Benefit Transfer (DBT) Scheme, a total of Rs 628 crore (54,20,114 transactions) has been transferred directly to the beneficiaries till 31st January 2014 under 27 Schemes.

**OVERVIEW OF THE INTERIM BUDGET**

In order to sustain the pace of plan expenditure, it has been kept at the same level in 2014-15 at which, it was budgeted in 2013-14. Ministries/ Departments which run key flagship programmes have been provided adequate funds in 2014-15 either equal to or higher than in the BE 2013-14. These include Ministries namely, Minority Affairs, Tribal Affairs, Housing & Poverty Alleviation, Social Justice & Empowerment, Panchayat Raj, Drinking Water and Sanitation, Women & Child Development, Health & Family Welfare, Human Resource Development and Rural Development.

**(a) Railways**

- ❖ Budgetary support to Railways has been increased from Rs 26,000 crore in BE 2013-14 to Rs 29,000 crore in 2014-15.
- ❖ It is proposed to indentify new instruments and new mechanisms to raise funds for Railway Projects.

**(b) SC sub-plan and Tribal sub-plan, gender budget and child budget**

Rs 48,638 crore and Rs 30,726 crore are allocated to the SC Sub-Plan and Tribal Sub-Plan respectively.

Gender Budget and Child Budget has Rs 97,533 and Rs 81,024 respectively.

**(c) Non plan expenditure**

- ❖ Non plan expenditure is estimated Rs 12,07,892 crore.
- ❖ The expenditure on subsidies for food, fertilizer and fuel will be Rs 2,46,472 crore slightly higher than the revised estimates of Rs 2,35,453 crore in 2013-14.
- ❖ Rs 1,15,000 crore has been allocated for food subsidies taking in to account, government's firm and irrevocable commitment to implement the National Food Security Act throughout the country.

**(d) Defence**

10 per cent hike in Defence allocation has been given in comparison to BE 2013-14.

Government has accepted the principle of one rank one pension for the Defence Forces which will be implemented prospectively from the FY 2014-15. A sum of Rs 500 crore is proposed to be transferred to the Defence Pension Account in the current Financial Year itself.

**(e) Central Armed Police Forces**

A modernisation Plan at a cost of Rs 11,009 crore has been approved the capacity of Central Armed Police Forces and to provide them the state-of-art, equipment and technology.

**(f) Financial sector**

- ❖ All the announcements concerning the Financial sector made in the Budget Speech of February 2013 have been implemented.
- ❖ Rs 11,300 crore is proposed to be provided for Capital infusion in Public Sector Banks.

- ❖ 5,207 new branches have been opened against the target of 8,023.
- ❖ Bhartia Mahila Bank has been established.
- ❖ Rs 6,000 crore and Rs 2,000 crore have been provided to Rural and Urban Housing Funds respectively.
- ❖ The target of Rs 700,000 crore of Agricultural Credit is likely to be exceeded by the Banks. The target for 2014-15 is \* 800,000 Crore.
- ❖ Rs 23,924 crore has been released under the Interest Subvention Scheme on farm loans, with effective rate of interest on farm loans at 4 per cent including subvention of 2 per cent and incentive of 3 per cent for prompt payment.

**(g) Credit to Minority Communities**

The number of bank accounts of minorities has increased to 43,52,000 at the end of March 2013 from 14,15,000 ten years ago. The volume of lending has soared to Rs 66,500 crore from Rs 4,000 crore in the same period. Loans to minorities stood at Rs 211,451 crore at the end of December 2013.

**(h) Self-Help Groups (SHGs) Loans**

Ten years ago, only 9,71,182 women Self-Help Groups (SHGs) had been credit linked to banks. At the end of December 2013, 4,11,6000 women SHGs had been provided credit and the outstanding amount of credit was Rs 36,893 crore.

**I. Education Loans**

A moratorium period is proposed for all education loans taken up to 31.3.2009 and outstanding on 31.12.2013. Government will take over the liability for outstanding interest as on 31.12.2013 but the borrower would have to pay interest for the period after 1.1.2014. An amount of Rs 2,600 crore has been provided this year and it will benefit nearly 9 lakh student borrowers.

**(k) Insurance**

LIC and the four public sector general insurance companies have opened around 3000 offices in towns with a population of 10,000 or more to serve peri-urban and rural areas.

**I. Financial Markets**

Steps envisaged to deepen the Indian Financial Market :

- ❖ ADR/ GDR Scheme revamp, an enlargement of the scope of depository receipt
- ❖ Liberalization of rupee denominated corporate bond market.
- ❖ Currency Derivatives Market to be deepened and strengthened to enable Indian Companies to fully hedge against foreign currency risk
- ❖ To create one record for all financial assets of every individual
- ❖ To enable smoother clearing and settlement for international investors looking to invest in Indian bonds.

**(m) Commodity Derivatives Markets**

Swift action taken to sequester National Spot Exchange Limited (NSEL) after the payment crisis in the NSEL, this prevented spill over of the crisis to the other regulated segment of the financial markets. Proposal to amend the Forward Contracts (Regulation) Act.

**(n) Revenue proposals**

- ❖ To give relief to automobile industry which is registering unprecedented negative growth, it is proposed to reduce the excise duty for the small cars, motor cycles, scooters and commercial vehicles by 4 percent. It will be cut from 12 percent to 8 percent.
- ❖ The excise duty on SUVs is proposed to be reduced by 6 percent. From 30 percent to 24 percent.

- ❖ In case of large and mid-segment cars, it is proposed to reduce excise duty by 3 percent i.e. 27/ 24% to 24/ 20%. All these reduced rates will be applicable upto June 30, 2014.
- ❖ To stimulate growth in capital goods and consumer non-durable, it is proposed to reduce the excise duty from 12 to 10 percent on all goods for a period up to June 30, 2014. It is applicable to all goods falling under Chapter 84 and 85 of the Schedule to the Central Excise Act.
- ❖ To encourage the domestic production of mobile handsets and reduce the dependence on imports, it is proposed to restructure the excise duty for category of mobile handsets. The rates will be 6 percent with CENVAT credit or 4 percent without CENVAT credit.
- ❖ To boost domestic production of soaps and oleo chemicals, it is proposed to rationalize the customs duty structure on non-edible grade industrial oils and fractions, fatty acids and fatty alcohols at 7.5 percent.
- ❖ It is proposed to withdraw the exemption from CVD on similar imported machinery to encourage domestic production of the specified road construction machinery.
- ❖ The Government has succeeded in obtaining information in 67 cases of illegal Off-shore Accounts and action is underway to determine the tax liability as well as impose penalty. Prosecutions for willful tax evasion have been launched in 17 other cases.
- ❖ Setting-up a Research Funding Organization that will fund research projects selected through a competitive process. Contributions to that organization will be eligible for tax benefit.
- ❖ The Direct Taxes code (DTC) is ready and it will be placed on the website for a public discussion. The Finance Minister appeals to all political parties to resolve to pass the GST laws and the DTC in 2014-15.

**Vision for future**

India poised to be third largest economy along with US and China, to play a leading an important role in global economy.

**10 Tasks as part of the road map ahead include :**

1. Fiscal consolidation : We must achieve the target of fiscal deficit of 3 percent of GDP by 2016-17 and remain below that level always.
2. Current Account Deficit : CAD will be inevitable for some more years which can be financed only by foreign investment. Hence, there is no room for any aversion to foreign investment.
3. Price Stability and Growth : In a developing economy, a high growth target entails a moderate level of inflation. RBI must strike a balance between price stability and growth while formulating the monetary policy.
4. Financial Sector reforms to be completed as laid down by Financial Sector Legislative Reforms Commission.
5. Massive investment in infrastructure : to be mobilized through the Public Private Partnership.
6. Manufacturing sector to be the base of India's development : All taxes, Central and State that go into an exported product should be waived or rebated. There should be a minimum tariff protection to incentivise domestic manufacturing.
7. Subsidies, which are absolutely necessary should be chosen and targeted only to the absolutely deserving.
8. Urbanisation to be managed to make cities governable and livable.
9. Skill development must be given priority at par with secondary and university education, sanitation and universal health care.

10. States to partner in development so as to enable the Centre to focus on Defence, Railways, National Highways and Telecommunication.

**HIGHLIGHTS OF THE RAILWAY BUDGET – 2014-15****Achievements / Initiatives**

- ❖ Major landmark achievement in National Project of Kashmir State of Meghalaya and capital of Arunachal Pradesh to be on Railway Map by this fiscal.
- ❖ Gauge Conversion of strategically important 510 km Rangiya Murkongselek line in Assam to be completed by this fiscal.
- ❖ XIth Five Year Plan Targets exceeded in New Lines (2,207 km), Doubling (2,758 km) and Electrification (4,556 km), Production of Diesel (1,288) & Electrical (1,218) Locos and Acquisition of Wagons (64,875)
- ❖ Dedicated Freight Corridors on the Eastern and Western Routes leading to strategically critical capacity augmentation.
- ❖ Railways met from its own means the total additional impact of Rs one lakh crore due to implementation of 6th Pay Commission
- ❖ In 2013-14, 1532 km of New Lines, Doubling and Gauge Conversion commissioned.
- ❖ Production commenced at the new factories Rail Wheel Plant, Chhapra ; Rail Coach Factory, Rae Bareli ; and Diesel Component Factory, Dankuni.
- ❖ Specially designed coaches for adverse weather condition for rail travel in Kashmir.
- ❖ Successful development of Corrosion resistant, lighter wagons with higher payload and speed potential up to 100kmph.
- ❖ Railways sportspersons dominate national events by winning titles in 23 disciplines

and runners up in 9 disciplines. In various international championships a total of 2 Gold, 4 Silver and 3 Bronze Medals won.

- ❖ Unigauge Policy started in 1992 has converted 19,214 km to Broad Gauge, benefitting several States including Gujarat, Rajasthan, Madhya Pradesh, Maharashtra, Karnataka, Uttar Pradesh, Assam and Tamil Nadu.

#### ***Measures for improving Safety & Security***

- ❖ No unmanned Level Crossing. A total of 5,400 unmanned level crossings eliminated 2,310 by manning it and 3,090 by closure / merger / construction of ROBs or RUBs.
- ❖ Improved audio visual warning to road users in advance of approaching trains.
- ❖ Induction of indigenously developed Train Collision Avoidance System.
- ❖ Development of 'crashworthy' coaches.
- ❖ In last five years, offering employment to over one lakh persons in Group C categories and to 1.6 lakh persons in erstwhile Group D categories.
- ❖ Provision of Vigilance Control Device in all locomotives.
- ❖ Various measures to prevent fire incidents on trains
  1. Fire retardant materials.
  2. Multi-tier protection for electric circuits.
  3. Portable fire extinguishers in coaches.
  4. Intensive checks against explosives and inflammable materials.
  5. Induction based cooking to replace LPG in pantry cars.

#### ***Financial Health***

- ❖ Rail infrastructure by cost sharing arrangement

with State Governments; Karnataka, Jharkhand, Maharashtra, Andhra Pradesh and Haryana agreed to several projects.

- ❖ Several Public Private Partnerships (PPP) projects are in the pipeline.
- ❖ FDI being enabled to foster creation of world-class rail infrastructure.
- ❖ Rail Land Development Authority raised Rs 937 crore so far.

#### ***Modernisation and Technology Induction-***

##### ***High Speed Trains***

- ❖ Joint feasibility study by India and Japan for Mumbai Ahmedabad Corridor to be co-financed by International Cooperation Agency
- ❖ Business Development Study by SNCF for Mumbai – Ahmedabad corridor.

Semi-High Speed Projects- Exploring low cost option of speeds 160- 200 kmph on select routes

##### ***Green initiative***

- ❖ Railway Energy Management Company becomes functional. Windmill and solar power plants to be set up with 40% subsidy from Ministry of New & Renewable Energy.
- ❖ 200 Stations, rooftops of 26 buildings and 2,000 level crossing gates to be covered.
- ❖ Railways bagged 22 out of 112 awards given by the Government.
- ❖ Green Curtains along the track close to major stations; Pilot work at Agra and Jaipur.
- ❖ Coverage of Bio-toilets in 2,500 coaches and would be increased progressively.

##### ***Passenger Friendly Initiatives***

- ❖ Overwhelming public response to e-booking of ticket.
- ❖ On-line tracking of exact location and running of train movements.