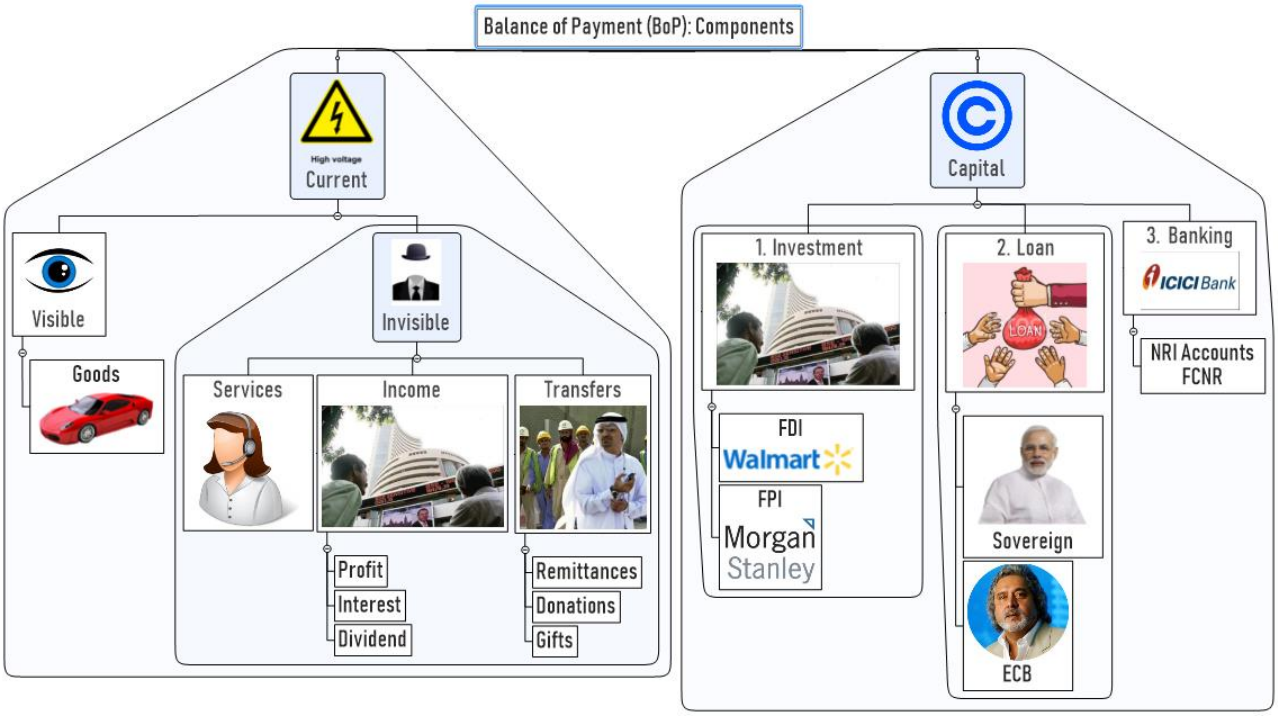
23 BALANCE OF PAYMENT (BOP: भुगतान संतुलन)

- It is a systematic record of all economic transactions made between the residents and non-residents of a country for a specific time period (usually a year).
- BoP records are prepared by Central Banks of each country as per the format given in IMF's BPM-6 manual, all the figures are expressed in Dollars.
- Since any country's debit (outgoing money) is a credit (incoming money) for another country → World's NET Balance of Payment is ZERO.
- BoP is further sub classified into two parts → current account (चालू खाता) and capital account (पूंजी खाता), based on the nature of transactions.



23.1 BALANCE OF PAYMENT → CURRENT ACCOUNT →

Component	***2017-18→ amount in billion dollars***	***NET Incoming***
_ _ _ _ दर्शनीय	Trade in Goods: $300 billion worth goods exported vs $460 worth imported.	-160
_ _ _ _ अदृश्य	Trade In Services (Highest: Software services > Business Services > Travel). $195 billion worth exported vs $118 billion worth imported.	+77
	Income: Profit, Interest, Dividend	-28
	Transfer: Remittance, Gift, Grants, Donations. Subtypes: Pvt transfers > Official.	+62
Net Current Account Balance (if negative: "Deficit")		-48 (~1.6% of GDP)

- From 2001-04, we had Current Account Surplus (because the pre-subprime crisis boom in global economy had boosted our exports). But before and after that period we are having deficit.
- The current account deficit for FY18 (2017-18)'s much higher than previous year due to (1) rising price of crude oil (2) protectionism by US/EU which is harming our exports.

23.1.1 Balance of Trade: व्यापर का संतुलन

- Balance of Trade = difference between the import and export (of goods and services). +300-460+195-118= (-83) bn.
- If +ve = Trade _ _ _ _ (i.e.Export > Import); If -ve = Trade Deficit (i.e. Import > Export)

As per Economic Survey 2017-18

- We've large trade deficit: व्यापार घाटा with China (cheap electronics, toys etc.) Switzerland (Gold, Luxury items), Saudi Arabia & Iraq (oil).
- We've trade surplus: व्यापार अधिशेष with USA (Chemicals, textile etc.), UAE & UK (Tea, Spices etc.).
- Our top import exports are as following:

Import	Crude Oil > Capital Goods (Machinery) > Gems & Gold > Chemicals > Electronics > Agro > Minerals
Export	Engineering Goods > Gems & Jewellery> Textile > petroleum products (e.g. asphalt, naphtha etc.) > agriculture > electronics > Marine Products > minerals > leather

MCQ. The balance of payments of a country is a systematic record of (Asked in UPSC-Pre-2013)
(a) All import and export transactions of a country during a given period of time, normally a year.
(b) Goods exported from a country during a year.
(c) Economic transaction between the government of one country to another.
(d) Capital movements from one country to another.

MCQ. Which of the following does not form part of current account of Balance of Payments? [UPSC-CDS-2014-II]
(a) Export and import of goods (b) Export and import of services
(c) Income receipts and payments (d) Capital receipts and payments

MCQ. With reference to Balance of Payments, which of the following constitutes/ constitute the Current Account? (Asked in UPSC-Pre-2014)
1. Balance of trade. 2. Foreign assets.
3. Balance of invisibles. 4. Special Drawing Rights.
Answer codes:(a) 1 only (b) 2 and 3 (c) 1 and 3 (d) 1, 2 and 4

23.1.2 _ _ _ _ _ _ _ _ 's Remittance Report 2018 विश्व बैंक प्रेषण रिपोर्ट

- India receives largest amount of remittance ($80bn) > _ _ _ _ (67) > Mexico tie with Philippines > Egypt.

- In quantitative figures too India received more amount compared to previous years. Higher oil prices → Arabian Sheikhs are earning more and spending more → Indian workers in middle east are earning more overtime → more remittance to India.
- World Bank also noted: remittances have a direct impact in poverty removal for many households, but National Post Offices charge very high fees in remitting the money to household. (so Financial inclusion, UPI/BHIM/IMPS blockchain Technology led money transfer mechanism are important in that context as well.)

23.2 BALANCE OF PAYMENT → CURRENT ACCOUNT → IMPORT OF OIL

- ➢ Self Study? India's energy resources, location of refineries & pipelines → Majid Hussain Geography of India ch.8.
- ➢ Govt's lofty goal of reducing the oil import by 10% by 2022. Therefore, boosting domestic exploration and production is necessary. So, …..

23.2.1 Domestic Oil Exploration Policies?

Nodal? Directorate General of Hydrocarbons: हाइड्रोकार्बन महानिदेशक (DGH) Ministry of Petroleum & Natural Gas.पेट्रोलियम और प्राकृतिक गैस मंत्रालय

- ✓ Before the 1991's LPG reforms, only ONGC and other Public sector companies were allowed to explore the oil, gas and hydrocarbon reserves in India. But under 1991's Liberalization norms, this sector was opened for the private sector players as well.
- ✓ 1997: New Exploration Licensing Policy to award contract to public and private sector companies using bidding / auction system.

NELP's primary limitations were

- ✓ Separate license required for each type of hydrocarbon.
- ✓ NELP worked on production sharing contract: उत्पादन साझाकरण अनुबंध (PSC), wherein the oil explorer will pay a share to Govt from the profits from production. However, 1) whenever the oil prices declined in the global market, Indian producers will also cut down their production. 2) They'd exaggerate their production costs to show less profit. → Govt earned less, and will do more 'inspector raj' to check account books → No ease of doing Biz.

2016: NELP was replaced with ____ ____ ____ ____ ____ ____ (HELP: हाइड्रोकार्बन अन्वेषण और लाइसेंसिंग नीति). Benefits?

- ✓ Single uniform license sufficient to explore and produce all type of hydrocarbons from the given area. (oil, gas, coal bed methane, shale gas, tight gas and gas hydrates etc)
- ✓ Govt to receive a share from gross revenueसकल राजस्व from sale of oil / gas etc. (irrespective of profit.)
- ✓ Government not to interfere in the marketing and pricing of the oil and gas.
- ✓ Relaxed norms for exploration in offshore areas, because they have higher risk and higher cost of production.
- ✓ Open acreage policy → company can pick and chose the blocks from the designated area.

2018-Jan: Govt auctioned 55 blocks using HELP policy.

23.2.2 India's Strategic Oil Reserves भारत के सामरिक तेल भण्डार

- Objective? (When crude prices are low) India should buy and store crude oil for strategic-cum-buffer stock → use during war & other emergency.
- Ministry of Petroleum & Natural Gas → Govt petro companies → three places 1) Visakhapatnam (Andhra) 2) Chandikhol (Odisha) 3) Padur (Karnataka).
- They're stored in underground rock cavern facilities = more secure / safe during airstrikes, more economical and environmental friendly than conventional 'above ground storage tanks' (which may require additional cooling / AC).

23.2.3 Oil prices & OPEC

- _ (OPEC: पेट्रोलियम निर्यातक देशों का संगठन) is a group of oil producing countries Saudi, UAE, Venezuela, Iran, Iraq etc.… total 14 members. Qatar withdrew from 1/1/19. Russia is NOT a member.
- HQ: _ _ _ _ , Austria (1961).
- 2016 onwards OPEC + Russia agreed to reduce their oil production. For a while, it resulted increasing the crude oil prices.
- But at later stage Iraq, Nigeria etc. produced more oil due to USA pressure.
- USA also increased its own domestic oil and shale gas production.
- Chinese tariff war on American cars → less car sales → less oil demand in China.
- In India, Governments did not reduce their Excise and VAT → petrol diesel prices kept increasing for the consumers. → less vehicle sales in India → less oil demand.
- 2018: All major currencies weakened against US Dollar, which further increased the cost of oil imports.
- Depending on these factors of supply versus demand, there have been ups and downs in the oil price movement in the last 2 years.
- 2018-Oct onwards the prices began to fall. Although 2019-Jan: OPEC+Russia group again reiterated their commitments for oil cuts. So risk is looming.
- Side Topics? 1) Cartel is an association of manufacturers who collude to keep prices high, and keep the competitors away. 2) _ _ _ _ Index is an index that measures price of crude oil.

23.3 BALANCE OF PAYMENT → CURRENT ACCOUNT → IMPORT OF GOLD

- From 2010 onwards, Indian economy was suffering from high level of inflation (8-12%) due drought → Food & Pulses shortage. MNREGA → higher wages in the hands of villagers without proportional growth in supply of commodities etc.
- So households earned 'Negative Real Interest Rate: नकारात्मक वास्तविक ब्याज दर' on their bank deposits → started investing in gold.
- But, high level of gold consumption → more trade deficit, current account deficit → Indian rupee gets weaker. Gold transactions also help in the storage of black money and tax evasion. India is the second largest consumer of Gold after China.
- Therefore, RBI and Indian government launched following schemes to reduce gold consumption:

23.3.1 RBI's 80:20 Scheme (2013-14)

- RBI mandated that min.20% of the imported gold must be exported back. Until then the Jeweller/ bullion dealers will not get permission to (convert their rupees into dollars / foreign currency) to import next consignment of gold.
- RBI gets such powers under Foreign Exchange Management Act FEMA.
- 2014: Scheme was stopped as the gold craze had declined.
- ~~2018: In news / Controversy because BJP alleges the former Finance Minister P Chidambaram pressurize RBI to relax norms for Nirav Modi and Mehul Choksi while the scheme was operational.~~

23.3.2 ____ ____ ____ ____ ____(2015: स्वर्ण बांड योजना)

- RBI (on behalf of Union Government) issued Gold bonds in the denominations of one gram and its multiples. One person can buy upto 4 kgs.
- They can be purchased from commercial banks, post offices and authorised agents. RBI continued to release them in 2018 as well.
- ***Tenure?*** 8 years. (But investor can exit from 5th year).
- Fixed 2.50% interest every year. On the redemption date you get the principal equivalent of the latest price of gold in grams.
- Bonds can be tradable in stock exchange. Can be used as collateral for loans.
- They are exempted from the TDS and (long term) capital gains tax.
- ***Benefit?*** People were investing in gold with speculation that when gold prices increase they'll profit. Gold Bonds offer them similar without actually giving them gold. So it help reducing gold import.
- Why dim-response? The gold prices are not rising so much and 2.50% is too little interest.

23.3.3 ____ ____ ____ ____(2015: स्वर्ण मुद्रीकरण योजना)

- Under this scheme, RBI allows commercial banks accept customers' idle gold / jewellery for 1 year to 15 years tenure. (2019- RBI also allowed Charitable Institutions and Central Govt to deposit their gold in the commercial banks)
- Commercial Banks pay the depositor 2.25-2.50% interest.
- Min. 30gm to maximum any amount of gold can be deposited.
- Gold goes to → Metals and Minerals Trading Corporation of India →
    - Gold sold to jewellers, electronic circuits companies and
    - Some of the gold used for Minting "Indian Gold Coin."
- Upon maturity you can redeem deposit in the form of gold coin/bars or cash equivalent. The profit exempted from Capital Gains Tax.

MCQ. Which of the following are the main objectives of Gold Monetization Scheme launched in the country ? (IEnggS-2018)

1. To monetize gold holdings in the country 2. To increase export of gold from the country
3. To reduce India's import bill 4. To meet the targets of reduction in fiscal deficit

Answer Codes: (a) 1 and 4 only (b) 2 and 4 only (c) 2 and 3 only (d) 1 and 3 only

MCQ. What is/are the purpose/purposes of Government's 'Sovereign Gold Bond Scheme' and 'Gold Monetization Scheme'?(Asked in UPSC-Pre-2016)
1.To bring the idle gold lying with Indian households into the economy.
2.To promote FDI in the gold and jewellery sector.
3. To reduce India's dependence on gold imports.
Answer codes:(a) 1 only (b) 2 and 3 (c) 1 and 3 (d) 1, 2 and 3

23.3.4 Indian (Sovereign) Gold Coins (2015: भारतीय स्वर्ण सिक्के)

- Issued by a Govt company "Metals and Minerals Trading Corporation of India".
- Available in denominations of 5, 10, 20 grams.
- These gold coins are not fiat money because not issued under the powers of Coinage act, they don't bear any markings indicating rupee denominations. Their markings only indicate gold grams. And since they're not 'fiat money' → they are not 'legal tenders'.
- Benefit? Trusted Purity → Easily resold → Easy liquidity, and Profit (if) gold price increases.

23.3.5 Bhartiya Nirdeshak Dravya (2017)

✓ Previously, gold refiner uses certified (gold) reference material from American Laboratories.
✓ 2017: India Government Mint + Assistance from BARC + CSIR + National Physical Laboratory etc. collaborated & launched India's own gold reference standard – Bharatiya Nirdeshak Dravya (BND-4201).
✓ It's basically a Parle-G biscuit sized gold bar with 99.99% purity (with impurities of only 100 parts-per-million.)
✓ This material helps the refiners and jewellers compare and cross check the purity of gold using electronic instruments. Doesn't require traditional 'fire-essay' method = environment friendly.
✓ Also helps checking the purity of gold deposited under Gold Monetization Scheme
✓ We'll be using DESHI material instead of American → foreign exchange saved, "Make in India" promoted. Our material is 25% cheaper than American → we can even export it to other nations.

23.3.6 BoP → Current → Export → GI Tag

- A _ _ _ _ _ _ _ _ _ _ _ _ (GI: भौगोलिक संकेतक) is a sign used on products with specific geographical origin and unique qualities due to that origin. E.g. Darjeeling tea from W.Bengal- It was the first to obtain GI tag from India.
- ***Benefit?*** GI tag adds premiumness to a product, helps fetching higher prices in the international market → better income for farmers and artisans.
- They're governed under
    - WTO's Trade Related Intellectual Property Rights Agreement (TRIPS) and
    - India's Geographical Indication of Goods Act, 1999. Once a product gets GI tag, it's valid for 10 years (and can be renewed further.) GI name cannot be used for products that are manufactured outside of the designated region, else party can be punished under the law

- International Nodal? UN's specialized agency _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ (WIPO; विश्व बौद्धिक संपदा संगठन), HQ @Geneva,Switzerland
- Indian Nodal? Commerce ministry → Controller General of Patents, Designs and Trademarks → Geographical Indications Registry in Chennai.

New Indian GI tag during *From April 2018 till March 2019.*

GI Product	***Type***	***Origin?***
Jhabua Kadaknath Black Chicken Meat	Food Stuff	Madhya Pradesh
Boka Chaul	Agricultural	Assam
Alphonso	Agricultural	Maharashtra
Rajkot Patola	Handicraft	Gujarat
Shahi Litchi	Agricultural	Bihar
Sangli Turmeric	Agricultural	Maharashtra
Pethapur Printing Blocks	Handicraft	Gujarat
Kolhapuri Chappal	Handicraft	Karnataka & Maharashtra
Silao Khaja	Food stuff	Bihar

Self Study? For UPSC interview, prepare your state's GIs from ipindia.nic.in/registered-gls.htm

GI-Controversy?
- 2010: GI status given to the basmati rice grown only in Punjab, Haryana, Delhi, Himachal Pradesh, Uttrakhand and parts of western Uttar Pradesh and Jammu & Kashmir.
- Madhya Pradesh state government had been fighting to get GI-status for its Basmati rice as well, but 2018 rejected by GI Registry @Chennai.

23.3.7 BoP → Current → Exports → SEZ

Whenever goods and services are manufactured in an ordinary part of India, they are subjected to excise duty/ service tax/ GST; and when they are exported they are subjected custom duty. And ultimately, Indian entrepreneur's profit will be subjected to corporation tax and income tax.

- _ _ _ _ _ _ _ _ _ _ _ _ (SEZ: विशेष आर्थिक क्षेत्र) is a specifically demarcated area of India which is deemed as foreign territory for the purpose of Tax laws and Trade laws. Thus, they're exempted from aforementioned taxes / subjected to lower rate of taxes of Union and State Govts. (For a specific time-period only, which is called "Tax holiday").
- They get single window clearance for various import / export licenses / permissions etc.
- Government will bear the cost of developing the roads, sewage, affluent treatment, weighing-packaging-labelling etc. infrastructure within the SEZ.

- They are regulated under SEZ policy (2000) and Special Economic Zone Act, 2005. State Govt forwards the proposal to create SEZ → Union's Commerce Ministry approves.
- 1965: Asia's first SEZ was set up in Kandla, Gujarat (At that time it was called Export Processing Zone/EPZ). Currently we've 220+ SEZ in India.
- ***Benefit?*** More exports, employment, economic growth.
- ***Challenges?*** SEZ entrepreneurs use legal loopholes → Tax avoidance, Workers deprived of EPFO/ESIC/Maternity benefit. When entrepreneurs' Tax holiday is over in one SEZ, they shutdown operation and move to another SEZ with new name/registration. Agricultural and forest lands diverted to build SEZs → future challenges in Food security, pollution control and climate change.
- ***Solution?*** 2018: Commerce Ministry had setup Baba Kalyani committee to look into SEZ issues. ~~Baba is Chairman of Bharat Forge ltd.~~

23.3.8 Baba Kalyani report on SEZ

1. While the number of SEZ & SEZ-led employment has increased, but their export growth rates were not encouraging in the last decade.
2. Instead of giving blanket-general-tax-holiday, SEZ-units should be given tax benefits linked to how many job created, how much FDI investment attracted, how much goods/services exported etc.
3. SEZs should be converted into _ (3Es: रोजगार और आर्थिक परिक्षेत्रों) with efficient transport infrastructure, uninterrupted water and power supply. (So, both domestic-consumer-centric entrepreneurs and export-centric entrepreneurs can operate from same locality, supply each other with intermediate goods/services. While export-wallas get further tax benefits in Customs Duty and Direct Taxes.)
4. Encourage MSMEs in 3Es, so we can create more jobs. Simpler entry and exit processes using time-bound online approval and dispute resolution for entrepreneurs.
5. Develop synergy of SEZ/3Es zones with coastal economic zones, Delhi-Mumbai industrial corridor (DIMC), National Industrial Manufacturing Zones (NIMZ) and food and textiles parks etc.
6. Develop High Speed Rail, Express roadways, Passenger/Cargo airports, shipping ports, warehouses etc. near SEZ/3Es zones.
7. Electronics are showing high domestic demand, so we should also focus on domestic production for domestic consumers, and need to have a plan for import substitution (i.e. encourage Swadeshi electronics companies in 3Es, so Indians buy import less VIDESHI products).

Conclusion in SEZ related Mains Qs? Government of India has set a target of creating 100 million jobs and achieving 25% of GDP from the manufacturing sector by 2022, as part of its flagship 'Make in India', so if above recommendations are implemented, it'll help in that regard.

23.3.9 *BoP → Current → Exports →Foreign Trade Policy (2015-2020)*

- ✓ India's export in goods and services in 2013-14 was ~$465 billions. This FTP Policy (विदेश व्यापार नीति) aims to almost double it to $900 billion by 2020.
- ✓ ***Nodal***? Director General of Foreign Trade (DGFT) under Ministry of _ _ _ _ _ _ _ _ .
- ✓ Introduced new schemes / streamlined previous schemes such as:
- ✓ Tax Benefits →
    - (1) Merchandise Exports from India Scheme (MEIS: भारत से व्यापारिक माल निर्यात योजना) (2) Services Exports from India Scheme (SEIS: भारत से सेवाएं निर्यात योजना). They provide tax credit to exporters, which they can use for paying taxes on their inputs.
    - Duty free import of capital goods (machinery required for production).
- ✓ Niryat Bandhu Scheme: Govt mentors the new and potential exporters and mentor them through training, counselling, orientation programmes
- ✓ Towns of Export Excellence (TEE: निर्यात उत्कृष्टता के शहर) and Trade Infrastructure for Export Scheme (TIES: निर्यात योजना के लिए व्यापार आधारिक संरचना): where Union gives ₹ for infra development for export (warehouses, transportation, packaging facilities etc.)
- ✓ E-governance initiatives →
    - CBIC → Single Window Interface for Facilitating Trade (SWIFT) for importers and exporters through icegate.gov.in
    - Commerce Ministry & FIEO (Federation of Indian Export Organisations) launched India Trade webportal and _ _ _ _ _ _ _ _ App.

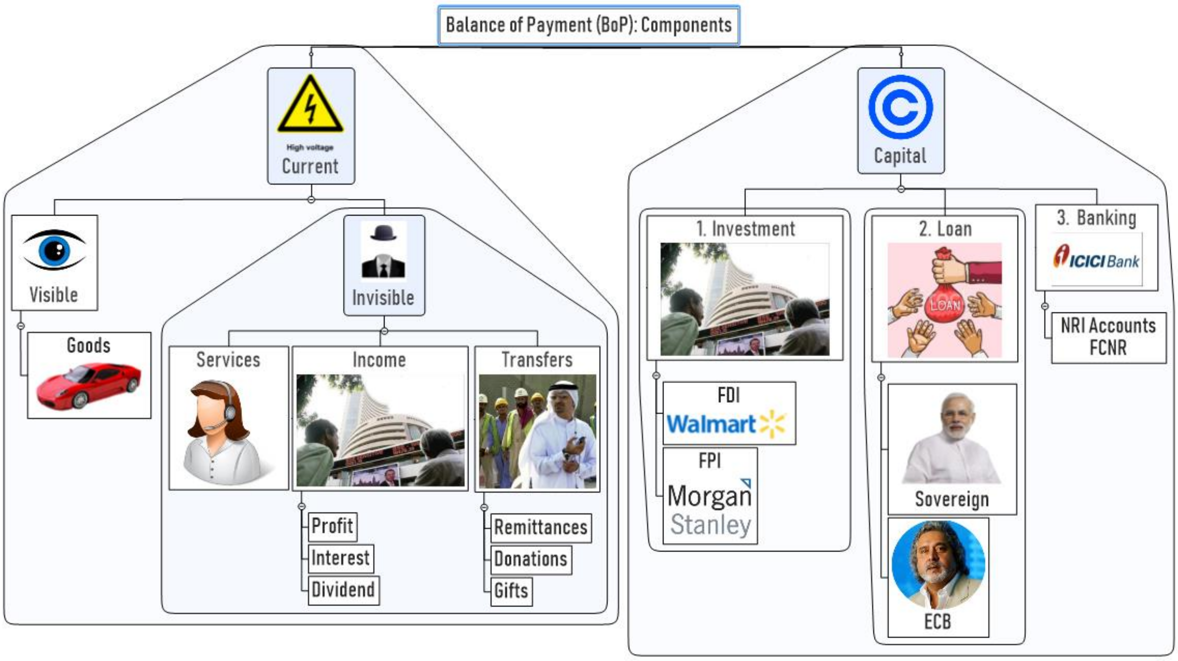
FTP-Policy identified region wise opportunities and challenges such as

US,EU	Due to variety of tariff and non tariff barriers @USA and EU, we should deepen trade ties the other countries in the respective continents (Mexico, Canada, Georgia, Albania etc) and use their FTAs with US/EU to send our products. Bulk tea cargo to Mexico → further processing → Free trade from Mexico to USA under NAFTA/USMCA.
SAARC	We should integrate SAARC region as a value added chain. E.g. Jute from Bangladesh → make stylish jute bags in India → Export elsewhere.
ASEAN	We have free trade agreements with these countries, but we're importing more than we're exporting here. Need to more focus on skilling, R&D, innovation in our products.
China, Japan	- Market access is difficult in China because of the non tariff barriers (e.g. their pharma regulators would delay approving Indian drugs) - Market access is difficult in Japan due to language barrier (they prefer Japanese over English in even product labelling & customer helpdesk support)

CIS	- Commonwealth of Independent States (CIS) like Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan etc. - We should create value added chains through them to export towards Russia and EU. e.g. Bulk drug cargo from India → Turkmenistan → repack them into tablets/bottles→send to EU
WANA	West Asia and North Africa region is full of so many countries that instead of pursuing individual free trade agreements with each & every country, better we approach their regional organizations such Gulf Cooperation Council (GCC), COMESA (Africa), ECOWAS (West Africa). and separately we should engage with Israel on one-on-one basis.
LAC	- In Latin American countries, we can explore 'contract farming' (अनुबंध खेती) e.g. like China has purchased vast track of land for cultivating Maize for biodiesel. - We can also provide LAC nations with project loans for infrastructure / transport development with conditions attached to make'em buy the machinery and engineering services from India. (just like how JICA-Japan gives bullet train loans to India).

Challenge? While policy has lofty goal of doubling Indian exports to $900 billion by 2020. But US/EU protectionism = target difficult to achieve.

23.4 BoP → Capital Account → Investment → FDI / FPI



23.4.1 _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ (FPI: विदेशी पोर्टफोलियो निवेशक)

- It is a foreign entity registered @SEBI, and who buys upto _ _ _ _ in equity / shares of an Indian Company.

- Previously they were called Foreign Institutional Investor (FII: विदेशी संस्थागत निवेशक) and Qualified Foreign Investors (QFIs), but in 2013 SEBI merged them all into a single category- FPI, Based on the recommendations of K.M. Chandrasekhar committee (and because Budget-2013 Chidambaram had promised it).
- FPI's primary objective is make money from buying and selling of shares through the capital market / share market. They even help the SEBI-non-registered foreign investors by issuing them _ _ _ _ _ _ _ _ _ _ _ _ (P-Notes) *[Ref: SEBI handout].*
- FPIs are not involved in the actual operations / production / management / business policy making of a company (like Walmart is for Flipkart).
- If FPI investor is hopeful to get better returns in the other countries' share/bond market, he may quickly sell his Indian securities and run away. The flight of such money is called ' _ _ _ _ _ _ _ _ ': 'चलायमान मुद्रा', It results into weakening of Indian rupee and falling of Sensex.

23.4.2 Foreign Direct Investment (FDI: प्रत्यक्ष विदेशी निवेश)

FDI is the (more than 10% equity / share) investment made by a foreign entity into an Indian company, with the objective to get involved in the management / production of that Indian company. (e.g. 2018: Walmart-USA bought 77% stakes in Flipkart @$16 billion.)

- FDI is prohibited in atomic energy, railway operations (except Metro & infra dev.); Tobacco Products, Real Estate Business, Farm Houses, Chit Funds, Nidhi Companies, Betting Gambling Casino & Lottery.
- For the remaining sectors, FDI is permitted either through:
    - A. _ _ _ _ _ _ _ _ ***Route:* स्वचालित मार्ग** i.e. Foreign entity doesn't require Indian Govt's approval.
    - B. _ _ _ _ _ _ _ _ ***Route:* सरकारी मार्ग** i.e. prior to investment, they've to get approval from the Government of India's respective Administrative Ministry/ Department (+ Commerce Ministry).

23.4.3 FDI → 100% Automatic permitted in

- ✓ Agriculture, Animal Husbandry, Plantation Sector, Food Processing
- ✓ Asset Reconstruction Companies (ARC), Credit Information Companies, Core Investment Company, White Label ATM Operation and Other Financial Services
- ✓ Pharma & Biotechnology(Greenfield), Healthcare (Greenfield), Medical Devices
- ✓ Satellites, Broadcast of non-NEWS TV Channels, Printing of scientific and technical magazines.
- ✓ Wholesale Trading, Single Brand Retail, E-Commerce
- ✓ Construction of Townships, Housing, Infrastructure
- ✓ Gems & Jewellery, Duty Free Shops, Tourism & Hospitality
- ✓ IT and BPM,
- ✓ Leather, Textiles & Garments,
- ✓ Manufacturing, Capital Goods, Industrial Parks
- ✓ Mining and Exploration of metal and non-metal,
- ✓ Petroleum & Natural Gas, Chemicals, Coal & Lignite, Thermal & Renewable Energy

✓ Civil Aviation (**Selected services), Airports (Greenfield & Brownfield)
✓ Ports and Shipping, Railway Infrastructure, Roads & Highways

23.4.4 FDI → Others

sector → FDI limits	***Automatic upto?***	***With Govt approval?***
Banking - Public Sector	20%	N/A
Printing / Publishing newspaper, and current affairs magazines	26%	N/A
Broadcasting of News TV-channels	49%	N/A
Multi Brand Retail Trading	_ _ _ _	N/A
Insurance, Pension, REITs / InvITs Infrastructure Companies	49%	N/A
Petroleum Refining (by PSUs), Power Exchanges	49%	N/A
Banking (Private Sector), Telecom Services, Defence, Private Security Agencies, Air Transport Services	49%	ABOVE 49%
Brownfield → Pharma, Biotech, Healthcare	74%	ABOVE 74%

For future updates, refer to https://www.investindia.gov.in/foreign-direct-investment

2017-18 (Bn. USD)	***(+) Inflow (Credit)***	***(-) Outflow (Debit)***	***NET inflow***
FPI	+ 295	- 273	+ 22
FDI	+ 64	- 34	+ 30
Foreign investment in India: भारत में विदेशी निवेश →			+ 52

From the above table you can see large amount of money comes via foreign portfolio investors but because it is speculative and volatile in nature, so it does not stay for long in Indian market.

23.4.4.1 ***India's new FDI rules for E-Commerce***

E-commerce means buying and selling of goods and services over digital & electronic network. Two subtypes

1. ***Inventory based*** (इन्वेंटरी आधारित) model of e-commerce: Company sells the inventory of goods and services is owned by them to consumers directly. E.g. primeabgb.com (A computer hardware site). FDI is not permitted here.

2. ***Marketplace based*** (बाजार आधारित) model of e-commerce: Company merely provides a webportal/app to act as a facilitator between buyer and sellers. E.g. Amazon, Flipkart. 100% FDI allowed here.

Marketplace E-Commerce companies were engaging in anti competitive behaviour e.g.

- Flipkart / Amazon would enter in exclusive partnerships with top smartphone brands such as Xiaomi and Oppo- Prohibiting them from selling their mobile phones through other online or offline channels → offline mobile shop suffer.
- Flipkart / Amazon run "Marketplace E-Commerce model" i.e. they allow any merchant to list their products on their website. However they will also have their own merchant company (e.g. Amazon's cloudtail) who would offer deep discounts / cashbacks to the customers. → Other online merchants on the same web platform will suffer. Offline brick and mortar shop merchants will also suffer.

So, govt updated FDI policy for (Marketplace) E-Commerce sites WEF 1st February 2019:

1. Such E-commerce companies can't have exclusive agreements with sellers. For example, Xiaomi can no longer sell Mi phones only on Flipkart.
2. Tightened the norms related to cashback and discounts.
3. Tightened norms on E-commerce company who were using their own subsidiary companies/shell companies as "Online Merchants" to sell products at deep discount.

MCQ. Both Foreign Direct Investment (FDI) and Foreign Institutional Investor (FII) are related to investment in a country. Which one of the following statements best represents an important difference between the two?(Asked in UPSC-Pre-2011)

(a) FII helps bring better management skills and technology, while FDI only brings in capital.
(b) FII helps in increasing capital availability in general, while FDI only targets specific sectors.
(c) FDI flows only into the secondary market, while FII targets primary market.
(d) FII is considered to be more stable than FDI

23.4.5 Ministry of Commerce and Industry:

वाणिज्य और उद्योग मंत्रालय looks after Internal and External Trade, WTO, Dumping, SEZ, FDI related issues. It's the boss of <List not exhaustive>

Attached offices	- Directorate General of Foreign Trade (DGFT: विदेश व्यापार महानिदेशालय) for promotion of foreign trade. - Directorate General of Trade Remedies (DGTR) to impose anti-dumping duty on foreign products.
PSUs	- MMTC ltd. *(Gold-coin-walle)* - Export Credit Guarantee Corporation of India (ECGC) ltd *(Exporters' Insurance)*
Autonomous bodies स्वायत्त निकाय/ संस्थाए	- Agricultural and Processed Food Products Export Development Authority (_ _ _ _ : कृषि और संसाधित खाद्य उत्पाद निर्यात विकास प्राधिकरण), under its statutory act. - Indian Institute of Foreign Trade (IIFT)- a "Deemed University" that offers MBA, PHD & other programs. - Statutory Commodity Boards → Coffee, Rubber, Tea, Tobacco, Spices Board

23.4.6 2017 → FIPB Abolished

- Foreign Investment Promotion Board (FIPB: विदेशी निवेश संवर्धन बोर्ड) was an inter-ministerial body in the Department of Economic Affairs in the finance ministry.
- FIPB processed the FDI applications where government approval was required. If investment amount exceeded ₹ 3,000 crore → application forwarded to Cabinet Committee on Economic Affairs (CCEA: आर्थिक मामलों की मंत्रिमंडलीय समिति).
- FIPB was chaired by the economic affairs secretary, and had members from other departments.
- 2017: Govt announced FIPB's abolition. Now, individual ministries/departments are empowered to clear FDI proposals in consultation with Commerce Ministry. e.g. FDI in Pendrive factory → MEITY + Commerce ministry.
- FIPB's webportal was renamed into "Foreign Investment Facilitation Portal" and transferred to Commerce ministry.
- Further, Only Home Ministry will clear FDI proposals coming from Pakistan and Bangladesh; and FDI proposals related to private security agencies, small arms manufacturing.

23.4.7 2019 → DIPP becomes DPIIT

- Interim-Budget-2019: Govt renamed Commerce Ministry's Department of Industrial Policy and Promotion (DIPP: औद्योगिक नीति और संवर्धन विभाग) → Department for _ (DPIIT: उद्योग और आंतरिक व्यापार को बढ़ावा देने के लिए विभाग).
- It'll function under Ministry of Commerce and Industry
- DPIIT's Objectives? Promotion of internal trade, including retail trade; welfare of traders and their employees; matters relating to ease of doing business; and startups.

23.4.8 _ (IFSC: अंतर्राष्ट्रीय वित्तीय सेवा केंद्र)

- In such centre, a nation will not apply its local taxation and investment norms.
- E.g. UAE → Dubai's IFSC centre: 100% FDI allowed in any sector. 100% Capital Account Convertibility (i.e.Invest & pullout money as & when you please in any currency of your choice!), 0% income tax for 50 years. DTAA with most countries. Independent judiciary not bound with local laws. Quick Visa etc.
- As a result, such place becomes a hub / base of operation for international financial companies and investment bankers. It also creates trickle down benefits for local people in the surrounding region e.g. Chartered Accountants, Hoteliers, Golf club owners, Taxi operators etc.
- London, New York, Hong Kong and Singapore to have also grown by setting up such centres. Taking their example, India too has set up Gujarat International Finance Tec (GIFT) city international financial services centre (IFSC) near Ahmedabad.
- Although it not yet attracted good number of international financial companies yet because the tax benefits available are very little compared to Singapore Hong Kong etc.
- This 'greenfield' GIFT city was developed by 50:50 Joint venture of (the infamous) IL&FS + Gujarat Urban Development Company Limited (GUDCL). Together they

were responsible for the construction, electricity, water, sanitation and other responsibilities of running this city. But post IL&FS crisis, Government of Gujarat has decided to buy IL&FS's 50% shareholding.

23.4.9 BoP → Capital Account → Debt (Loans & NRI deposits)

2017-18 (Bn. USD)	***NET inflow***
Foreign Investment (FPI & FDI)	52
External borrowing by Govt > Pvt. sector	17
NRI Deposits in Indian Banks [FCNR accounts] & other misc. components of Capital Account	22
NET balance in Capital Account	+ 91

MCQ. Which of the following constitute Capital Account? (Asked in UPSC-Pre-2013)

1. Foreign Loans. 2. Foreign Direct Investment.
3. Private Remittances. 4. Portfolio Investment.

Answer codes:(a) 1, 2 and 3 (b) 1, 2 and 4 (c) 2, 3 and 4 (d) 1, 3 and 4

23.5 BoP → SUMMING UP

Sr.	***2017-18***	***(Bn. USD)***
1	Current Account Deficit: चालू खाता घाटा	- 48
2	Capital Account Surplus: पूंजी खाता अधिशेष	+ 91
3	Errors & Omissions: त्रुटियां और चूक	0.9
4	Overall Balance: समग्र संतुलन/ शेष	+ 43
5	Official Reserve Transactions or Monetary Movements in RBI's Foreign Exchange Reserves**	_ _ _ _
	NET Balance of Payment for India	_ _ _ _

- **Minus (-) indicates increase in RBI's forex reserve. That means RBI must have sold Indian ₹ and purchased those many ($43 billion) US dollars to make India's BoP stay at zero. Had RBI not done it, then → more $$ in Indian market than ₹ → Rupee becomes stronger (e.g. $1 =₹ 60 → $1= ₹ 40) → bad for our exports, Because then Indian goods / services will begin to appear more expensive to foreign consumers, who may then shift to another country for their purchases.
- (+) would have indicated decrease in RBI's forex reserve.
- Sr. no 5 is called ***Accommodating transaction***, because RBI will do it based on whether we are having surplus or deficit due to previous four items (so that RBI can accommodate NET BoP to ZERO).

- Sr. no 1 to 4 are called ***Autonomous transactions*** because they occur independently on their own without RBI's involvement.

23.5.1 _ _ _ _ _ _ _ _ _ _ _ _ (स्थिरीकरण)?

- In above case, **(-) indicates increase in RBI's forex reserve. That means RBI must have sold Indian ₹ to purchase those many ($43 billion) US Dollars.
- But that'd result in increased supply of rupee currency in the Indian market → it can cause inflation if there is not sufficient supply of goods for purchase.
- So, RBI must 'absorb' that excess rupee currency back. RBI will it through Open Market Operation (OMO) → sell government securities to buyback Indian rupees. This process is called Sterilization.

23.6 INDIA'S BALANCE OF PAYMENT CRISIS (1991)

- Nowadays India usually has "DEFICIT" in current account (due to crude oil imports), but there is sufficient "SURPLUS" in capital account (thanks to FDI/FPI) to counter/offset that Current Account DEFICIT.
- But in the pre-1991's Nehruvian Socialist Economy, many sectors were nationalised (banking insurance) and / or reserved for the public sector companies only = mismanaged & inefficiency. Private sector industrialists were allowed only in selected sectors, and were subjected to Licence-Quota-Inspector Raj → low level of competition, low innovation = low exports.
- And our policy makers restricted foreign investments (FDI /FPI) fearing that
    - It'll bring USA-CIA's invisible hand in Indian Affairs,
    - Our Swadeshi industries & our 'Non-Alignment Movement (NAM)' will be harmed.
- ***End result?*** High level of "DEFICIT" in Current Account and not enough surplus in Capital account to counter/offset that DEFICIT. The situation could be like this:

1991 → imaginary figures for illustration only	(Bn. USD)
Current Account (Deficit)	- 100
Capital Account (Surplus)	+ 51
Errors & Omissions	0
Overall Balance	- 50
Monetary Movements in RBI's Foreign Exchange Reserves**	+ 50
NET Balance of Payment for India	0

- **Here plus (+) indicates RBI must sell dollars from its forex reserve to keep India's BoP at ZERO level. If they can't do it then shortage of dollars in Indian market to pay for our import bills → results in heavy weakening of Indian rupee (e.g. $1 =₹ 60 → $1= ₹ 6000) then it becomes even more impossible to import oil.

- In 1991, RBI didn't have enough forex reserves to get India's BoP zero → we had to pledge our gold to IMF & borrow dollars.
- IMF also imposed certain conditions which required India to open up its economy through LPG reforms (Liberalisation, Privatisation, Globalisation: उदारीकरण, निजीकरण, वैश्वीकरण). ***Self-study*** it from (new) NCERT Class 11: Indian economic development → Chapter 3.

23.6.1 RBI's Forex Reserve: विदेशी मुद्रा रिजर्व

- Consists of Foreign Currencies > Gold > SDR (and its Reserve Tranche Position).
- Total Value: $400 billion as of 2019. We're 8th largest after _ _ _ _ ($3 Trillion)> Japan > Switzerland > Saudi Arabia > Russia > ...
- USA is not in the top-10 list, it barely keeps ~$120 billions in reserve.

MCQ. Which one of the following groups of items is included in India's foreign-exchange reserves? (Asked in UPSC-Pre-2013)
(a) Foreign-currency assets, Special Drawing Rights (SDRs) and loans from foreign countries.
(b) Foreign-currency assets, gold holdings of the RBI and SDRs.
(c) Foreign-currency assets, loans from the World Bank and SDRs.
(d) Foreign-currency assets, gold holdings of the RBI and loans from the World Bank.

23.7 CURRENCY EXCHANGE RATE: मुद्रा विनिमय दर

- The price of one currency in terms of the other is known as the exchange rate. E.g. $1 = ₹ 70. Meaning, it costs ₹ 70 to buy one dollar (or $0.014 to buy ₹ 1).
- This is also called ***Nominal Exchange Rate*** because it does not take into consideration inflation or purchasing power in the respective countries.
- The place where currencies are exchanged is called ***Foreign Exchange Market:* विदेश विनिमय बाज़ार**. Their dealers are called Authorized (Forex) Dealers (AD). They can be banks or non-banks. They have to get registered with RBI under the Foreign Exchange Management Act (FEMA).
- These dealers keep separate prices for buying and selling, to make profit in between e.g. ICICI: $1 Dollar buying price ₹ 67.95 and $1 selling price is ₹ 72.76.
- Such currency transaction service is also subjected to GST, however the rate depends on the quantum of currency exchanged. (e.g. upto ₹ 10 lakh exchanged in foreign currency then only ~₹ 3000 of that 10 lakh will be taxable in GST → 18% of 3000 → ₹ 540 GST Tax.)
- American Economist James Tobin had suggested 0.1% to 0.5% Tobin Tax on currency exchange transactions to discourage the speculative trading and volatility in the International Financial Market, but on that logic if ₹ 10 lakhs exchanged then 0.1-0.5% = ₹1,000 to 5,000 should be levied as 'tax', but since GST amount is much lower, so in reality it can't be labelled as 'Tobin Tax'.

23.7.1 Exchange Rate Regime: Theory

It is the set of rules governing the exchange of domestic currency with foreign currencies.

<table>
<tr><th>_ _ _ _ or Flexible (अस्थाई विनिमय दर)</th><th>_ _ _ _ or Pegged (नियत विनिमय दर)</th></tr>
<tr><td>Here the exchange rate is determined by the market forces of demand and supply.
- So if there are more number of Indian people wanting to import crude oil, gold, iphones;/ going to USA for higher studies,... Compared to the number of Americans willing to buy Indian goods, services; / coming to vacation in Kerala
- Then, demand for dollars will be more than that of rupees. So, $1 = 50 → $1=70</td><td>When the central bank of a country itself decides the exchange rate of local currency to foreign currency e.g. People's Bank of China (PBC) $1 = 6 Yuan.
- If excess dollars are entering in their market, the central bank will print more yuan to buy and absorb the excess dollars, to ensure Yuan doesn't strengthen against Dollar ($1=6 → 5 Yuan). As a result their forex reserve will get large build up of dollars, due to Central bank's purchase.
- In future, if less dollars are entering in their market, the central bank will sell the (previously acquired) dollars from its forex reserve to ensure Yuan doesn't weaken (₹ 1= 6 → 7 Yuan)</td></tr>
<tr><td>In this system,
- if rupees weakens, it's called " _ _ _ _ (मूल्यह्रास e.g 50 → 70); Makes the export look cheaper to the foreign buyer
- if ₹ strengthens it's called " _ _ _ _: अभिमुल्यन" (e.g. 70 → 50)</td><td>In this system,
- if yuan is weakened by Central Bank's official notification, it's called 'devaluation' (अवमूल्यन e.g $1=6 → 7); usually done when it doesn't have enough dollars in reserve to play the game and / or when it wants to deliberately weaken yuan to encourage exports.
- if yuan is strengthened by Central Bank's official notification, it's called "Revaluation: पुनर्मूल्यांकन" (e.g. $1=7 → 6)</td></tr>
<tr><td>Challenge?
- Currency Speculation: When a person buys $ and other foreign currency with the hopes they become more expensive in future so he can sell@ profit to others. (so he'd be hoping for ₹ to depreciate / $ to appreciate). Such elements distort the exchange rate by hording foreign currencies.
- Interest Rates: If US repo rate / Treasury Bonds are going @2% whereas in Greece's bonds going@4% Then American investors</td><td>Challenge?
- If trade deficit widens / speculators are hoarding dollars / FPIs are pulling their money back to USA due to higher interest rates → shortage of $ in local forex market→ PBC will have to sell $ from its forex reserve to keep the exchange rate stable.
- but since PBC will not have infinite amount of dollars in its reserve ultimately it will be forced to be devalue the local currency → imports will become more expensive.</td></tr>
</table>

will convert Dollars to invest in Greece. Later, when US fed increases their repo rate from 2% to 4% American investors might pull back from Greece. (Because America commercial bank loans will become more expensive ~5%, then there will be American companies willing to borrow by issuing Bond/debentures at 4.5%.)	- Therefore, most of the countries have abandoned this system after 70s. China too abandoned it in 2005-06, and shifted to Managed Floating Exchange Rate.

MCQ. Under flexible exchange rate system, the exchange rate is determined by [UPSC-CDS-2015-II]

(a) predominantly by market mechanism
(b) by the Central Bank
(c) as a weighted index of a group of currencies
(d) by the World Trade Organization

23.7.2 ____ ____ _________ / Dirty Float; प्रबंधित चल/ मलिन चल

- It is the middle path between the two extremes (floating and fixed).
- RBI will not decide the exchange rate (unlike the fixed system). In the ordinary days, RBI will let the market forces of supply and demand decide the exchange rate.
- But if there is too much volatility, then RBI will intervene to buy / sell $ to keep the volatility controlled.
- Similarly, People Bank of China will not intervene in ordinary circumstances. They'll intervene during volatility ie. if $ to Yuan value changes more than "x%" up or down compared to previous day's exchange rate.

23.7.2.1 *Challenges in Managed Float System?*

1. Currency speculation and interest rates .
2. ***Currency Manipulation/ मुद्रा जोड़-तोड़***: usually occurs when a central bank keeps buying dollars to create artificial scarcity of $ in the forex markets → dollar becomes expensive → local currency becomes weak (-***"UNDERVALUED: कम मूल्यांकन")*** → boost to exports. US Department of the Treasury publishes a semi-annual report to track such nations. 2018: China, Germany, Japan, Switzerland, Korea and India have been kept in ('Watch list') citing the (allegaged) lack of transparency and consistency in their respective Central banks operations. USA has not officially labelled anyone as "Currency Manipulator". (Since 1994).

MCQ. Consider the following statements: (Asked in UPSC-Pre-2012)

1. The price of any currency in international market is decided by the World Bank.
2. Demand for goods/services provided by the country concerned.
3. Stability of the government of the concerned country.
4. Economic potential of the country in question.

Answer codes:(a) 1, 2, 3 and 4 (b) 2 and 3 (c) 3 and 4 (d) 1 and 4

23.8 Exchange Rate Regime: Historic

23.8.1 Fixed exchange rate system → _ _ _ _ _ _ _ _; सोने के मानक/ स्वर्णमान (1870-1914)

- USA would issue $1 note, if only it has 14 grams of gold in reserve, whereas England would issue one pound note if only it has 73 grams of gold in its reserve. Accordingly their exchange rate will be 1 pound =73/14 = ~5 USD.
- And, each Central Bank Governor has promised to convert their currency into gold at a fixed amount. So, a person could walk with paper currency and demand the gold coins or bars in return.
- When the gold mining production declined, nations gradually shifted to 'bimetallism' e.g. $1 promised with 14 gm gold or 210 gm of silver whichever available with their Central Bank.
- This system collapsed during the first world war (WW1) because the nation's currency printing capacity was limited by their gold reserve, but their governments where more eager to print more money to finance the war (soldiers' salaries, rifles' ammunition etc.)

23.8.2 Fixed exchange rate system → _ _ _ _ _ _ _ _ _ _ _ _ (1946-1971)

- Here, USA agreed to fix price of its $1 = (1/35) ounces of gold. [1 ounce = 28 grams]. USA allowed free convertibility of Dollar to Gold. So if a person walked into the US Federal Reserve with $35, their chairman (Governor) will give him one ounce of gold.
- Then IMF fixed the exchange rate of every country's currency against USA. e.g.₹ 1= $0.30 = 0.88 grams of Gold. So, that implied India can't issue more currency If Indian RBI does not have proportionately sufficient gold reserve of its own. Still if RBI issues more ₹ currency, International Monetary Fund (IMF: अंतरराष्ट्रीय मुद्रा कोष) will order India to devalue its rupee exchange rate against dollar.
- American Economist Robert Triffin claimed this system will collapse eventually because gold is a finite commodity and its price will continue to rise (from 1 ounce of gold = $35 to $40). So there is always danger of people converting the local currency into dollars and then converting dollars into gold @$35, then selling it in open market @profit, then US Feds Chairman can't continue honoring his promise. It was called "Triffin Dilemma: त्रिफ़िन दुविधा". He therefore suggested an alternative SDR (Paper gold) system for IMF.
- 1971: USA President Robert Nixon pulled out of this Bretton Woods gold convertibility system, mainly because he wanted freedom to printing more dollars to finance the cold war and arms race against the USSR.
- Thus, USA shifted to "Managed Floating Exchange System". Eventually most of the nations also shifted in that system.
- 2000: Ecuador adopted dollarization i.e. it abandoned the domestic currency and adopted the US dollar as their official currency.

23.8.3 Currency Exchange in India

We need not waste time looking at what was the system in India before 1995. But for reference:

Towards Fixed Exchange Rate: निश्चित विनिमय दर की ओर →

- ➢ 1860 onwards: Fixed Fiduciary System. i.e. British Indian Govt can issue Rs.10 crore notes on fiduciary ("trust") backed by G-Sec. Beyond that every note must be backed by gold / silver.
- ➢ 1935 onwards: Proportional Reserve. RBI must keep ~40% gold to the value of currency issued. British govt fixed exchange rate.
- ➢ 1946 onwards: Bretton Woods / IMF system of fixed exchange rate. Wherein ₹ price was fixed (pegged) against dollar, and dollar price was fixed (pegged) against gold.
- ➢ 1956 onwards: While RBI could issue any amount of Indian currency but that has to be balanced by the Assets of the issue department (Recall M0). Ofcourse, if RBI printed too much currency backed by only Indian G-sec but (without adequate Gold / Forex Reserve, then IMF may force ₹ devaluation against Dollar). So, we adopted "Minimum reserve system" i.e. RBI must keep ₹ 400 crore of foreign currency/security + ₹ 115 crore worth gold = Minimum ₹ 515 cr of forex reserve was required.

Towards Managed Floating Exchange Rate →

- ✓ 1992 onwards: Liberalised Exchange Rate Management System, which paved way for gradual transition from 'fixed' to 'managed floating' exchange rate.
- ✓ 1995 onwards: " _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ ; न्यूनतम आरक्षित प्रणाली" is continued but RBI is required to only keep ₹ 115 crores of gold. No compulsion for RBI to keep additional 400 crore worth foreign currency or foreign securities. RBI can print as much currency it wants as long as its balanced by assets of Issue Dept. (such as Indian G-sec, Foreign Securities etc)

23.9 IMF _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ (SDR: विशेष आहरण अधिकार)

- With the collapse of Bretton Woods Exchange Rate System, IMF was converted into a type of 'deposit bank', where the members would deposit currencies in the proportion of quotas allotted to them (depending on size of their economy, openness etc).
- IMF will pay them a small interest rate for their deposits. And IMF would lend this money to a member facing balance of payment crisis. To operationalize this mechanism, IMF would allot an artificial currency called SDR to the members based on their deposits.
- Initially the price of SDR was fixed against the amount of gold but present mechanism →

Currency Basket	***Weight***	***Exchange rate against Dollar?***
U.S. Dollar	41.73	$1=$1
Euro	30.93	1.13
Chinese Yuan (Renminbi,RMB) (*added in 2015)	10.92	6.7
Japanese Yen	8.33	And so on
Pound Sterling	8.09	And so on

- By applying a formula involving (weight * exchange rate), IMF will obtain value of 1 SDR = how many dollars? Presently, 1 SDR = $1.40 = ₹ 98 (because $1 is trading @₹ 70).
- SDR is called 'paper gold' because it's merely an accounting entry or artificial currency, without any gold involved.
- SDR can be traded among the members, it can be converted into members' currencies as per above method & be used to settle their Balance of Payment Transactions / Crisis.
- If the BoP crisis is so big, that a country's entire SDR quota exhausts, then member country may borrow more SDR from IMF (and then convert it into dollar etc to pay off the import bill), but eventually member will have to repay this loan to IMF with interest.
- 2016-Reforms: The total quantity of SDR was increased, and India's quota was increased from 2.44% to ~2.75%, accordingly, we are allotted ~13 billion SDR (25% of it is kept as reserve tranche position RTP: ~~What that means and how does that work is not important.~~)
- India is 8th largest quota holder after USA (~18%), Japan (~7%), China (~6%)...
- In IMF, a member's voting power depends on his SDR quota contribution.
- For India, this voting power is exercised by India's Finance Minister as the the ex-officio Governor in IMF's Board of Governors. If FM absent, then RBI Governor can vote as the Alternate Governor during the IMF's meetings.

MCQ. Recently, which one of the following currencies has been proposed to be added to the basket of IMF's SDR? (Asked in UPSC-Pre-2016)
Answer codes:(a) Rouble (b) Rand (c) Indian Rupee (d) Renminbi

23.10 CURRENCY CONVERTIBILITY(मुद्रा परिवर्तनीयता)

- Presently, India has managed floating exchange rate system wherein, currency exchange rate is determined by the market forces of supply and demand however during high level of volatility RBI will intervene to buy / sell ₹ or $ to stabilize the exchange rate.
- But if people are allowed to convert the local and foreign currency in an unrestricted manner → so much volatility that RBI will not be able to manage.
- So, RBI puts certain restrictions on the convertibility of Indian rupee to foreign currency using the powers conferred under
    - Foreign Exchange Regulation Act, 1973 (FERA). विदेशी मुद्रा विनियमन अधिनियम, 1973
    - FERA was later replaced by Foreign Exchange Management Act, 1999 (FEMA).विदेशी मुद्रा प्रबंधन अधिनियम,

23.11 RBI RESTRICTION ON CONVERTIBILITY OF RUPEE: रुपये की परिवर्तनीयता

<u>Convertibility on Capital Account Transactions: पूंजी खाता लेनदेन पर</u>

BoP → Capital Account → Borrowing → External commercial borrowing (ECB)

- RBI's ECB ceiling is up to $750 million (or equivalent other currency) per year for Indian Companies.
- That means even if Bank of America was willing to lend $1500 million to Reliance ltd, Mukesh Ambani can't bring all those dollars (or its converted rupee equivalent) in India. If he tries, then Enforcement Directorate (ED प्रवर्तन निर्देशालय) will take action for FEMA violation.

BoP → Capital Account → Investment → FPI

- An FPI can't invest in more than 5% of available government securities in the Indian market and more than 9% of the available corporate bonds in the Indian market.
- So, even if Morgan Stanley or Franklin Templeton investment fund has billions of dollars they can't bring them all to India because of above restrictions.
- Similar restrictions on FDI as well. Govt decides FDI policy → RBI mandates the forex dealers accordingly to convert or not convert foreign currency into indian currency. E.g. Las Vegas's Flamingo Casino company can't convert $ into ₹ to invest in Goa's Casino. (Because FDI prohibited in Casino). If they manage to 'smuggle' rupees through Mafia-don-walla boats then again ED will take action for FEMA violation.

Thus, Indian rupee is not fully convertible on capital account transactions.

<u>Convertibility on Current account transactions: चालू खाता लेनदेन पर</u>

BoP → Current account → Trade → import (of Gold)

- During 2013 to 2014, RBI's 80:20 norms mandated that min.20% of the imported gold must be exported back. Until then the Jeweller/bullion dealers will not get permission to (convert their rupees into dollars / foreign currency) to import next consignment of gold.
- However, if we disregard such few rare examples, Indian rupee is considered fully convertible on current account transactions (i.e. Import and export, remittance, income transfer gift and donations).

Sidenote: if NGO / Universities were allowed to accept foreign donations in an unrestricted manner, they may become puppets of ISI / Pakistan / China / CIA. Hence, Ministry of Home Affairs (MHA) requires them to 'register' and furnish annual reports under Foreign Contribution Regulation Act 2010 (FCRA -विदेशी अंशदान विनियमन अधिनियम). JNU didn't furnish report so MHA cancelled their registration and banned them from accepting foreign donations (2017) - But this angle takes us towards the 'National security and sovereignty of India'. We need not confuse or mix it up with 'Economics concept' of Rupee convertibility under FEMA Act.

23.11.1 ____ ____ ____ ____ ____ ____:रुपये की पूर्ण परिवर्तनीयता?

Meaning? India should permit unrestricted conversion of Indian ₹ to foreign currency for both current account and capital account transactions. → more FDI investment in India → NPA problem solved, new factories, jobs, GDP growth, rivers of honey and milk will flow.

Anti-Arguments:

- Before 1997, East Asian "Tiger" economies: (South Korea, Indonesia, Malaysia, Thailand, Vietnam Philippines etc.) allowed full capital account convertibility to attract FDI.
- But 1997: Their automobile & steel companies filed bankruptcy → The foreign investors panicked, sold their shares and bonds → got local currency → converted

into $ and ran away. The flight of this 'hot money' resulted into extreme depreciation of local currency $1 = 2000 Indonesian Rupiah → $1= 18,000 Indonesian Rupiah → heavy inflation in petrol diesel → social unrest, riots and political instability. None of their central banks had enough forex reserve to combat this crisis.

- So, in 1998, their GDP growth rates fell in negative territory e.g. Indonesia (-13.7%) Because of their mistake of allowing full currency convertibility. Whereas India and China grew at 6-8% because we had not allowed it.

23.11.2 ₹ Convertibility → S.S. ____ ____ Committee (1997)

He suggested India to allow full capital account convertibility only when the fundamentals of our economy become strong enough, such as:

- RBI must have enough forex to sustain 6 months' import
- Fiscal deficit must not be more than 3.5% of GDP
- Inflation must not be more than 3-5%
- Banks' NPA must not be more than 5% of their total assets. And so forth.

23.11.3 ₹ Convertibility → RBI reforms (2004-2019)

While RBI has not permitted full convertibility of Indian rupee (on Capital Account), but over the years it has liberalised the norms, such as

- 2004 → ____ ____ ____ ____ ____ (LRS: उदारीकृत विप्रेषण योजना) for each financial year, An indian resident (incl. minor) is allowed to take out upto $2,50,000 (or its equivalents in other currencies) from India. He may use it for either current account or capital account transaction as per his wish. (e.g. paying for college fees abroad, buying shares, bonds, properties, bank accounts abroad.)
  Controversy? Panama papers allege certain bollywood celebrities used LRS window to shift money from India in their shell companies in tax havens → later used those shell companies for tax avoidance. *[Ref: Black Money Handout for more]*
- ***2016 onwards:*** RBI began relaxing the norms for ____ ____ ____ ____ (ECB: विदेशी वाणिज्यिककर्ज), mainly to soften the NPA problem e.g. Software cos. can bring up to $200 million in ECB, Microfinance $500 mill, Infra.cos $750 mill etc.
- ***2018-19:*** When ₹ started to depreciate heavily against dollars ($1 → ₹ 63 → ₹ 74), RBI had to encourage the flow of dollars into Indian economy. So, aforementioned sector-specific limits streamlined → all eligible companies automatically allowed to borrow upto $750 millon via ECB route. (Although prohibited in certain categories e.g. purchase of farm house, tobacco, betting, gambling, lottery etc.)

MCQ. Convertibility of rupee implies:(Asked in UPSC-Pre-2015)
(a) being able to convert rupee notes into gold.
(b) allowing the value of rupee to be fixed by market forces.
(c) freely permitting the conversion of rupee to other currencies and vice versa.
(d) developing an international market for currencies in India.

23.12 CURRENCY WAR 2018 (मुद्रा युद्ध)

- 2015: Chinese authorities announced they don't manipulate/control Yuan exchange rate. They only intervene if Yuan's exchange rate varies +/- 4% from previous day.

- During 2018, People's Bank of China injected more Yuan (renminbi) in the system to makes loans cheaper in domestic market and boost the consumption, demand, growth.
- But, On the other side,US Feds is pursuing Hawkish monetary policy, so dollar supply is shrinking, and hence dollar is becoming more expensive against other currencies.
- So, increased supply of Yuan vs. reduced supply of $: resulted in $1=6.20 Yuan weakening to almost $1= 7 Yuan.
- Trump alleges Yuan was deliberately weakened to make Chinese product more cheaper in global trade. He even accused Russia and Japan of playing similar 'Currency War' against him.

23.12.1 Currency War → Fall of Indian ₹ in 2018

- 2018: Turkey suffering from high level of Inflation, current account deficit and political turmoil.
- US Feds is pursuing Hawkish monetary policy → so dollar supply is shrinking, and hence dollar is becoming more expensive against other currencies. In this atmosphere, foreign investors feared Turkish companies (who had previously borrowed lot of money from American financial market) will not be able to repay their loans in dollar currency.
- So foreign investors began selling their shares and bonds from Turkeys market → got _ _ _ _ currency → exchanged it to dollars and ran away.
- Because of this mad rush, demand of dollars strengthened even further → other currencies became even weaker. Including India: $1=₹ 63 in January → $1= ₹ 74 in Oct. Although such depreciation is good for our exporters but bad for our importers.

To combat this fall, Govt and RBI initiated following steps

1. FPI's investment limits in Bond market was relaxed. (So they feel encouraged to convert their Dollars into Rupees and invest in Indian bond market)
2. External commercial borrowing norms were also relaxed.
3. RBI sold ~25 billion dollars from its forex reserve to calm down the demand of dollars.
4. Further, to attract NRI's dollar savings into India:
    a. RBI could announce more interest rates on Foreign Currency (Non-Resident) Account (Banks) [FCNR (B) Account] & then pay interest subsidy to Indian Banks, like they had done in 2013.
    b. Govt could also tell RBI to issue NRI bonds to attract their $ savings to India.
5. But, they avoided doing #4A and #4B because eventually such borrowed dollars have to be returned back to NRI with interest, which could result in exchange rate crisis in future.
6. RBI could also pursue Hawkish Monetary Policy to reduce rupee supply in market (so that ₹ can also become expensive just like dollars) - but because RBI act mandates inflation control within 2-6% CPI, and by December 2018 the CPI has been falling towards 2% so RBI's MPC had to actually reduce the policy rate (2019-Feb) to combat deflation.
7. 2018-Oct: The central banks of India and Japan signed _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ ***(मुद्रा स्वैप समझौता)*** of $75 billions i.e. either party can use that much dollar currency

from other party's forex reserve during the crisis. Even in 2008 and 2013 too they had signed similar agreement but lower amount was involved.

8. 2018-Dec: India signed pact with Iran to pay crude oil bill in rupee currency. National Iranian Oil Co (NIOC) will open a bank account in India's UCO Bank (a PSB). Indian oil companies will make payments there in ₹ currency. This will help curbing the demand of dollars in India.

23.12.2 Quantitative Easing and Federal Tapering

- 2007-08: Subprime crisis in USA → Borrowers unable to repay the home loans → American Banks and NBFCs' bad loans / NPA / toxic assets increased → to help them, US Federal Reserve printed new dollars & used it to buy those toxic assets → increased the dollar supply in the system. This phenomenon was called " _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ (मात्रात्मक आसानी)".
- 2013: US Federal Reserve gradually cut down its toxic asset purchasing program → less new dollars issued → it was called " _ _ _ _ _ _ _ _ _ _ _ _ (संघीय टेपिंग)".
- As a result (perceived) shortage of dollars in USA → Loans become more expensive in USA→ American investors began selling shares/bonds in other countries, and took their dollars back to USA. This phenomenon was called "Taper Tantrum". It resulted into weakening of other currencies against USD. ~~Old topic but theHindu's columnists recalling old things just to fillup space in their columns related to Rupee exchange rate.~~

23.12.3 Helicopter Money & Zero interest rate regimes

- Economist Milton Friedman (1969) introduced concept of 'helicopter money' that to combat recession, a central bank should supplying large amounts of money to the public at near zero interest rate, as if the money was being showered on them from a helicopter. It will encourage consumption, demand → more factories, jobs and economic growth.
- In the aftermath of Supreme crisis and global financial crisis → fall in consumption, demand → deflation & recession scenario. So, the Central Banks of Sweden, EU and Japan cut their interest rates into negative figures (-0.1%) so if a commercial bank parked/deposited its surplus money into the central bank, it's money will be deducted in penalty instead of earning deposit interest.
- Result? Commercial banks will proactively try to give away more loans to customers to boost demand in economy. ~~Another Old topic but theHindu's columnists recalling old things just to fillup space in their columns related to Rupee exchange rate.~~

23.12.4 Yuan as global currency?

- 2015: Yuan added in an SDR basket of currency. → It increases the acceptance of Yuan in global economy.
- China is also loaning yuans to other nations for infra. development in One Belt One Road Initiative (OBOR: एक क्षेत्र एक मार्ग पहल), via AIIB and BRICS bank, and even via Panda Bonds.

- In future, China may have to be less dependent on $$ while importing oil, missiles, metal and food commodities- as other nations begin to happily accept Yuan. Though such yuan dominance may pose strategic challenges to USA and India.

23.13 EXCHANGE RATE → MISCELLANEOUS TERMINOLOGIES

23.13.1 NEER and REER? (Hindi not imp because only prelim relevant)

- In real life we are not just trading with USA but other countries, using foreign currencies other than US dollars (Euro, Pound, Yen, Yuan etc).
- Therefore only tracking $1=60, $1=70 will not give a full picture. So, RBI also calculates geometric average of rupee's exchange rate against upto 36 types of foreign currencies. The formula will give weightage to each of those 36 foreign currencies depending on their trade-volume with India.
- The result is called " _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ (NEER)".
- When NEER is mathematically adjusted as per the CPI-inflation levels in India and those foreign countries, it's called "Real effective exchange rate (REER)".
- NEER vs REER values help analysing whether a currency is really weakening (depreciating) against the foreign currencies or not, thus helps to know our international competitiveness in exports.
- 2018's analysis reveals that though Indian rupee weakened against dollar $1=₹ 63 → ₹ 74, but rupee has not so greatly weakened against other foreign currencies.
- ~~Exact formula and implication? NotIMP~~

_ _ _ _ _ _ _ दोहरा घाटा	It's the term used when both Current Account Deficit and _ _ _ _ _ _ _ are high : चालू खाता घाटा और राजकोषीय घाटा
_ _ _ _ _ _ _ _ : क्रय शक्ति समता (PPP)	- Hypothetical concept that tries to compare two currencies' exchange rate through their purchasing power in respective countries. - So, If 1 cup of coffee in India = ₹ 20 whereas 1 cup of coffee costs $2 in USA then Dollar to Rupee exchange rate (PPP) should be $1 = ₹ 10. (According to OECD, exact figure is $1=₹ 17@PPP). - This (hypothetical) exchange rate can happen in real life, if both the countries have Floating exchange rate without any intervention of the respective Central banks; and if the bilateral trade is free of protectionism (= without tariff /non-tariff barriers).
Big Mac Index	The Economist magazine's informal index to measure PPP exchange rate using the price of one Mcdonald burger in USA vs the respective country.

Next Handout: Notable organisations (BRICS Bank, AIIB, World Bank, IMF, WTO-Its important summits & agreements), Other trade agreements, Protectionism, Trade war, etc.

23.13.2 Mock Questions for Mains:

1. Craze for gold in Indians have led to a surge in import of gold in recent years and put pressure on balance of payments and external value of rupee. In view of this, examine the merits of Gold Monetization Scheme. ***GSM3-2015***

2. There is a clear acknowledgement that Special Economic Zones (SEZs) are a tool of industrial development, manufacturing and exports. Recognizing this potential, the whole instrumentality of SEZs requires augmentation. Discuss the issues plaguing the success of SEZs with respect to taxation, governing laws and administration. ***GSM3-2015***
3. Justify the need for FDI for the development of the Indian economy. Why there is gap between MOUs signed and actual FDIs? Suggest remedial steps to be taken for increasing actual FDIs in India. ***GSM3-2016***
4. Foreign direct investment in the defence sector is now said to be liberalised. What influence this is expected to have on Indian defence and economy in the short and long run? ***GSM3-2014***
5. Discuss the impact of FDI entry into multi-trade retail sector on supply chain management in commodity trade pattern of the economy. ***GSM3-2013***
6. Though India allowed foreign direct investment (FDI) in what is called multi brand retail through joint venture route in September 2012, the FDI even after a year, has not picked up. Discuss the reasons. ***GSM3-2013***
7. Though 100 percent FDI is already allowed in non-news media like a trade publication and general entertainment channel, the Government is mulling over the proposal for increased FDI in news media for quite some time. What difference would an increase in FDI make? Critically evaluate the pros and cons. ***GSM2-2014***