

Economics

Development Economics: Poverty, Inequality & Unemployment

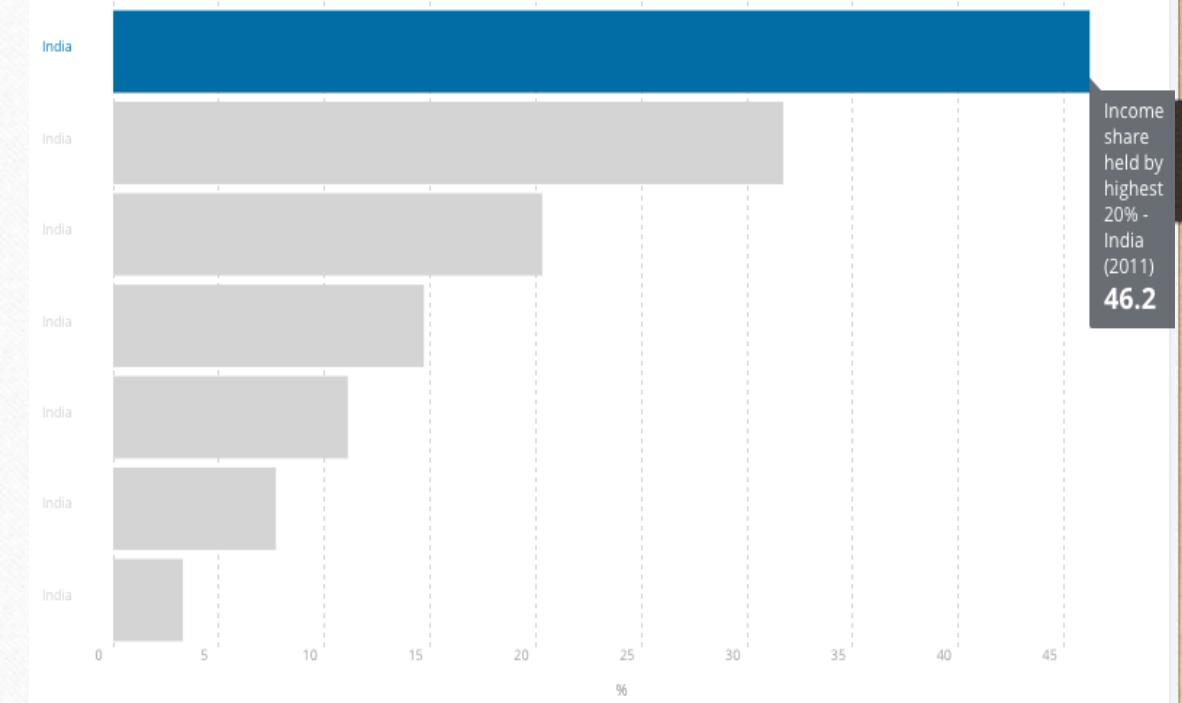
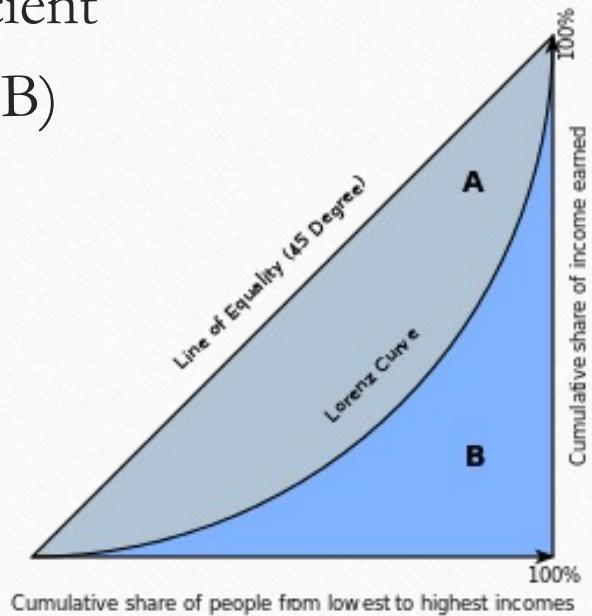
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Inequality

- Relative Poverty
- 3 common dimensions on inequality – wealth, income, consumption
- Reasons for inequality-
 - Conventional:
 - Natural/geographical advantages (v/s the ‘curse’ of resources?)
 - Social factors like accident of birth
 - Comparative advantage – Despite similar conditions, some excel while most others do not
 - Modern Economic reasons:
 - Return on factors of production- Labour v/s Capital & Entrepreneurship
 - Average returns v/s exceptional returns
 - Ability to generate exceptional returns

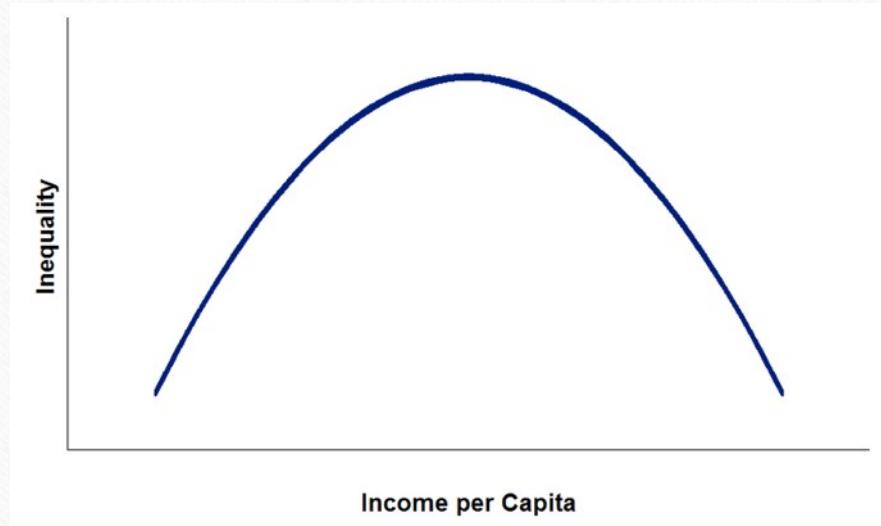
Measuring Inequality

- Lorenz Curve
- Gini Coefficient
 $= A/(A + B)$



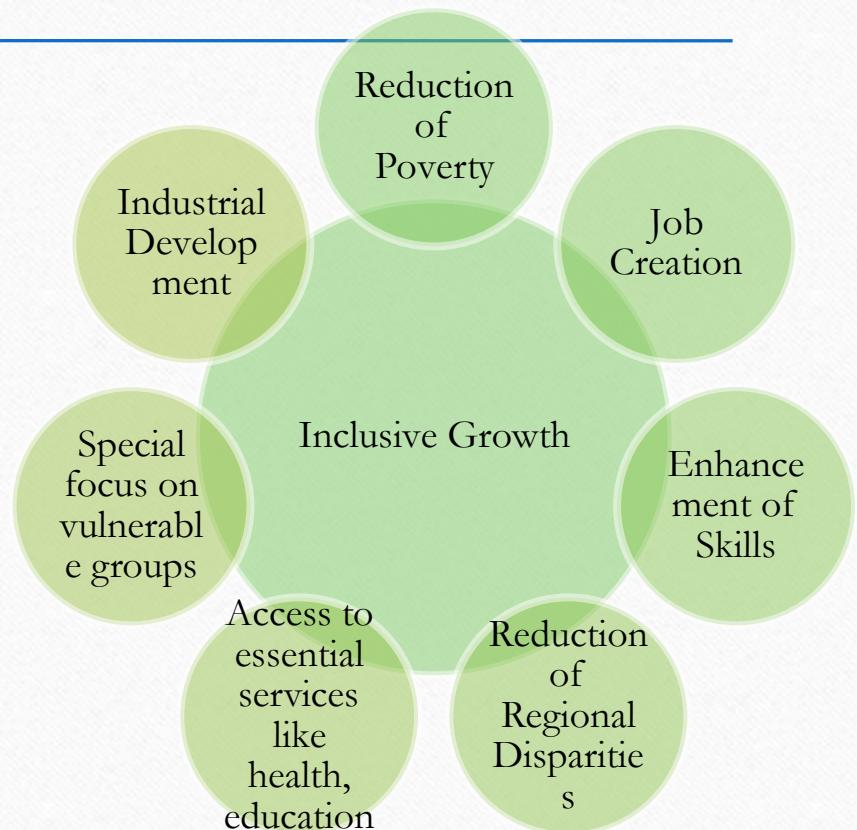
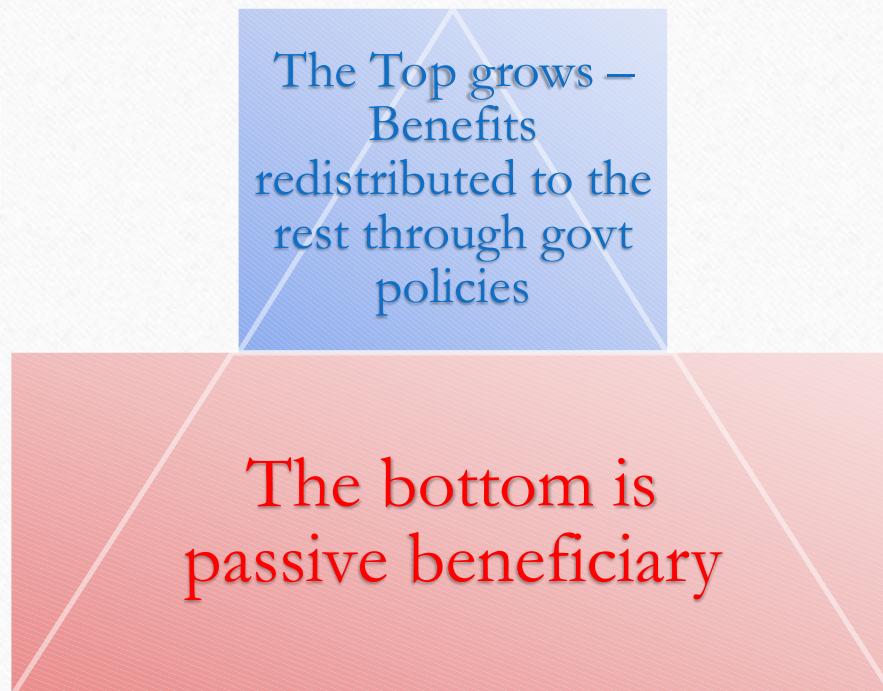
Inequality

- Kuznet's Curve-
 - Trickle down of benefits over time
 - Is Kuznet's curve real/empirical or prophetic?
 - Modern view of inequality
 - Pikkety's Views
 - Inequality in Capitalist and socialist countries
 - Role of capital in inequality
 - Counter views
 - Inequality as a consequence of growth



Correcting Inequality through Inclusive Growth

Trickle Down Approach to Growth



Rising or Converging Inequality in India?

TRANSFORMING, CONVERGING, EQUALISING INDIA

STATE	2015			2020			% Change in All Indices
	Gender Equality	Female Empowerment	All Indices	Gender Equality	Female Empowerment	All Indices	
Total Indicators	5	5	17	5	5	17	
Maximum Index Value	500	500	1700	500	500	1700	
CATCH-UP STATES							
Bihar	114	116	381	130	251	594	55.8 %
Jharkhand	167	166	450	198	306	779	73.1 %
Madhya Pradesh	177	118	483	257	227	816	68.8 %
Odisha	242	206	721	247	296	865	20.0 %
Rajasthan	157	179	592	235	274	949	60.1 %
Uttar Pradesh	168	149	531	254	266	849	60.0 %
West Bengal	238	141	649	268	256	804	23.8 %
RICH STATES							
Kerala	450	351	1281	455	372	1300	1.5 %
Punjab	315	270	1044	348	393	1240	18.7 %
Tamil Nadu	361	283	1010	327	361	1178	16.6 %
India (pop weighted)	230	194	702	273	286	918	
Percent change				18.8	47.7	30.8	
Gini	0.179	0.171	0.167	0.122	0.076	0.098	-41.3 %

Notes – The 2015 corresponds to the NFHS – 4 dataset while 2020 pertains to the NFHS – 5 dataset. Gini captures inequality across states. Index value for each indicator has the numerator as the distance from maximum (or minimum) value; the denominator is the difference in the maximum and the minimum value.

Economics

Development Economics: Poverty, Inequality & Unemployment

Aditya Kalia

Poverty

- Ways to define poverty – Income? Well-being? Health & Education? Opportunities.
- Concept of Deprivation
- World's Bank definition-Poverty is pronounced deprivation in well-being, and comprises many dimensions. It includes low incomes and the inability to acquire the basic goods and services necessary for survival with dignity. Poverty also encompasses low levels of health and education, poor access to clean water and sanitation, inadequate physical security, lack of voice, and insufficient capacity and opportunity to better one's life.
- In general - Poverty is the state of not having enough material possessions or income for a person's basic needs. Poverty may include social, economic, and political elements.

Understanding Poverty- Absolute, Relative, Normative, Positive?

- Understanding Poverty in absolute and relative terms. Absolute poverty is the complete lack of the means necessary to meet basic personal needs, such as food, clothing, and shelter, etc. Relative poverty is being relatively poor w.r.t someone else.
- Normative v/s positive ways to measure and define- Normative – according to norms. Norms are set by some else (probably an expert, but yes, some one else). Positive means a matter of fact – Someone *is* poor or not. Or, using an analogy- someone *is* *human being*, someone else *is a frog*. In economics, we desire ‘positive’ answers to questions of opinion, and hence, a quest to define and redefine poverty.
- Measures:
 - Poverty line
 - Headcount ratio
 - Poverty Gap
 - Squared poverty gap

Measurement of Poverty in India (per capita PL)- Different Poverty Line Baskets (PLBs)

Pre-independence: Dadabhai Naoroji (Rs. 16-35 per year), National Planning Committee (NPC) (Rs.15-20 pm) , etc.

Planning Commission-

- Dandekar and Rath (1971, calorie based – 2250 cal per day)
- YK Alagh committee (1979, calorie based, better estimation, separate for Rural & Urban)
- Lakdawala (1993, introduced state specific measurements and CPI based updation, expanded consumption basket to include housing, clothing, transport)
- Tendulkar (major expansion of consumption basket and its update – pvt health and education expense, concepts of MRP instead of URP in surveys)
- Rangarajan (further update to Tendulkar method)

* Estimation was done by Planning commission using data from NCES (National Consumer Expenditure Survey carried out by NSSO. Estimates are also arrived at separately using data from National Account Statistics.)

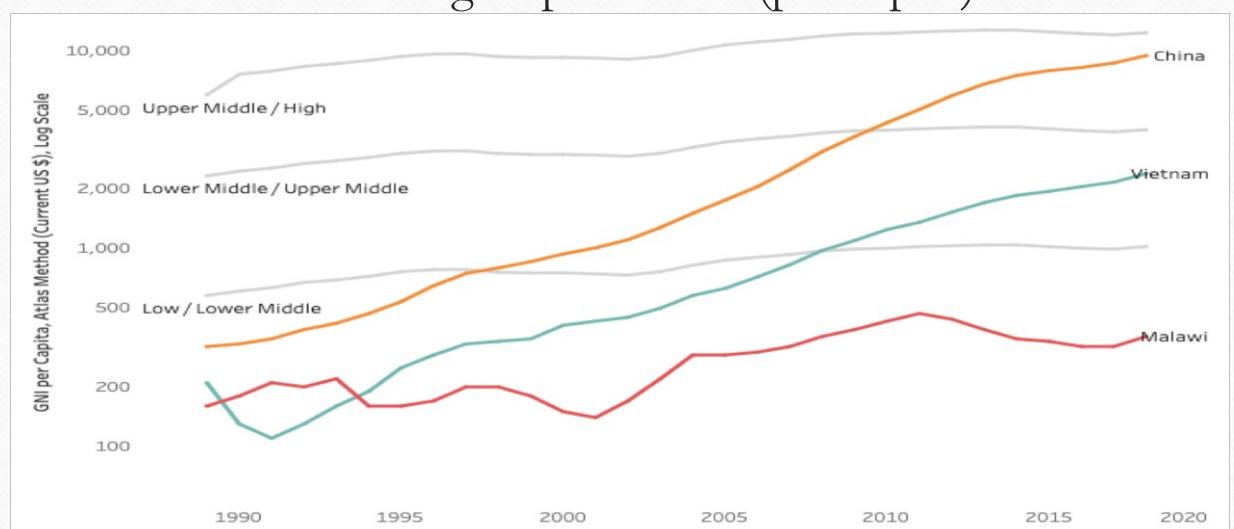
*Adjustments to prices using relevant inflation metrics

Other measures of Poverty

- NC Saxena Committee – Identification of BPL households
- Socio Economic and Caste Census – Giving status of ‘Automatically included’, ‘Automatically Excluded’ and ‘Deprived’ on the basis of deprivation criteria.
- World’s Bank Approach- Poverty line for countries based on income groups: GNI(per capita)-
 - High Income
 - Upper Middle Income
 - Lower Middle Income
 - Low income

Extreme Poverty as defined by World Bank -
\$1.90/per capita/per day

- Multi-dimensional poverty



Multidimensional Poverty Index (MPI) by OPHI (Oxford Poverty and Human Development Initiative) & UNDP

DIMENSIONS OF POVERTY	INDICATOR	DEPRIVED IF LIVING IN A HOUSEHOLD WHERE...	WEIGHT	SDG AREA
Health (1/3)	Nutrition	Any person under 70 years of age for whom there is nutritional information is undernourished .	1/6	SDG 2: Zero Hunger
	Child mortality	A child under 18 has died in the household in the five-year period preceding the survey.	1/6	SDG 3: Health and Well-being
Education (1/3)	Years of schooling	No eligible household member has completed six years of schooling .	1/6	SDG 4: Quality Education
	School attendance	Any school-aged child is not attending school up to the age at which he/she would complete class 8 .	1/6	SDG 4: Quality Education
Living Standards (1/3)	Cooking fuel	A household cooks using solid fuel , such as dung, agricultural crop, shrubs, wood, charcoal, or coal.	1/18	SDG 7: Affordable and Clean Energy
	Sanitation	The household has unimproved or no sanitation facility or it is improved but shared with other households.	1/18	SDG 6: Clean Water and Sanitation
	Drinking water	The household's source of drinking water is not safe or safe drinking water is a 30-minute or longer walk from home, roundtrip.	1/18	SDG 6: Clean Water and Sanitation
	Electricity	The household has no electricity .	1/18	SDG 7: Affordable and Clean Energy
	Housing	The household has inadequate housing materials in any of the three components: floor, roof, or walls .	1/18	SDG 11: Sustainable Cities and Communities
	Assets	The household does not own more than one of these assets: radio, TV, telephone, computer, animal cart, bicycle, motorbike, or refrigerator, and does not own a car or truck.	1/18	SDG 1: No Poverty

India's progress on Poverty

- Official estimates – Latest is 22% in 2011-12, down from 37% in 2004-05 (Tendulkar Committee)
- Estimates according to World Bank, World Poverty Clock.
 - i. India's GDP pc (2019) - ₹ 1,49,183 | \$ 2,104 | \$ 7,034
 - ii. Poverty headcount ratio at \$1.90 a day (2011 PPP) (% of population) (See graph)
- According to Global MPI 2020, India is 62nd among 107 countries with an MPI score of 0.123 and 27.91% headcount ratio, based on the NFHS 4 (2015/16) data.
- 271 million fewer people in poverty in 2016 than in 2006

Take any measure, there is a strong correlation of poverty alleviation and growth

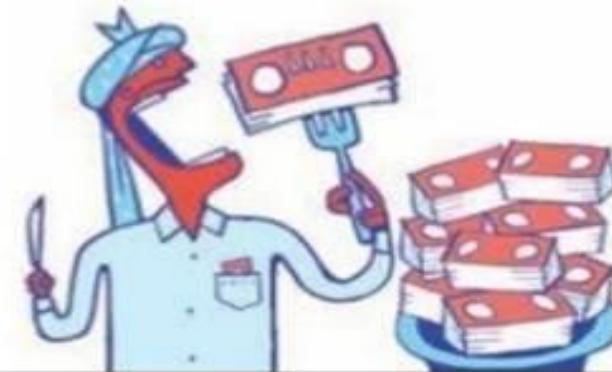
Year	Rural	Urban	Total
1993 - 94	50.1	31.8	45.3
2004 - 05	41.8	25.7	37.2
2009 - 10	33.8	20.9	29.8
2011 - 12	25.7	13.7	21.9



India's progress on Poverty

IS INDIA WITNESSING A RECORD PACE OF POVERTY REDUCTION?

	TYPE 1		TYPE 2		
	2004/05	2011/12	2017/18 ⁴	2011/12	2017/18 ⁴
Population (in mil)	1097	1217	1327	1217	1327
Per Capita Consumption (per month, in Rs.)					
Nominal	712	1627	3203	1773	3489
Real	1200	1483	1990	1619	2172
Per Capita Consumption growth (per year, annualised ¹ in %)					
Nominal	-	11.8	11.3	-	11.3
Real	-	3.0	4.9	-	4.9
Poverty line (in current Rs per person per month)					
Tendulkar ²	485	893	1311	893	1311
World Bank ³	817	1504	2208	1504	2208
Poverty Rate (in % of total population)					
Tendulkar	37.7	22.2	6.3	14.9	3.7
World Bank	77.6	65	41.6	58.1	32.2
Number of Poor (in mil)					
Tendulkar	414	270	84	181	49
World Bank	851	791	552	707	427



Sources: NSS Consumption Expenditure Surveys, 2004/05 & 2011/12; author's calculations for 2017/18.

Notes: 1) Per Capita Consumption growth represents annualised growth between the seven-year period 2004/05-2011/12 and the six year period 2011/12 and (projected) 2017/18.

2) Tendulkar Poverty Line for India, equivalent to World Bank's poverty line for a poor economy, 1.9 PPP\$ per person per day.

3) World Bank's International Poverty line for lower middle-income country (GNI per capita between \$1,006 and \$3,955; India's GNI per capita in 2016 was 1670 current US\$) is set at \$3.20 per person per day.

4) Numbers for 2017/18 are forecasts derived from author's calculations.

Economics

External Sector – Balance of Payments

Aditya Kalia

Balance of Payments Account

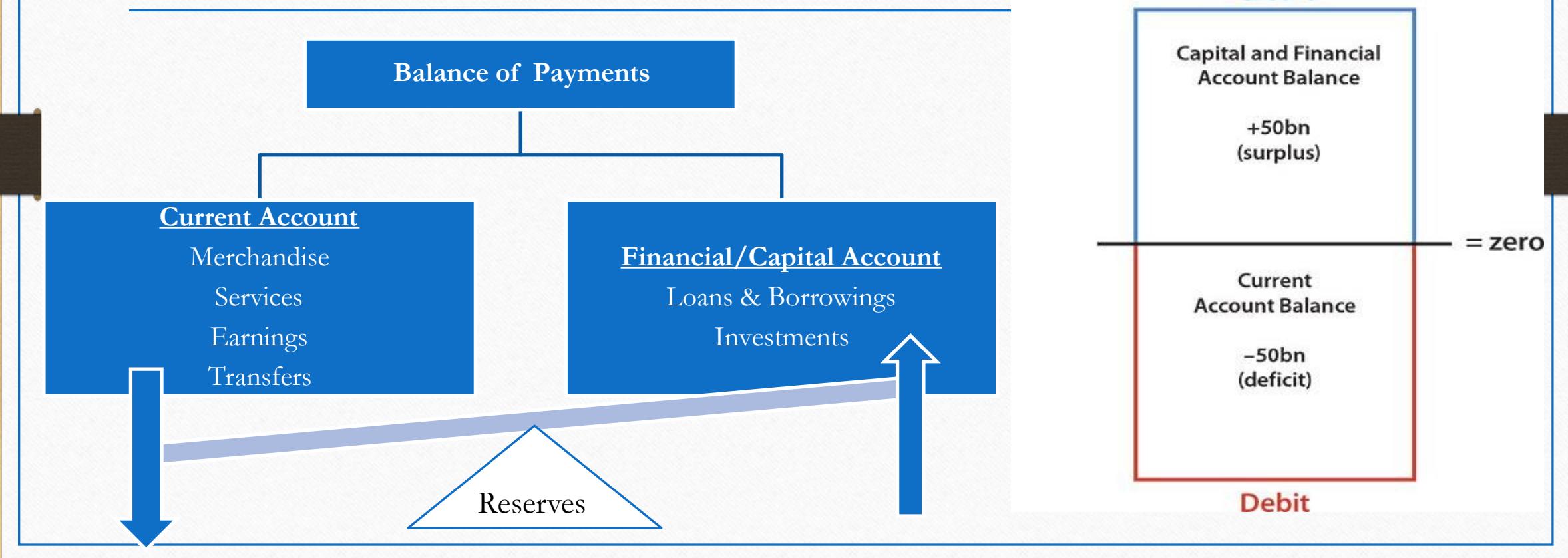


Table 6: Major Components of India's Balance of Payments

Year / Item (Net)	(US\$ Billion)									
	2019-20				2020-21				2021-22 (P)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
A. Current Account	-15.0	-7.6	-2.6	0.6	19.1	15.3	-2.2	-8.2	6.5	-9.6
A 1 Merchandise Trade Balance	-46.8	-39.6	-36.0	-35.0	-11.0	-14.8	-34.6	-41.7	-30.7	-44.4
A 1a Merchandise Exports	82.7	80.0	81.2	76.5	52.2	75.6	77.2	91.3	97.4	104.8
A 1b Merchandise Imports	129.5	119.6	117.3	111.6	63.2	90.4	111.8	133.0	128.2	149.3
A 2. Invisibles	31.8	32.1	33.4	35.6	30.0	30.1	32.4	33.6	37.2	34.8
A 2.a) Services	20.1	20.9	21.9	22.0	20.8	21.1	23.2	23.5	25.8	25.6
A 2.b) Transfers	18.0	20.0	18.9	18.4	17.0	18.4	19.3	18.8	18.9	18.9
A 2.c) Income	-6.3	-8.8	-7.4	-4.8	-7.7	-9.4	-10.1	-8.7	-7.5	-9.7
B) Capital Account	28.6	13.6	23.6	17.4	1.4	15.9	34.1	12.3	25.5	40.1
B.1) Foreign Investment	18.8	9.8	17.6	-1.8	0.1	31.4	38.6	10.0	12.1	13.3
B.1.a) Foreign Direct Investment	14.0	7.3	9.7	12.0	-0.5	24.4	17.4	2.7	11.7	9.5
B.1.b) Foreign Portfolio Investment	4.8	2.5	7.8	-13.7	0.6	7.0	21.2	7.3	0.4	3.9
B.2) Loans	9.6	3.1	3.1	9.9	2.8	-3.9	0.3	7.7	2.8	7.6
B.2.a) External Assistance	1.5	0.4	1.3	0.6	4.1	1.9	1.2	4.0	0.3	1.1
B.2.b) Commercial Borrowings (MT & LT)	6.1	3.3	3.2	10.3	-1.2	-4.0	-1.1	6.1	0.6	4.1
B.2.c) Short Term Credit to India	2.0	-0.6	-1.4	-1.0	-0.2	-1.8	0.2	-2.3	1.9	2.4
B.3) Banking Capital	3.4	-1.8	-2.3	-4.6	2.2	-11.3	-7.6	-4.4	4.1	0.4
B.4) Rupee Debt Service	-0.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	-0.1	0.0
B.5) Other Capital	-3.1	2.5	5.2	13.8	-3.7	-0.3	2.8	-1.0	6.6	18.8
C) Errors and Omissions	0.4	-0.9	0.6	0.9	-0.6	0.4	0.6	-0.7	-0.2	0.7
D) Overall Balance	14.0	5.1	21.6	18.8	19.8	31.6	32.5	3.4	31.9	31.2
E) Foreign Exchange Reserves (Increase - / Decrease +)	-14.0	-5.1	-21.6	-18.8	-19.8	-31.6	-32.5	-3.4	-31.9	-31.2

FDI v/s FII



Foreign Direct Investment

- Intention to exercise of control - More than 10% ownership
- Sectoral limits on investment- mostly liberalised
- Considered as long term in nature- intention is to stay invested, explore economy's potential.
- Usually the investor will bring new technology
- Will need multiple level approvals- Sectoral regulator, Different government departments- Home, Defence, Environment, etc.
- Earlier approval- Foreign Investment Promotion Board (FIPB) and CCEA (Cabinet Committee on Economic Affairs)
- Now approval- Mostly automatic subject to certain conditions, some large investments may need CCEA approval, FIPB dismantled.
- E.g. In Budget 2021, FDI limit in insurance sector was increased to 74% from 49%.



Foreign Portfolio Investment (formerly FII)

- No intention of exercising significant control – Less than 10% holding
- Instrumental limits on investment – mostly liberalised
- Investors will bring only money for investment.
- Considered as **Hot Money** – Investors cash out as soon as their targets are achieved or if they can't bear occurring losses.
- May cause sharp appreciation/depreciation in exchange rate due to large inflow/outflow.
- Approvals are less cumbersome- financial regulators deal with them- RBI and SEBI mostly
- E.g. FIIs investing in Indian Stock market, government bonds, etc.

Exchange Rate Systems (XRS) – Fixed, Floating and Mixed

- Free-Floating XRS – No intervention by government or any agency. Forces of Demand & Supply determine the price at which one currency can be purchased using another currency. This exchange occurs in currency market.
 - Concepts of Appreciation/Depreciation – automatic adjustment – becoming costlier or cheaper.
- Fixed XRS – XRs are pre-determined by the government or an authority or through a mutually agreed system between countries.
 - Concepts of Devaluation/revaluation – intervention to make currency cheaper or costlier
- Many ways through which countries maintain Fixed XRS:
 - Control of Demand or Supply of foreign currency in currency market. (refer convertibility of rupee, next slide)
 - Pegging to a commodity having a relatively stable value- E.g. Gold (Gold standard in pre-World War era)
 - Pegging to another currency through setting up currency boards to ensure
- Managed Floating XRS – It is a mix between Fixed and floating – a currency is allowed to be exchanged in a currency market, but its certain aspects may be regulated – E.g. volatility. India follows a Managed float system.

Convertibility of Rupee

- Ease at which domestic currency can be exchanged with foreign currency
- Tarapore committee recommendation- graded move towards full convertibility:
 - Control of Fiscal Deficit
 - Control over inflation
 - Shoring up govt ability to repay debts
 - Controlling Gross NPAs of Banks
- 2nd Tarapore committee further recommended:
 - Raising of ECB limits
 - Relaxations for NRIs
 - Abolition of Participatory Notes

Challenges and Opportunities?

Counterview [article](#) (reference)

Capital Account- India's External Debt

External Debt includes:

- Sovereign Debt
- External Commercial Borrowing
- FII debt
- Multilateral Debt
- Masala Bonds
- Sovereign Debt Bonds (proposed)
- Etc.

Most of foreign debt is denominated in US dollar, followed by INR denominated debt.

Most of the debt is of long term maturity.

Refer in detail article [here](#).

India's BoP: Trade balance

Figure 9: Increasing Merchandise Trade Balance due to high growth in exports and imports

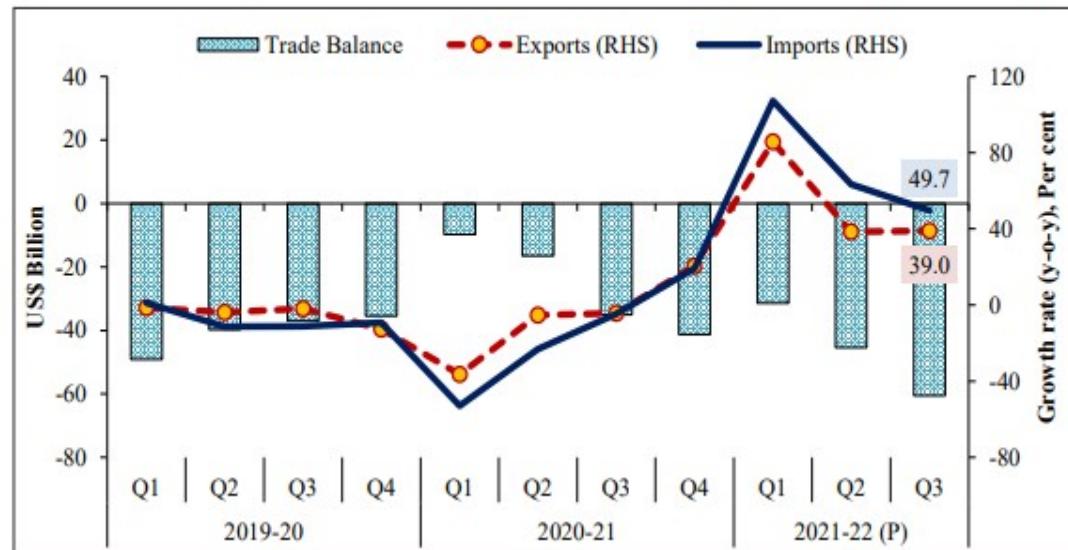
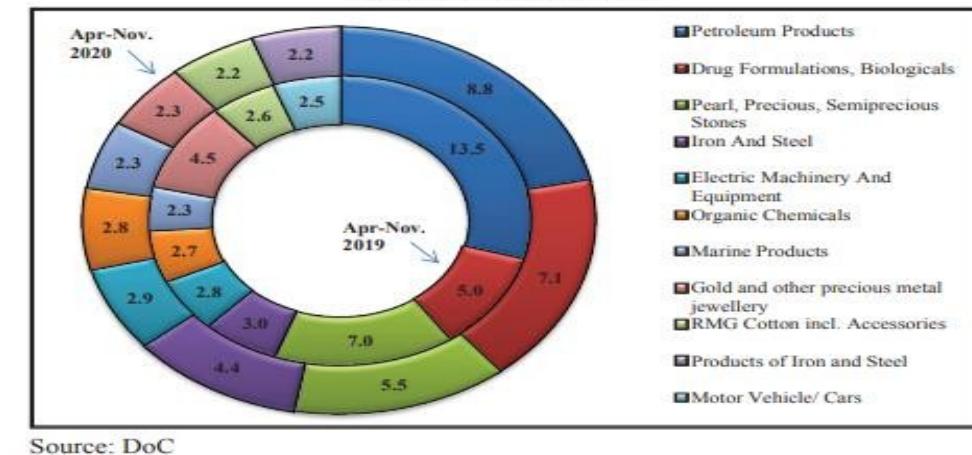


Figure 6: Top 10 Export Commodities in April-November 2020 and April-November 2019 [By Share in Per cent]



India's BoP: Trade balance

Table 3: India's Merchandise Trade Balance with Major Countries

S. No	Country	Exports		Imports		Trade Balance	
		(US\$ Billion) Apr-Nov 20	(US\$ Billion) Apr-Nov 21 (P)	(US\$ Billion) Apr-Nov 20	(US\$ Billion) Apr-Nov 21 (P)	(US\$ Billion) Apr-Nov 20	(US\$ Billion) Apr-Nov 21 (P)
1	USA	31.3	49.0	16.3	27.4	15.0	21.6
2	Bangladesh	5.1	9.2	0.6	1.3	4.4	7.9
3	Nepal	3.5	6.0	0.4	1.0	3.1	5.0
4	Turkey	2.3	5.1	0.9	1.3	1.4	3.8
5	Netherland	3.8	6.9	1.9	2.8	1.9	4.1
6	UK	4.6	6.8	2.6	4.3	2.0	2.5
7	Italy	2.6	5.4	2.2	3.2	0.4	2.1
8	Korea	2.9	4.8	7.1	11.1	-4.2	-6.3
9	Qatar	0.8	1.2	4.6	7.7	-3.8	-6.5
10	UAE	9.7	17.5	13.1	27.9	-3.4	-10.4
11	Saudi Arab	3.6	5.8	9.2	19.2	-5.6	-13.4
12	Iraq	1.0	1.3	7.6	18.5	-6.6	-17.2
13	Switzerland	0.9	0.9	5.8	17.8	-4.9	-16.9
14	China	13.6	15.6	38.8	59.0	-25.2	-43.4

Figure 8: Top ten Import Sources in 2021-22 (April-November) [By Share in Per cent]

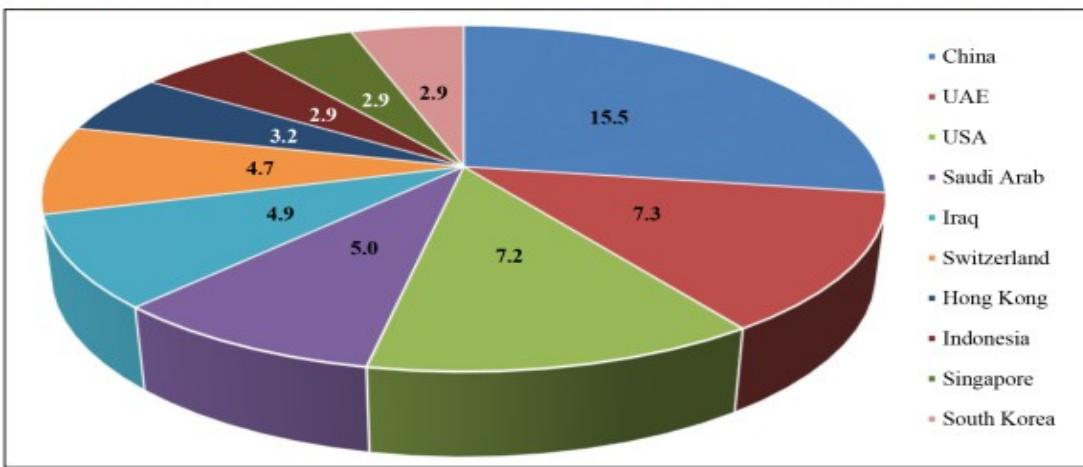
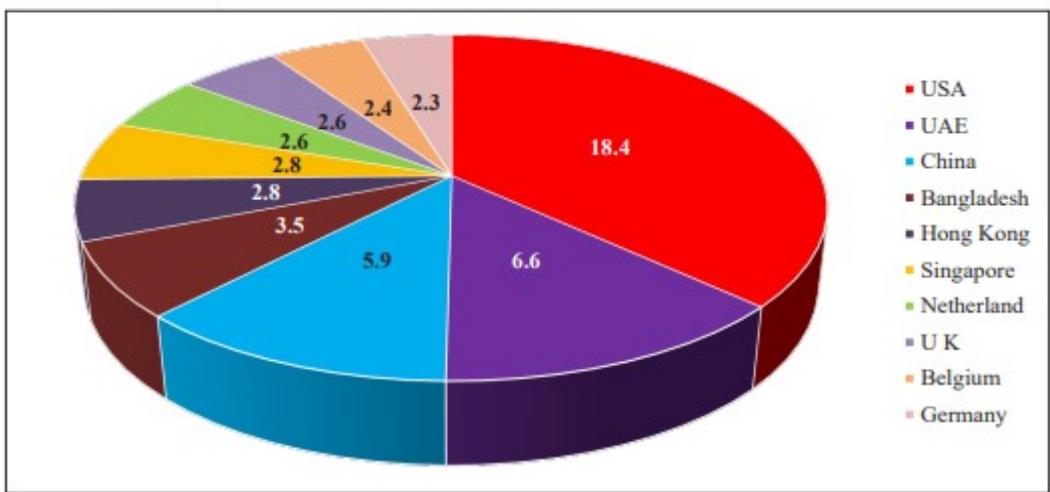


Figure 6: Top ten Export Destinations in 2021-22 (April-November) [By Share in Per cent]



India's BoP: Invisible balance

Figure 10: Rising Services Exports and Imports

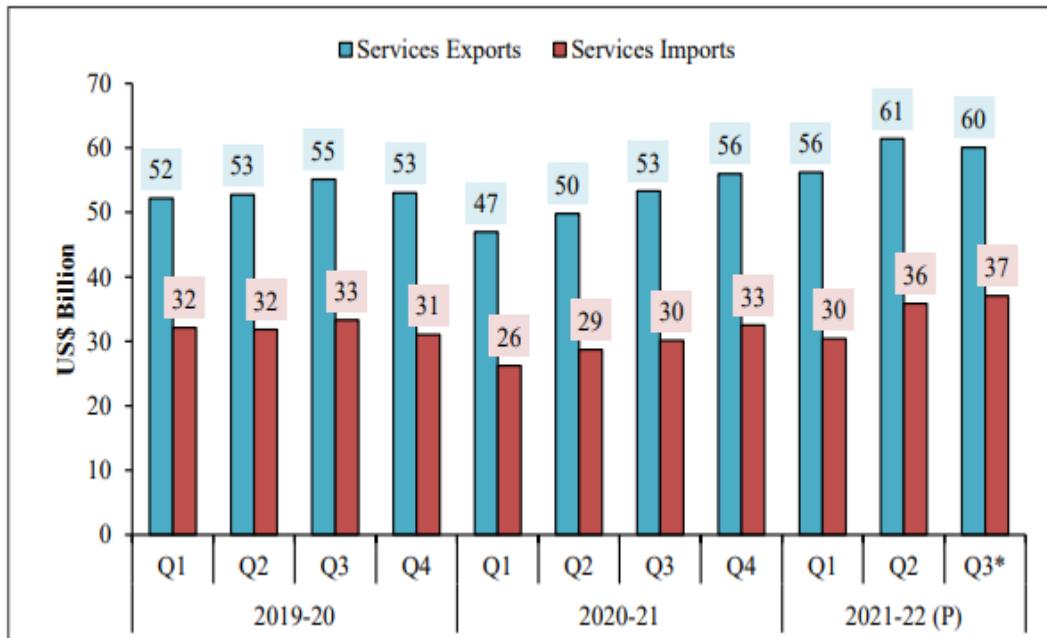


Figure 12: Composition of Net Invisibles

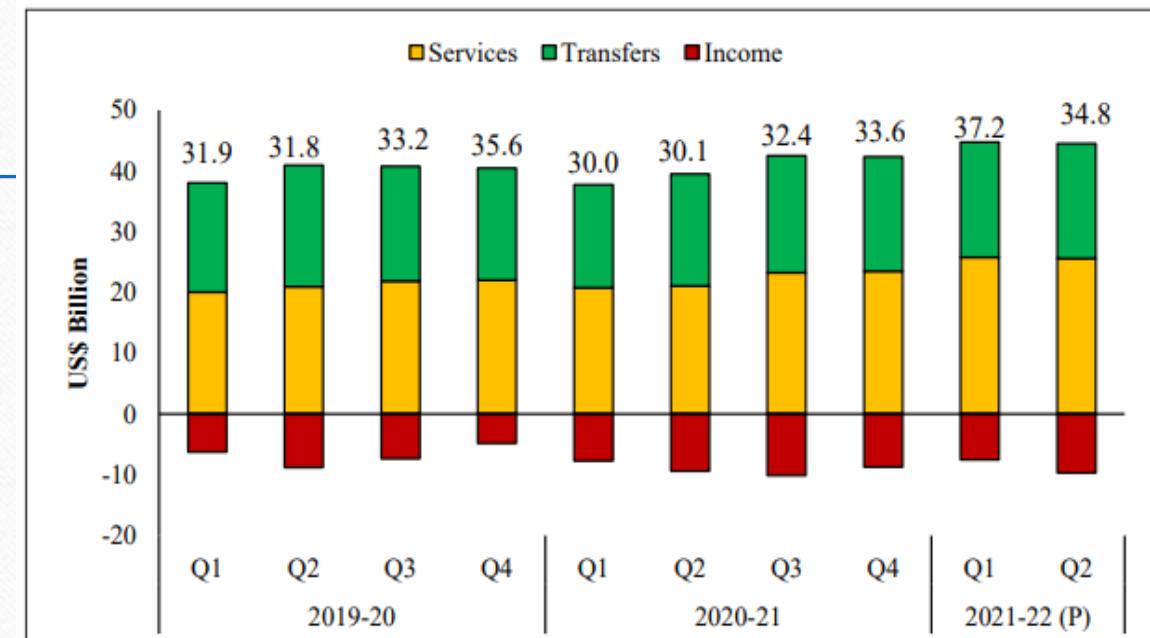
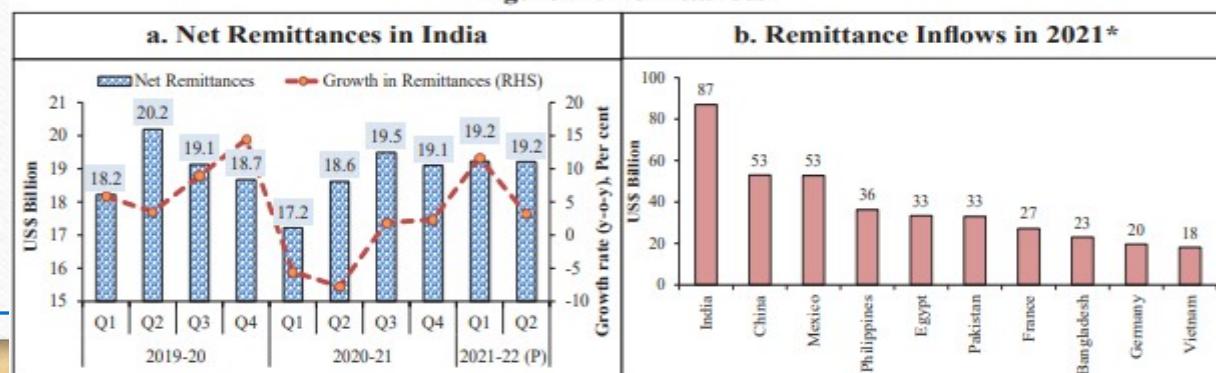
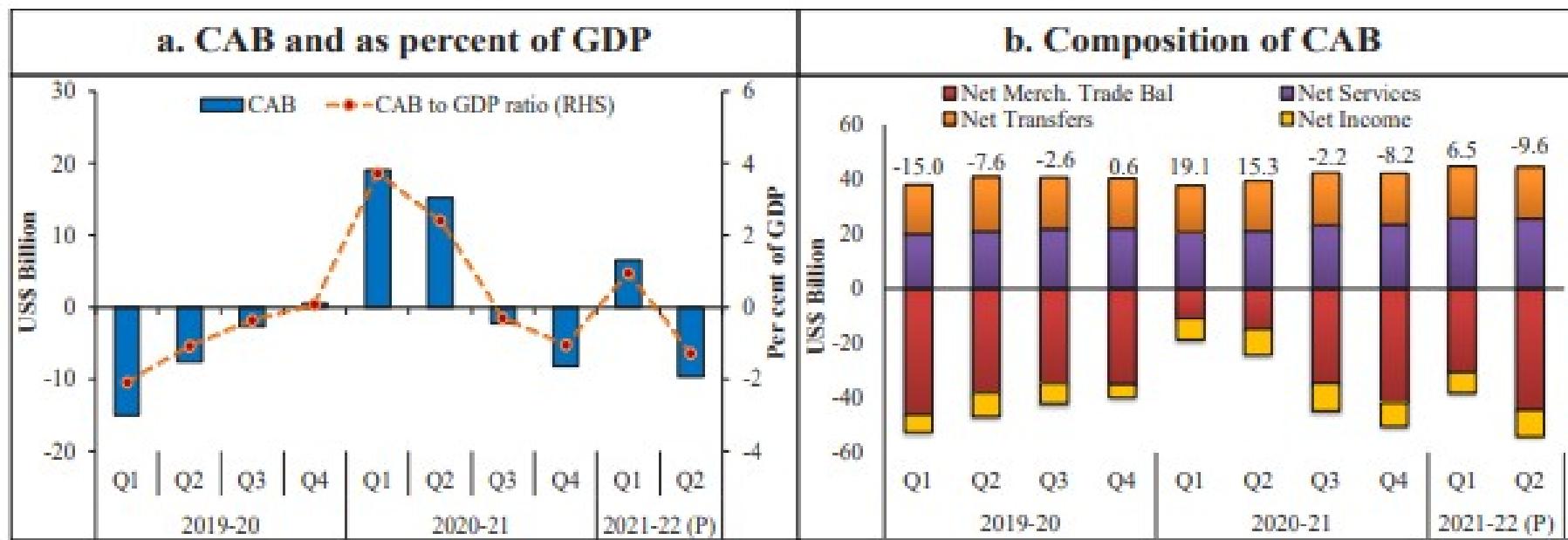


Figure 11: Remittances



India's BoP: Current Account

Figure 13: Current Account Balance (CAB)



India's BoP: Financial/Capital Account

Figure 15: Foreign Direct Investment

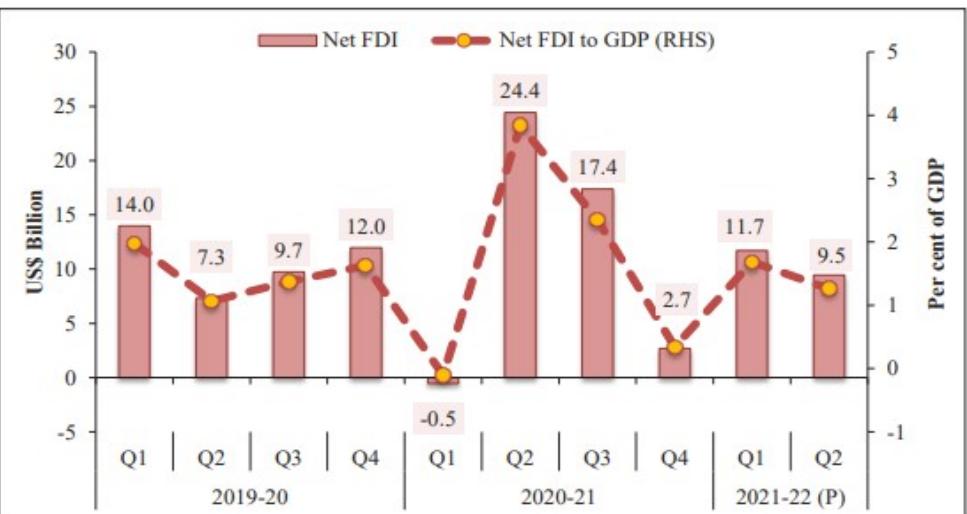


Figure 16: Foreign Portfolio Investment remained volatile

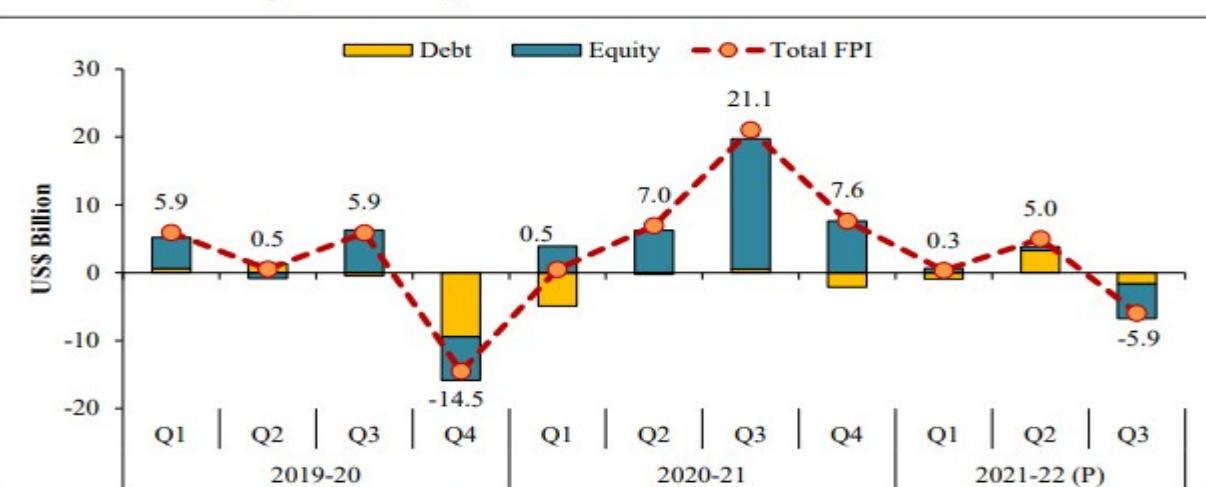
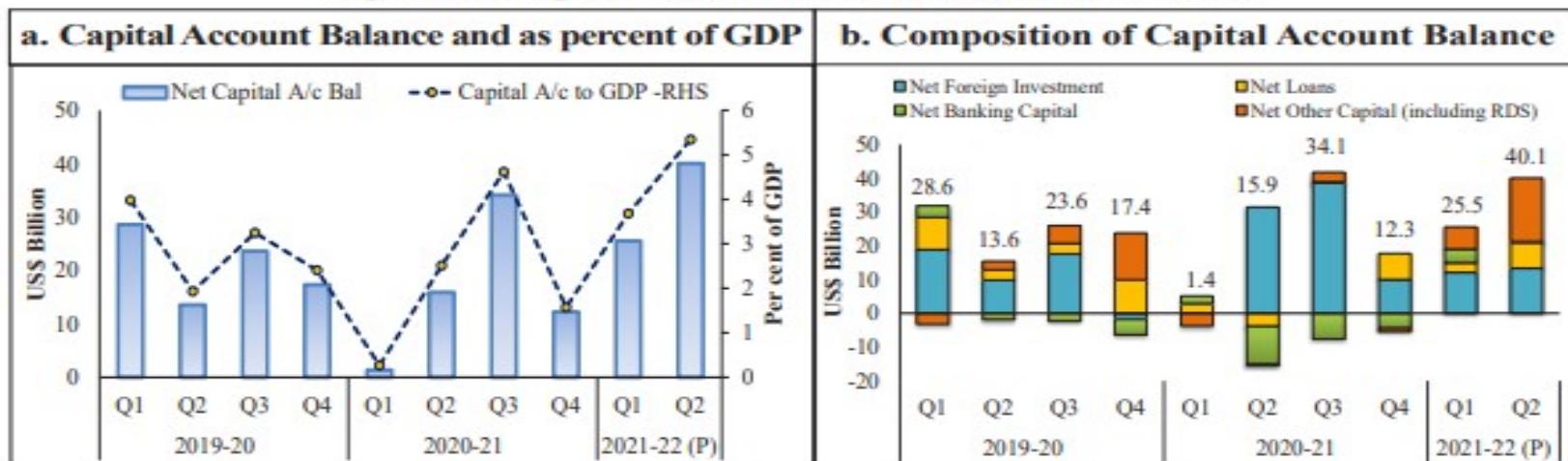
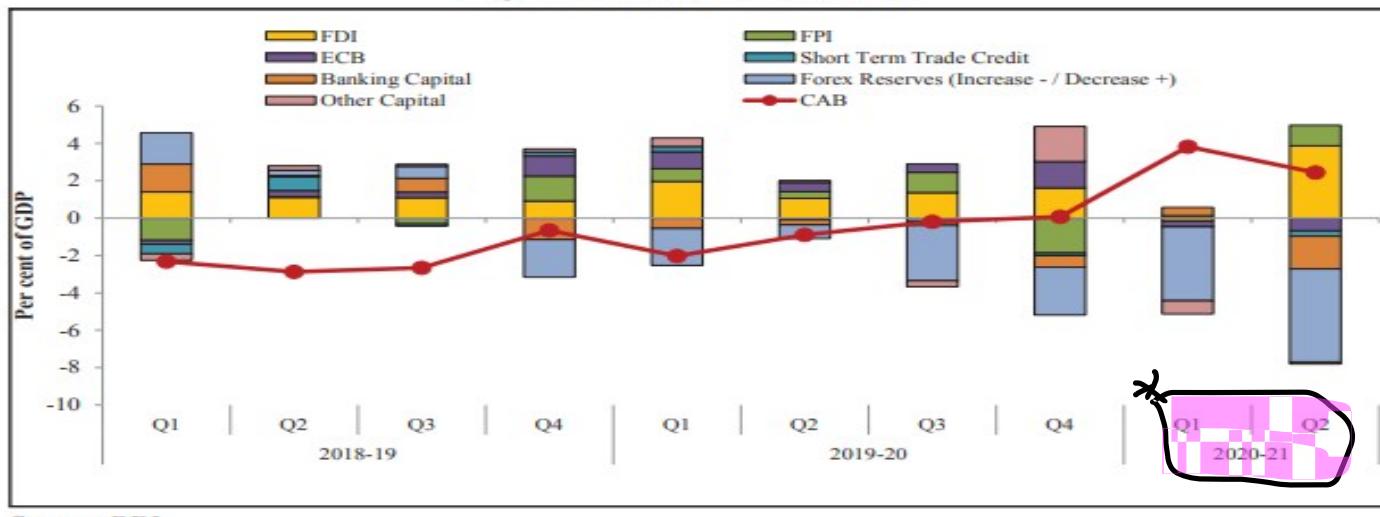


Figure 14: Capital Account Balance and its ratio to GDP



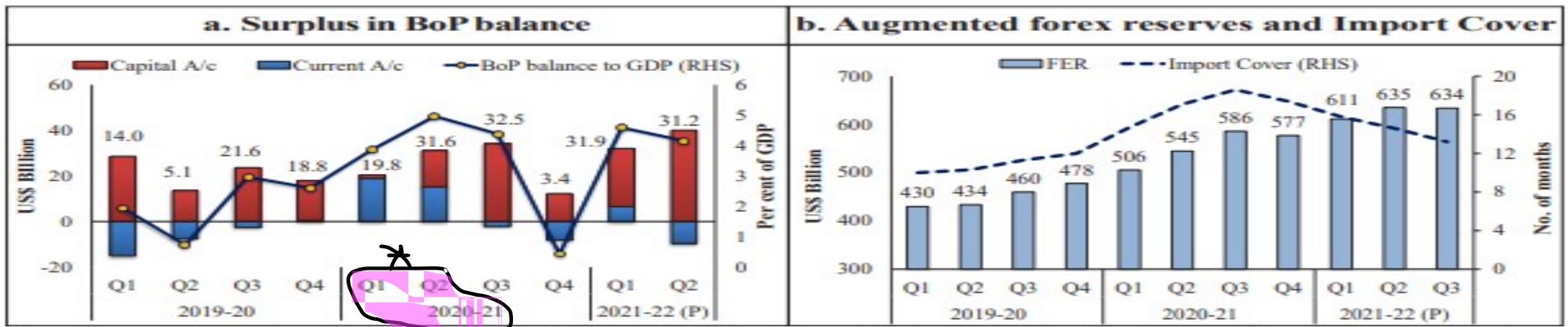
India's BoP: Overall

Figure 16: Trends in India's BoP



Source: RBI

Figure 17: Overall BoP Balance and Forex Reserves



Causes of Deficits?

- Demand side?

- Strong domestic growth
- Weak foreign growth/recession abroad
- Strong Exchange Rate

- Supply Side?

- Low investment
- Low productivity
- High relative inflation
- High labour costs
- Poor quality of exports
- Depletion of resources

*Dutch Disease?

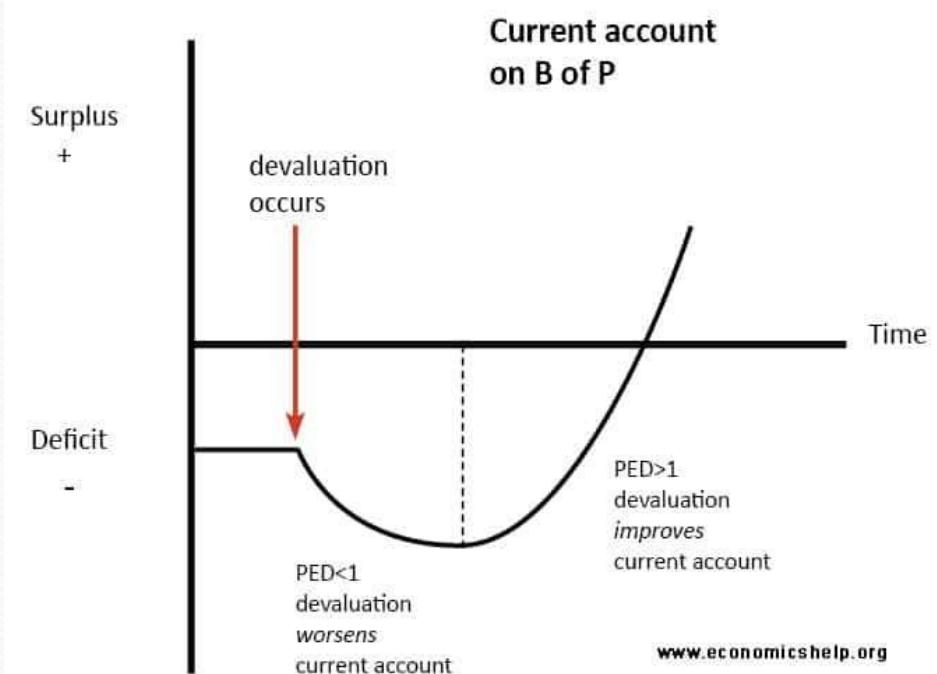
How to address Deficits? Identify the cause and recognise the side-effect

Central Reason: Higher Imports than Exports

- Cause: High Incomes at home | Policy: Demand Reduction
 - Action? – Contractionary fiscal or monetary policy
 - Consequence? – Reduction in output, employment, business confidence
- Cause: Cheaper Imports | Policy: Impose tariffs, Quotas
 - Consequence? Retaliation, Costly, Inflationary, WTO violation, Higher prices for consumers

How to address Deficits? Identify the cause and recognise the side-effect

- Cause: Strong Currency (Exchange Rates) making exports uncompetitive | Policy: Devaluation of ER, Domestic Subsidies to exports
 - Consequence? – Currency wars, Imports costlier, Elasticity of imports & exports- change w.r.t. currency (J Curve effect)

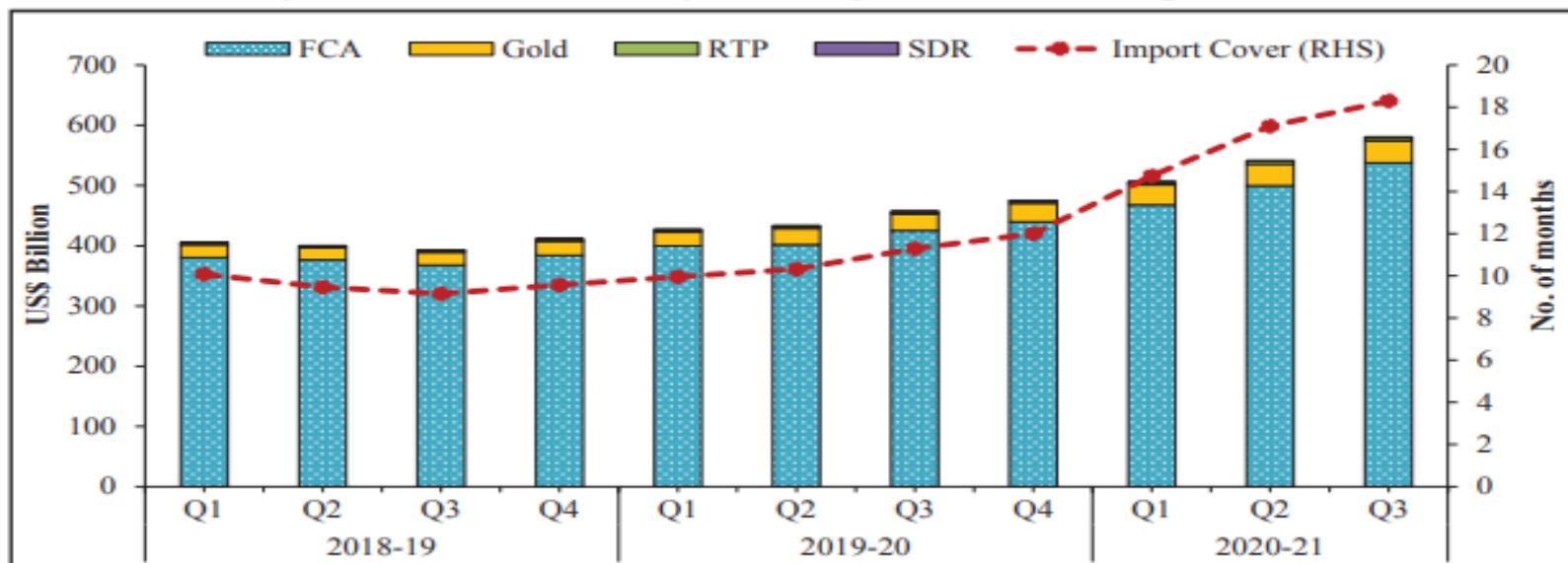


How to address Deficits? Identify the cause and recognise the side-effect

- Cause: Inefficiency, Supply side |
Policy: Supply side policy- investment
 - Consequence? Long term, costly, No guarantee of success
 - E.g. Building better infra, skilling workforce, quality checks (Zero Defect, Zero Effect), Production Linked Incentive Schemes

India's Forex Reserves

Figure 19: Sources of Foreign Exchange Reserves and Import Cover



Source: Reserve Bank of India (RBI).



India's top 5 trading partners



USA
11.3%*

China
10.9%*

UAE
7.3%*

Saudi Arabia
4.1%*

Hong Kong
3.7%*

India's top 5 imports

1. Crude petroleum
2. Gold
3. Petroleum Products
4. Coal
5. Coke and Briquettes

India's top 5 exports

1. Petroleum Products
2. Precious stones
3. Drug formulations and biologicals
4. Gold and precious metals
5. Iron and steel

*based on total percent of India's foreign trade

Overview of External Sector Eco Survey 2020-21

COVID-19 pandemic has triggered the worst global recession in 2020 since the Great Depression; the adverse economic impact is, however, expected to be lesser than initially feared. The resulting economic crisis has led to a sharp decline in global trade, lower commodity prices and tighter external financing conditions with varying implications for current account balances and currencies of different countries. Global merchandise trade is expected to contract by 9.2 per cent in 2020. Trade balance with China and the US improved as imports contracted. The changing nature of India's global trade manifested in terms of sliding exports of gems and jewellery, engineering goods, textile and allied products and improving exports of drugs and pharma, software and agriculture and allied products. Pharma exports, in particular, used this opportunity to enhance their share in total India's exports and indicate India's potential to be the pharmacy of the world. Supported by resilient software service exports, India is expected to witness a current account surplus during the current financial year after a gap of 17 years. Balance on the capital account, on the other hand, is buttressed by robust FDI and FPI inflows. These developments have led to accretion of foreign exchange reserves that rose to an all-time high of US\$ 586.1 billion as on January 8, 2021. RBI's interventions in forex market have been largely successful in controlling the volatility and one-sided appreciation of the rupee. High levels of headline inflation, however, posits the classical trilemma before RBI to maintain a fine balance between tightening of monetary policy to control inflation on the one hand and stimulate growth on the other hand. Against the aforesaid backdrop, various initiatives undertaken to promote exports, including Production Linked Incentive (PLI) Scheme, Remission of Duties and Taxes on Exported Products (RoDTEP), emphasis on improvement of trade logistics infrastructure and use of digital initiatives would go a long way in enabling 'ease of doing exports'.

Overview of External Sector Eco Survey 2021-22

External trade recovered strongly in 2021-22 after the pandemic-induced slump of the previous year, with strong capital flows into India, leading to a rapid accumulation of foreign exchange reserves. The resilience of India's external sector during the current year augurs well for growth revival in the economy. However, the downside risks of global liquidity tightening and continued volatility of global commodity prices, high freight costs, coupled with the fresh resurgence of COVID-19 with new variants may pose a challenge for India during 2022-23.

Owing to the recovery of global demand coupled with revival in domestic activity, India's merchandise exports and imports rebounded strongly and surpassed pre-COVID levels during the current financial year. The revival in exports was also helped by timely initiatives taken by Government. USA followed by UAE and China remained the top export destinations in April-November, 2021, while China, UAE and USA were the largest import sources for India. Despite weak tourism revenues, there was significant pickup in net services receipts during April-December, 2021 on account of robust software and business earnings, with both receipts and payments crossing the pre-pandemic levels.

India's current account balance turned into deficit of 0.2 percent of GDP in the first half (H1) of 2021-22, largely led by deficit in trade account. Net capital flows were higher at US\$ 65.6 billion in H1: 2021-22, on account of continued inflow of foreign investment, revival in net external commercial borrowings (ECBs), higher banking capital and additional special drawing rights (SDR) allocation. India's external debt rose to US\$ 593.1 billion as at end-September 2021, from US\$ 556.8 billion a year earlier, reflecting additional SDR allocation by IMF, coupled with higher commercial borrowings.

The robust capital flows were sufficient to finance the modest current account deficit, resulting in an overall balance of payments (BoP) surplus of US\$ 63.1 billion in H1 of 2021-22, that led to an augmented foreign exchange reserves crossing the milestone of US\$ 600 billion and touched US\$ 633.6 billion as of December 31, 2021. As of end-November 2021, India was the fourth largest forex reserves holder in the world after China, Japan, and Switzerland.

A sizeable accretion in reserves led to an improvement in external vulnerability indicators such as foreign exchange reserves to total external debt, short-term debt to foreign exchange reserves, etc. India's external sector is resilient to face any unwinding of the global liquidity arising out of the likelihood of faster normalisation of monetary policy by systemically important central banks, including the Fed, in response to elevated inflationary pressures.

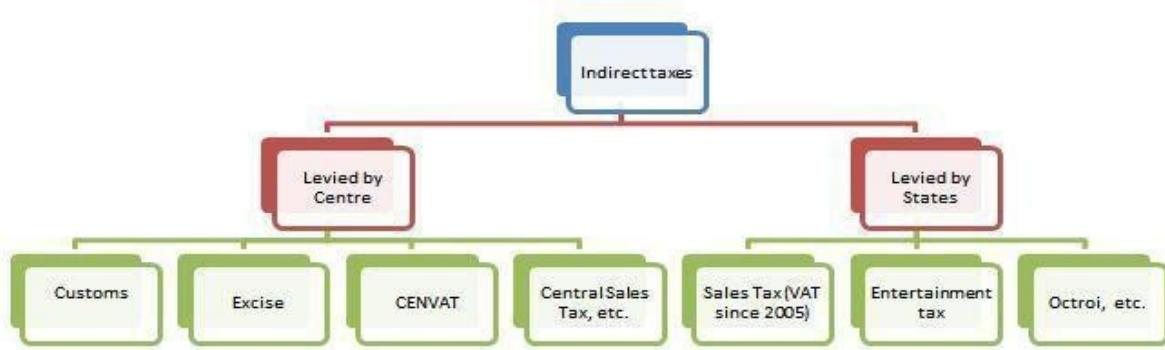
Goods and Services Tax

The Goods and Services tax came into effect from 1st July 2017 after the relevant bills were passed in the Parliament and the State legislatures. This explanation is structured in 3 parts: -

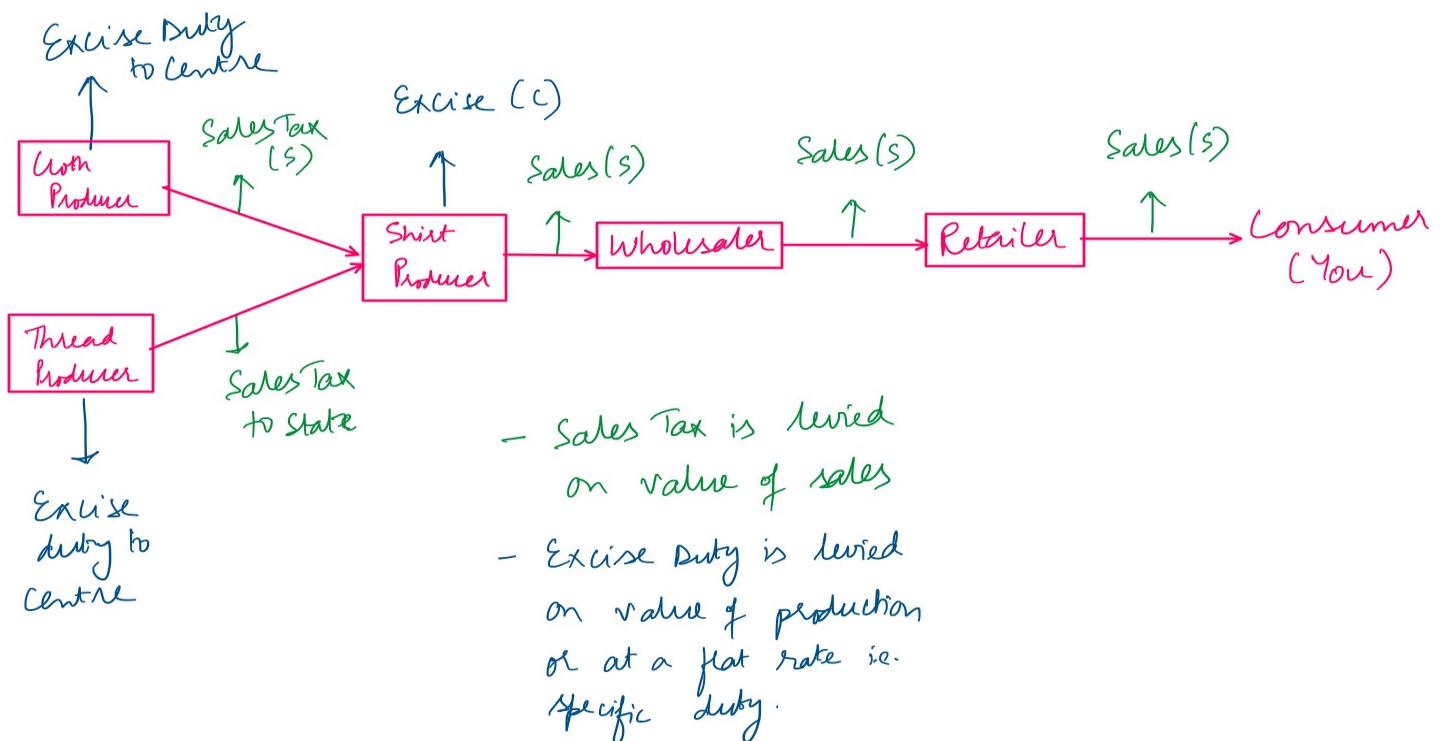
1. We understand the old system of indirect taxation.
2. We look at the problems in that system.
3. See how can those problems be addressed and overhaul the old system into a new one – GST.

Part 1: - The old system of indirect taxes (pre-2005)

Taxes are levied on events. A person responsible for causing that event has the responsibility to pay tax to the levying authority. For example, sale of a good or service, generation of income, change of international boundary, earning of profit by a company, etc. All these are events which are taxed by the government. The responsibility to pay tax i.e., deposit tax with the government, is always of the person on whom tax has been levied. In some cases, though, the person can rightfully collect the tax from someone else. In such cases, the tax is levied on A, and it will be A who will pay this to the government, but A can collect this tax from B, who actually bears the burden. Such taxes are indirect taxes. Centre, State and local bodies levy such indirect taxes, some of which are given below.



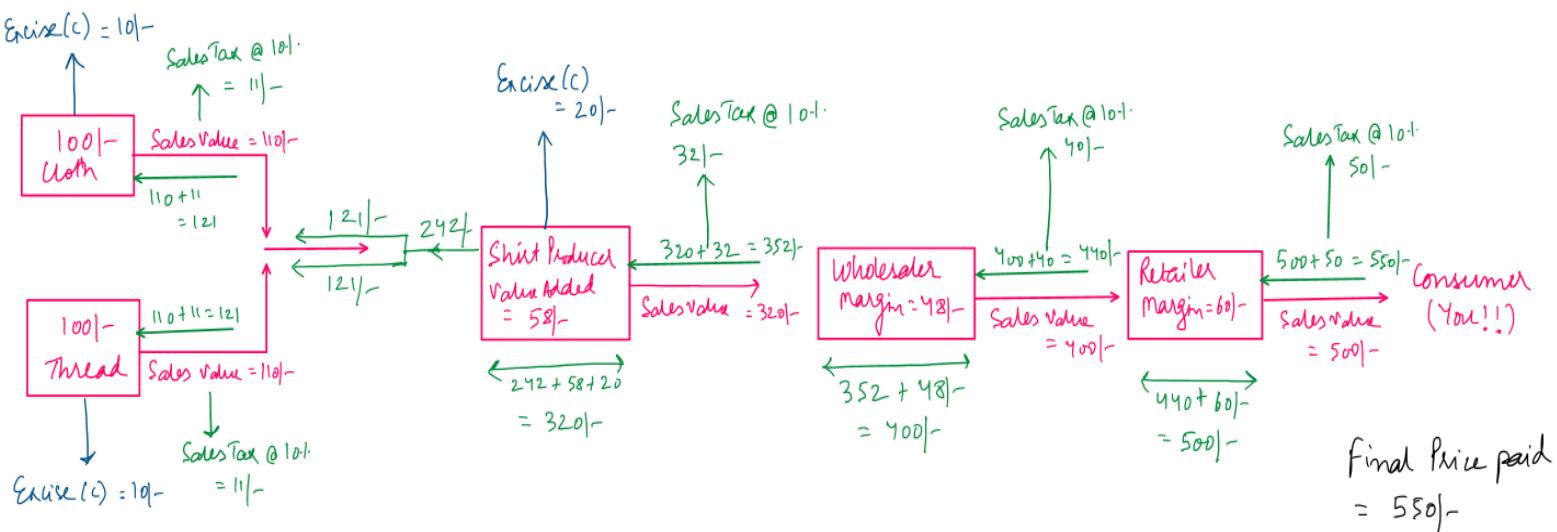
Here is an example of taxation in the old regime: -



Every producer pays excise duty to the Centre on production. On every sale, a sales tax is levied by the state government (it was later changed to VAT, more on that later). The wholesaler adds his margin (profit) and sells to the retailer, who in turn adds his own margin before selling it to the consumer. Again, a sales tax is levied at every sale instance. Also, if the sale is an inter-state sale, the State government cannot levy a sales tax, rather it is the Centre that levies a Central Sales Tax (CST*). Since all these are indirect taxes, they are ultimately borne by the consumer.

*CST - If the sale is from one state to another, the state government cannot levy a sales tax as this will distort the free movement of goods in course of inter-state trade. This is a constitutional requirement (Art 301-307). In order to compensate the selling state for loss of sales tax, the central government levies a Central Sales tax and transfers the entire amount to the selling state. In the following illustration, the taxation in old regime is explained through the production and sale of a shirt. A shirt producer buys 2 inputs, cloth and thread. Sale takes through the wholesaler and retailer, who add their own margins.

Example with numbers



Part 2: - The problem with the old system

If we observe the above flow chart closely, we will notice that the consumer is paying a very high price as compared to the cost of production. The total value added at different stages of production is Rs. 366 (100/- by cloth producer, 100/- by thread producer, 58/- by shirt producer, 48/- by Wholesaler, 60/- by the retailer). Whereas, the final value paid by the consumer is Rs. 550/-, which amounts to an effective tax of 33.5% (184/550). No wonder that no one would be ready to pay taxes by asking for bills from the seller. The problem is compounding of taxes – double taxation of the same value and a tax on tax. This is also referred to as cascading of taxes.

Let's see the tax paid at the stage of sale from Producer to Wholesaler. The sales value is Rs. 320/-, and at the rate of 10% Sales Tax, a Rs. 32/- tax is levied, which is collected by the producer from the wholesaler, taking the total amount paid by wholesaler to Rs. 352/-. Let's break it down-

$$Tax = 10\% \text{ of } 320$$

$$32 = 10\% \text{ of } (300 + 20 \text{ (Excise duty paid to Centre)})$$

$$32 = 10\% \text{ of } (242 \text{ (cost of inputs)} + 58 \text{ (value added by producer)} + 20 \text{ (Excise duty)})$$

$$32 = 10\% \text{ of } (121 \text{ (cost paid to cloth producer)} + 121 \text{ (cost paid to cloth producer)} + 58 + 20)$$

$$32 = 10\% \text{ of } (110 \text{ (value of sale)} + 11 \text{ (sales tax)} + 121 + 58 + 20)$$

$$32 = 10\% \text{ of } (100 \text{ (value recd. by Cloth producer)} + 10 \text{ (Excise Duty)} + 11 + 121 + 58 + 20)$$

$$32 = 10\% \text{ of } (100 + 10 + 11 + 100 + 10 + 11 + 58 + 20)$$

$$32 = (10 + 1 + 1.1) + (10 + 1 + 1.1) + (5.8) + (2)$$

So, the tax of Rs. 32 paid by the wholesaler to the producer consists of the following: -

1. A tax of Rs. 5.8 paid on the value added by the producer
2. A tax of Rs. 2 paid on the excise duty, itself a tax, on the excise duty paid by producer to Centre – A tax on tax.
3. A tax of Rs. 10 paid on value added by the cloth producer, which is a value that has already been taxed during the sale from cloth producer to the shirt producer. Similarly, Rs. 10/- on value added by the thread producer – A tax on value already taxed.
4. A tax of Rs. 1/- each paid on the excise duty of Rs. 10/- each paid by the cloth & thread producer to the Centre – A tax on tax.
5. A tax of Rs. 1.1/- each on the sales tax of Rs. 11/- levied on the sale transaction between cloth & thread producer and the shirt producer – A tax on tax.

Out of Rs. 32/- tax levied at this stage, only Rs. 5.8/- was on that value that had yet not been taxed. Rest, Rs. 26.2/- was either a tax on tax or a tax on value already taxed.

Part 3: - Correcting the old system

3.1 Introduction of VAT (2005)

Since 2005, sales tax in the states is levied on the Value added and not the entire value of sales transaction. This new way of levying sales tax was itself called VAT (Value added tax).

In case of Excise duty (Central Tax), the VATting system (levying a tax on value added and not on entire value) was already implemented in the 1980s. That tax was called CENVAT/MODVAT. Let us understand this VATting system.

Under the VAT system, only the value added at any stage is taxed, rather than the total value. The objective is to decrease the tax burden by making the taxation system fair, and thus increase compliance. In the above example, it would be a tax on Rs. 58/- only (=Rs. 5.8/-) during the sale from producer to wholesaler.

How would VAT be levied? For that we need to understand something called as Input Tax Credit (ITC). This system is based on taxable value at the previous (input) stage and the proof of tax paid on it, i.e., the bill, which is *offset* against the tax *to be paid* at the later (output) stage.

In the above example, the producer has already deposited a sales tax (called the VAT after 2005) on the value of his inputs, i.e., Rs. 11/- each to the cloth and thread producer. This 11/- is a proof that a tax on value of 110/- has already been paid, and as such, the tax that he has paid to the state government is reflected in his record with the government. If, and when, he sells the good in future, he would have to charge from buyer and pay to the government his VAT liability. From whatever tax liability on account of a sale transaction that arises for him in future (i.e., VAT), his account shows that he has paid Rs. 22/- already, and thus needs to pay only the additional amount, i.e., tax on the additional value only. This Rs. 22/- is the Input tax credit that he has received in his account, which he will use to offset the tax liability on his output.

Two very important points to keep in mind are: -

1. Tax is always charged on the entire value of transaction, not on the value added. How will the government know what is your value added? For all we know, the thread and cloth sellers may not have even deposited the tax collected with the government. Taxing the value added is the objective. It is achieved through the system of ITC. A tax will always be levied on entire value. We will levy it in such a manner that effectively only the value added is taxed.
2. The system of ITC and offsetting is available only for a tax against the same tax, not any other tax. ITC can be offset for VAT only against VAT, and not any other tax- neither Excise duty, which is a central tax, nor taxes like entertainment, luxury, octroi, etc. which are state taxes.

The government would always and always collect tax on the entire value of transaction. Only if the seller has ITC in his account with the government, would he be able to use it to offset. To achieve this, the seller would prepare a bill in which the value of transaction would be that of his inputs and value added only, and charge the customer according to that. Here is the comparison: -

Bills of Transaction between Producer and Wholesaler

<u>Old Regime</u> (pre - 2005)	<u>New Regime</u> (2005 - 2017)
Value of Sale = 320	Value of Input = 110 + 710 = 220/-
Sales Tax = 32/- @ 10%	Tax already paid = 22/-
<u>Total paid = 352/-</u>	Value Added = 58/-
	Excise paid = 20/-
	$\therefore \text{Value of Sale} = 220$ $\frac{58}{20}$ $\underline{298}$
	Sales Tax = 29.8/- ← Value charged by producer @ 10%
	<u>Total paid = 327.8/-</u> ← Value paid by wholesaler
	Tax paid by producer = 29.8 - 22 (ITC) = 7.8/- = 5.8 + 2 $(10.1\% \text{ of } 58) \quad (10.1\% \text{ of } 20)$ Value Added Excise duty

From the above illustration, both the benefits and shortcomings should be clear. To summarize: -

- The tax burden is substantially reducing as the taxable value is now much less than before.
- Entire cascading effect (tax on tax) is not eliminated because a VAT is being levied on Excise duty as well.

GST addresses this problem of cascading completely. It does so by removing all other events of taxation other than sale, so that they can be offset against each other.

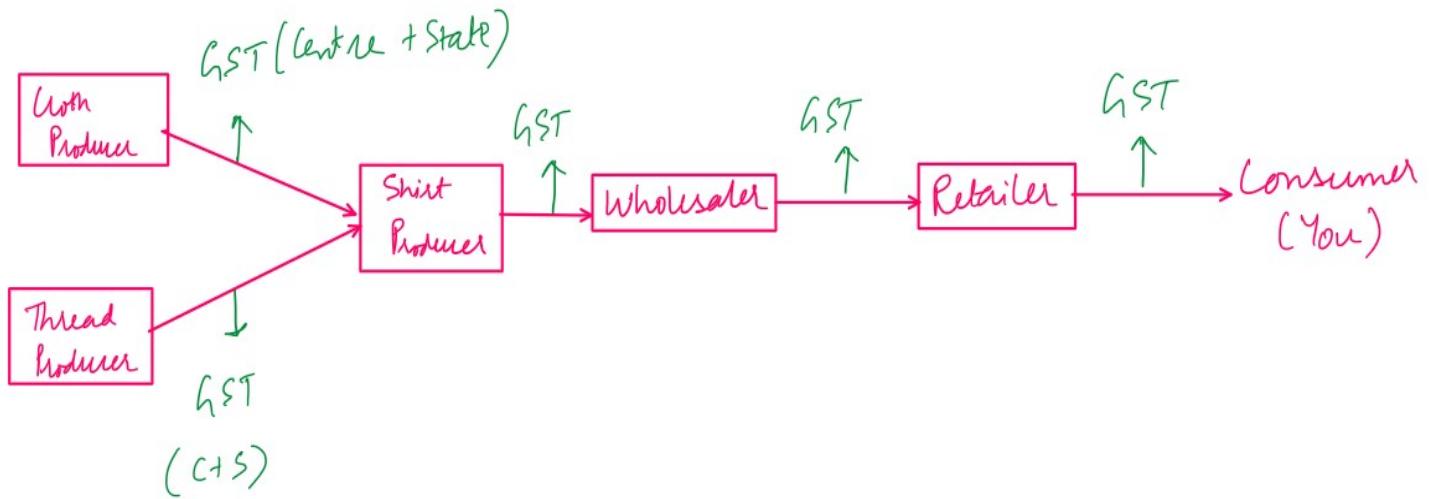
3.2 The GST system

If the above example seems complex, try adding other taxes in between. In case of inter-state sale, a Central Sales Tax (CST) is levied. Upon entry into a state, district or municipal bodies, various entry taxes/octroi are levied. There would hardly be a business in the country that is completely based out of one state. The supply chains run through various states, and thereby, are subject to multiple taxes. VAT of one state is not the same as other state and more importantly, is not offsetable against VAT paid in another state. Even VAT paid is not offsetable against other indirect taxes in the same state. Of course, a central indirect tax (such as excise) is not offsetable against a state tax or vice-versa. The VATting system of 2005 was merely a start. GST is the culmination of that process of integration of taxes to develop a fair, compliance incentivizing taxation system.

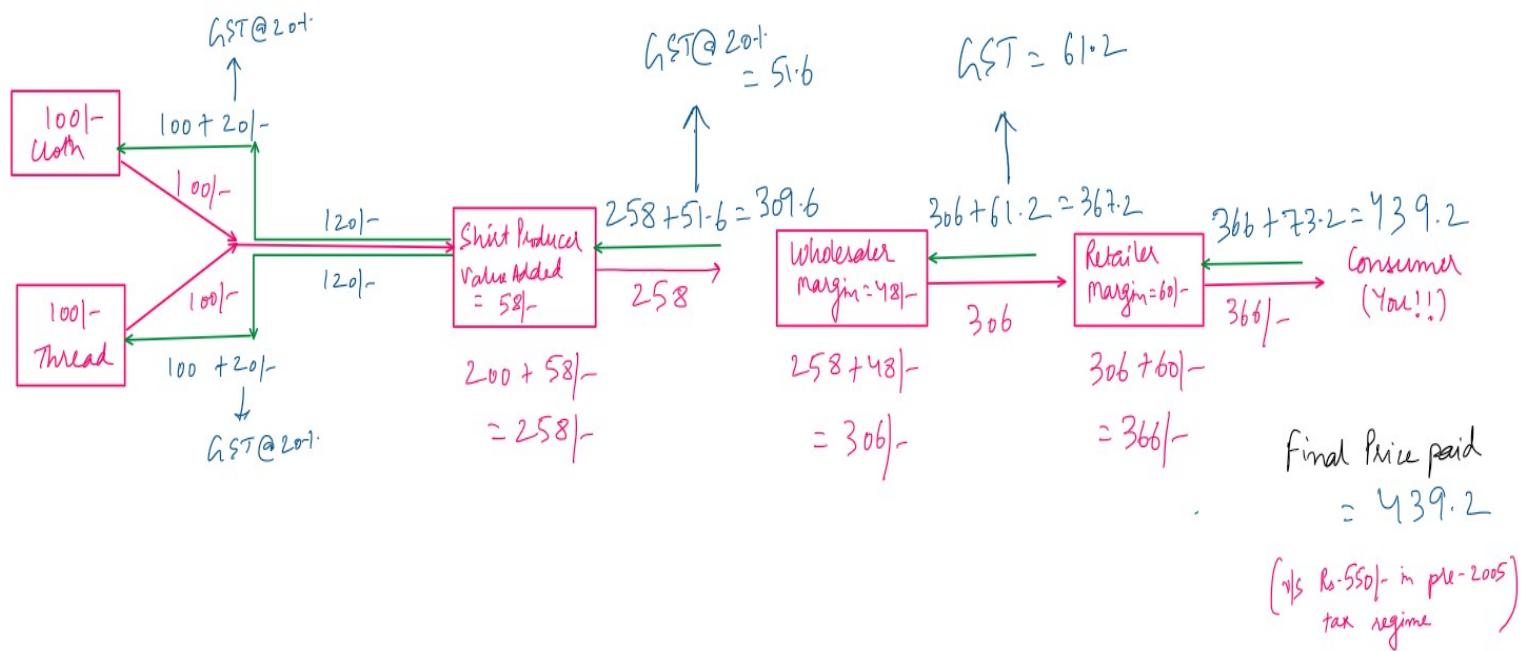
***A note on compliance** – Any law is only as good as it is complied with. A tax law needs to have low cost of compliance and a high cost of non-compliance in order to encourage and force people to comply with tax laws. Multiple events of taxation and multiple authorities associated with them create a complex system with high monetary and human costs of compliance. Further, such a complex system will have inherent coordination problem and therefore, catching a tax evader becomes systemically impossible. It is only a tax officer – the person, who catches the evader, not the system. As such, the cost of compliance is extremely high, and that of non-compliance is a low probability of getting caught and even then, the cost is usually the bribe paid to a person. It is the person who can be bribed, not the system. Since one is caught by the person, a tax officer, it is relatively ‘cheap’ to get away. I hope now you realize what is actually meant by the common rant that you come across- ‘Bribes have only gone up since the new system came into place’. Well, now it is the system that is catching the evader, not the person. So, the costs of non-compliance are naturally reaching the level of legal penalty, much more than the bribe paid in earlier times.

What is GST?

If you understood the VAT system above, understanding GST is very simple. GST is simply the wider application of the VAT system. It **removes all other events of indirect taxes** (**except Customs) and combines them into one single event – the sale of a Good or a service. Whenever a good is sold from one person to another, GST is levied, which is simply the VAT of the old system, i.e., sales tax levied in a Value-added manner. There is no other tax like the excise duty, central sales tax or entry/octroi, etc. A produces and sells a good to B, only GST is paid. B sells it to C and charges a tax on value added in the same manner as was described above.



Example with numbers :- Let GST be @ 20% (double the Sales Tax rate)



Net Tax Paid :

- ① By Cloth & Thread producer = $20 - 0 = 20/- = 20\% \text{ of } 100/-$
- ② By Shirt producer = $51.6 - 40 = 11.6/- = 20\% \text{ of } 58/-$
- ③ By wholesaler = $61.2 - 51.6 = 9.6/- = 20\% \text{ of } 48/-$
- ④ By Retailer = $73.2 - 61.2 = 12/- = 20\% \text{ of } 60/-$
- ⑤ By Customer = 73.2
 $= 20\% \text{ of Entire Value Added}$
 $= 20\% \text{ of } (100 + 100 + 58 + 48 + 60)$
 $= 20\% \text{ of } 366/-$

Statutory definition: - GST has been defined as any tax on supply of goods and services other than on alcohol for human consumption. It has three important properties:

- It has a one nation-one tax structure. This means it will subsume many indirect taxes like VAT, CST, Excise, Service tax, etc.
- It is a destination-based tax. This means the taxing authority is the place where goods are supplied to and not where the sale originates.
- It has a VAT like structure. This means that taxes paid at previous stages will be available as setoff at the subsequent stage.

Normally when you (the consumer) buy something, you will see two components of GST – Central and State. This is because when a sale is made within a State (say Tamil Nadu), GST will be shared between Center and the State. In case the sale takes place across two States, IGST (Integrated GST) will be levied. The revenue collected under CGST is for the Centre, while that collected under SGST is of the destination state. In order to ensure smooth operations, the goods & services to be taxed as well as other essential design features of the GST would have to be common between the Center and the States.

GST and its administration

GST will be administered by the **GST council**. It will be the apex policy making body consisting of Central and State ministers in charge of Finance. The Council will make recommendations on model GST laws, its rates, place of supply rules and any other matters relating to GST. Some commentators say that GST has led to surrender of financial sovereignty of States to the Center. This became visible during Covid times when States could not raise taxes by way of increasing their indirect taxes as they used to do earlier by raising rates of VAT on various items. Well, this is not just misrepresentation of truth but also a cunning reasoning to go back to the old, inefficient, tax-evasive, bribe-heavy, tax-terrorism days of a rent-seeking state. Yes, the states, earlier, had the right to tax transactions in their territory. Now it is both center and the states, *together*, through the GST council which will levy taxes. They have not surrendered their sovereignty, rather both the center and states have '**pooled their sovereign rights**' to streamline and better manage the taxation of goods and services in India. A streamlined administration, an easy compliance, a unified system of taxation throughout the country has truly created a better environment for doing business, paying taxes and led to reduction of tax burden on the consumer while increasing tax revenues for the government by widening tax base.

As yet (March 2022), petroleum and petroleum products, i.e., crude, high speed diesel, motor spirit, aviation turbine fuel and natural gas, are not subject to GST and shall be subject to it from a date to be notified by the GST Council. They continue to be under the earlier system. VAT and other input taxes paid on them cannot be offset against GST. It has also been decided that the area up to 12 nautical miles will be under Central administration. However, States can collect tax on economic activities carried therein. Stamp duties which are levied on legal agreements by states, will continue to be levied separately.

Benefits of GST?

The main benefit is that it is a simple to administer and thus, an efficient taxation system. In 2017, it was merely an expectation, in 2022, it is a reality that it has substantially increased compliance. The much wider and still growing tax base (users registered with GST) is a proof of this. In the low compliance system of the past, the honest tax payer was not only paying his own share, but also that of the evader.

As has been illustrated above, elimination of multiple events of taxation and their cascading effects has led to a reduction in price (*Refer anti-profiteering clause below). The system of input tax credit (ITC) which allows for offsetting of all indirect taxes paid at earlier stage is the biggest reform. Earlier, since central and state taxes were completely isolated from each other and were administered separately, there was no scope of offsetting taxes paid to the center or state against the other. Harmonization of center and state tax administrations would also reduce duplication of efforts and cut red-tape. Additionally, the new automated system of GSTN would reduce errors and ease up the return filing procedure.

Challenges in the GST system

Most important one is the multiple slabs of GST rates. In the current model, there are 5 rates of 0%, 5%, 12%, 18% and 28%. Besides, there are number of items such as raw agricultural produce which is zero rated and some luxury goods and those with negative externalities which attract a cess over and above the rate of 28%. This has made the system highly complicated. It is, though, important to see this complication in context.

In the earlier system, in order to comply with tax laws, a firm would have to do numerous filings with different departments of governments at all three levels (Centre, State, local). This meant not just higher overall monetary costs to simply remain compliant (i.e., not the tax cost, but filing cost), but also dedicating time and resources for compliance.

Imagine someone standing over your head and asking to simply submit a signed document every day. It won't take long for you to get fed up. The costs were so prohibitive that almost everyone chose *complete non-compliance*. In a system where not collecting and depositing tax with government could only be found out through random raids by tax officials, a businessman would take the chances of not being caught. And if, due to bad luck or sheer visibility of his business, was caught, then may choose to resort to bribe the inspector and even earn impunity for some time.

The new system is based on Input tax credit, which requires submitting an invoice. The total number of filings (GST Return filings such as GSTR-3B) a business would have to do have come down drastically, but anything is still more than Zero- the number of filings that a business was practically doing earlier. This is the reason for a random rant that you see by lazy commentators about GST- 'Oh the idea was good but implementation was shoddy'. Shoddy? Really? This is a below average disgruntled journalist trying to couch his/her mediocre sophistry.

A more ponderance worthy drawback of the system is lobbying and politicization. Many producers or service providers, especially in the food processing sector would want their products to be zero rated or so. This may give rise to unscrupulous classifications in order to escape taxation. The central government with its majority in GST council has been accused of enabling reduction of GST rates on items with an eye on elections.

An ideal GST system may be one that has just one flat rate on all items traded. But that would be a regressive taxation regime. The current multiple tax rates reflect progressive element in GST system with items of lesser value and necessity taxed at a 0 or 5% tax rate and items of higher value, luxury and demerit goods taxed at 18%, 28%, including Cess. A reform in the tax slabs is still desirable.

GST compensation to states

The states put a condition before agreeing to pool their constitutional rights together. They asked for compensation in the event of a shortfall. Whatever was a state's total revenue from indirect taxes pre-2017 was taken and an average nominal growth rate of 14% was decided, i.e., it was assumed that it would grow at the rate of 14% every year for next 5 years. Against this assumed collection in future, there would have been some actual collection once GST comes into force. The Centre agreed that if there would be any shortfall in State's revenues on account of implementation of GST, then the Centre would compensate the State to that extent till the next 5 years (i.e. till 2022). Mark the words – it is on account of shortfall *due to GST implementation* – if for e.g., the state itself is unable to do it, or if there is a pandemic, then Central government is not responsible for a compensation arising out of general shortfall. The GST compensation cess levied on luxury and demerit goods is for purpose of compensation. It was originally meant to go away in 2022. Thanks to Covid, it seems it's not yet going away.

Concept of Revenue Neutral rate

It is the tax rate that allows the government to *receive the same amount of revenue despite the change in tax laws*. In Pre-GST era, the total incidence of indirect tax in most of the states was about 30% (12% excise, 14% VAT and other taxes, depending on the good). Under the GST regime, if the average incidence of taxation comes out to be, say 20%, the government will lose out on revenue. However, the government also expects an increase in tax base, and thus, an increase in revenue on account of that. Therefore, pre-GST, the effort was to make sure that new tax rates are such that revenue of the government does not decrease. The average GST rate which ensures this is called revenue neutral rate. It is the rate at which tax revenue will remain the same, despite allowing input credits, exemptions, etc.

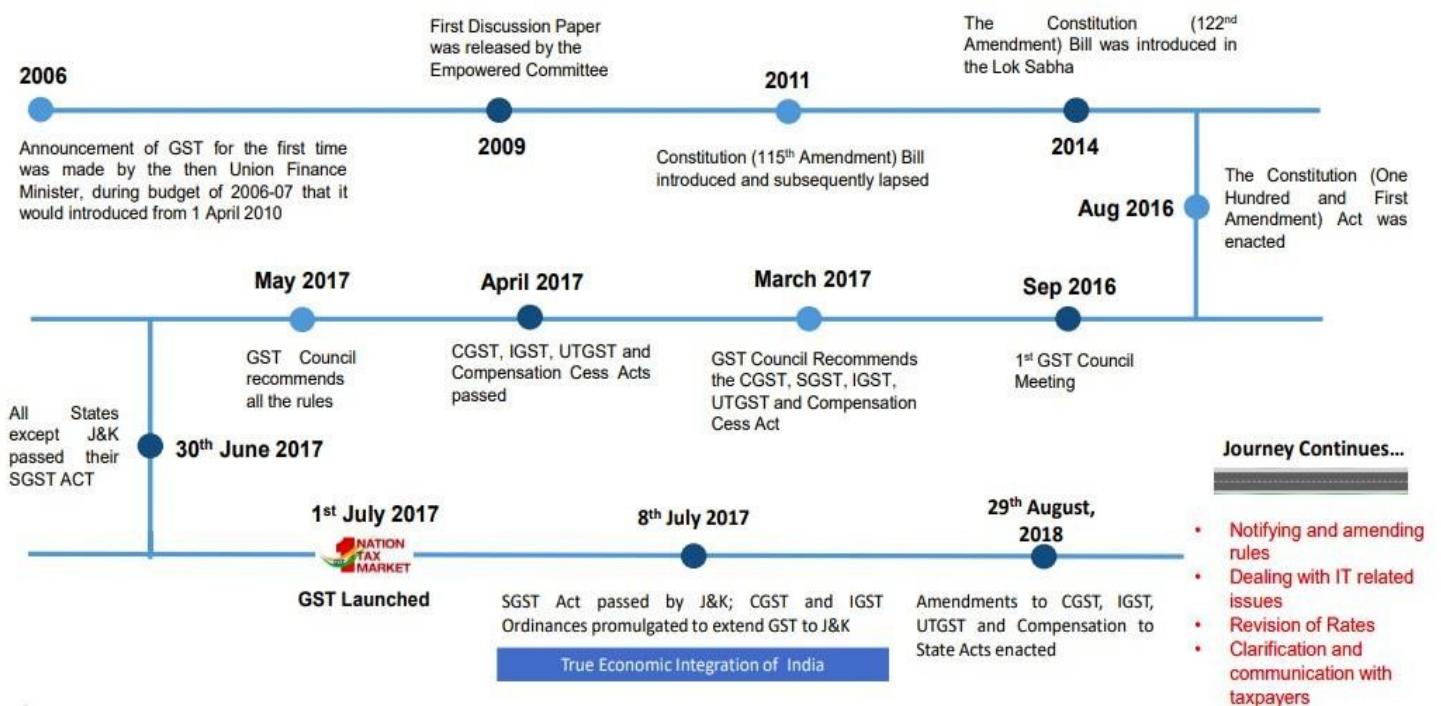
At the effective rate of 30% on 100/- rupees of actual value of output produced, if we were collecting only Rs. 10/- of tax, that would mean that we were able to tax only 33 rupees of the total value produced, i.e., $1/3^{\text{rd}}$ of GDP ($30\% \text{ of } 33 = 10$). In the new regime, if we are able to tax double the value, i.e., $2/3^{\text{rd}}$ of GDP, then, even if we levy a 15% tax, our tax revenue would not change ($15\% \text{ of } 66 = 10$). This is RNR.

Anti-profiteering clause

Look at the illustration above again. The buyer will only benefit if the seller charges a tax on him only on the value, not on the tax that he has paid. The GST system, with a much lower RNR (or average tax rates than earlier), should definitely make goods cheaper for the consumer. However, whether the consumer actually receives this benefit or not depends on the seller, who may try to profit off the consumer behaviour. The consumer is already paying a higher price. The seller may increase his own profit by increasing the price of good by the amount of reduction in taxes that the consumer would see. He may, not pass on the benefits. This is profiteering off the changes in tax system. GST law makes it illegal.

GST on international trade- Imports and Exports: - Since GST is a destination-based tax, exports would be zero-rated as the sale is not made in India. Zero rated does not mean exempt. They will be eligible for full duty drawback. Please note **customs duty is not part of GST**. Imports would attract tax in the same manner as domestic goods and services. They will be subjected to a basic customs duty when they enter the territory of India. After that, they will be subjected to IGST.

The Journey to GST



GST Law from a Constitutional Perspective (1/2)



Article 366(12A)

Definition of GST

“Goods and services tax” means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption

SI No	Definition	Article	Definition
1.	Goods	366(12)	Includes all materials, commodities, and articles [Pre Existing Definition]
2.	Service	366 (26A)	Anything other than goods [Introduced vide 101 st Constitutional Amendment Act]
3.	State	366(26B)	With reference to articles 246A, 268, 269, 269A and Article 279A includes a Union territory with Legislature. [Introduced vide 101 st Constitutional Amendment Act]

“Goods and Services tax” law while having unique principles, has significant elements of prior Central and State laws; and is also inspired by VAT/GST legislation of EU, Australia, Malaysia etc. along with International VAT/GST guidelines of OECD

- Notified as Constitution (101st Amendment) Act, 2016 on 08.09.2016
- Key Features:
 - o Concurrent jurisdiction for levy & collection of GST by the Centre & the States – Article 246A
 - o Centre to levy & collect IGST on supplies in the course of inter-State trade or commerce including imports – Article 269A
 - o Compensation for loss of revenue to States for five years on recommendation of GSTC – Clause 19
 - o GST on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas & aviation turbine fuel to be levied from a later date on recommendations of GSTC

GST Council – Constitution (Article 279A of the Constitution)

Chairperson – Union FM

Vice Chairperson - to be chosen amongst the Ministers of State Government

Members - MOS (Finance) and all Ministers of Finance / Taxation of each State Quorum is 50% of total members

Decision by 75% majority

States - 2/3 weightage and Centre - 1/3 weightage

Council to make recommendations on everything related to GST including laws, rules and rates etc.

Main Features of the GST Act

- Concurrent jurisdiction for levy & collection of GST by the Centre (CGST) and the States (SGST)
- Centre to levy and collect IGST on supplies in the course of inter-State supplies & on imports Compensation for loss of revenue to States for five years
- All transactions and processes only through electronic mode – Nonintrusive administration
- PAN Based Registration

- Registration only if turnover more than Rs. 20 lac (Rs. 10 lac for special category States except J&K)
- Option of Voluntary Registration
- Composition threshold shall be Rs. 100 lac
 - o Composition scheme shall not be available to inter-State suppliers, service providers (except restaurant service) and specified category of manufacturers
- Deemed Registration in three working days
- Input Tax Credit available on taxes paid on all procurements (except few specified items)

-The e-way bill system has been introduced nation-wide for all inter-State movement of goods with effect from 01.04.2018. As on 16.06.2018, all States and Union Territories have introduced e-way bill system for intra-state movement of goods

- Anti-Profiteering provision – National Anti-Profiteering Authority already set up
 - o Standing Committee on Anti-Profiteering already set up
- o State level Screening Committee already set up

What is composition levy under GST?

The composition levy is an alternative method of levy of tax designed for small taxpayers

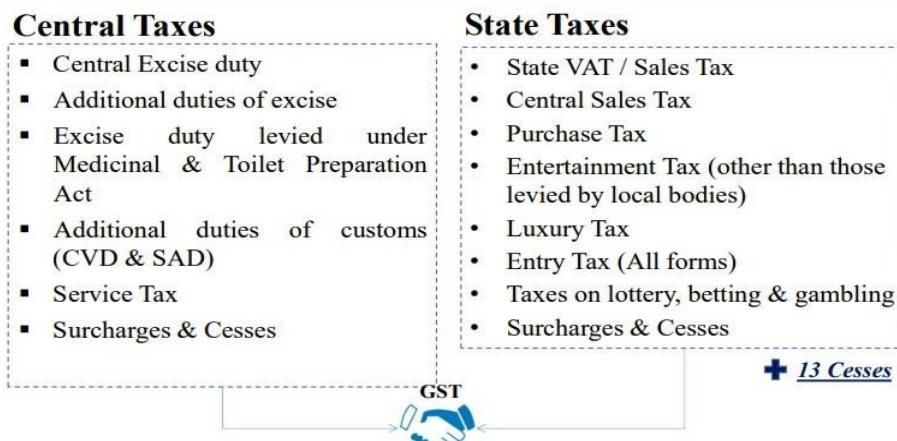
whose turnover is up to Rs. 75 lakhs (Rs. 50 lakhs in case of few States). The objective of composition scheme is to bring simplicity and to reduce the compliance cost for the small taxpayers. Moreover, it is optional and the eligible person opting to pay tax under this scheme can pay tax at a prescribed percentage of his turnover every quarter, instead of paying tax at normal rate.

Such persons need to electronically file **quarterly returns** in Form GSTR-4 on the GSTN common portal by the 18th of the month succeeding the quarter. For example return in respect of supplies made during July, 2017 to September, 2017 is required to be filed by 18th October, 2017.

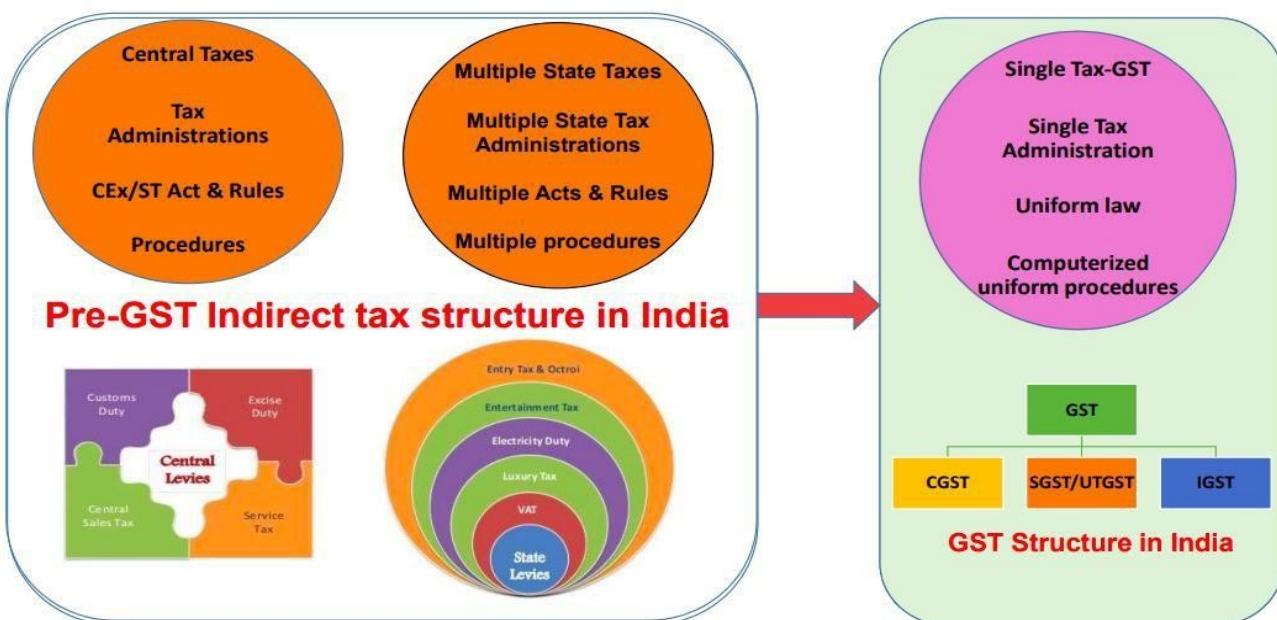
Goods and Service Tax Network

- Incorporated in March 2013 as Section 25 private limited company with paid up capital of Rs. 10 crore
- Equity Holders – Earlier Centre, State and private sector. Now completely government owned.
- To function as a Common Pass-through portal for taxpayers
 - o submit registration application
 - o file returns
 - o make tax payments
 - o Infosys appointed as Managed Service Provider (MSP)
 - o Appointed 73 GST Suvidha Providers (GSPs)

Pre-GST Indirect Tax Structure in India



Constitution amended to provide concurrent powers to both Centre & States to levy GST (Centre to tax sale of goods and States to tax provision of services)



Outside GST !



Alcohol for human consumption

Power to tax remains with the State



Five petroleum products – crude oil, diesel, petrol, natural gas and ATF

GST Council to decide the date from which GST will be applicable



Tobacco

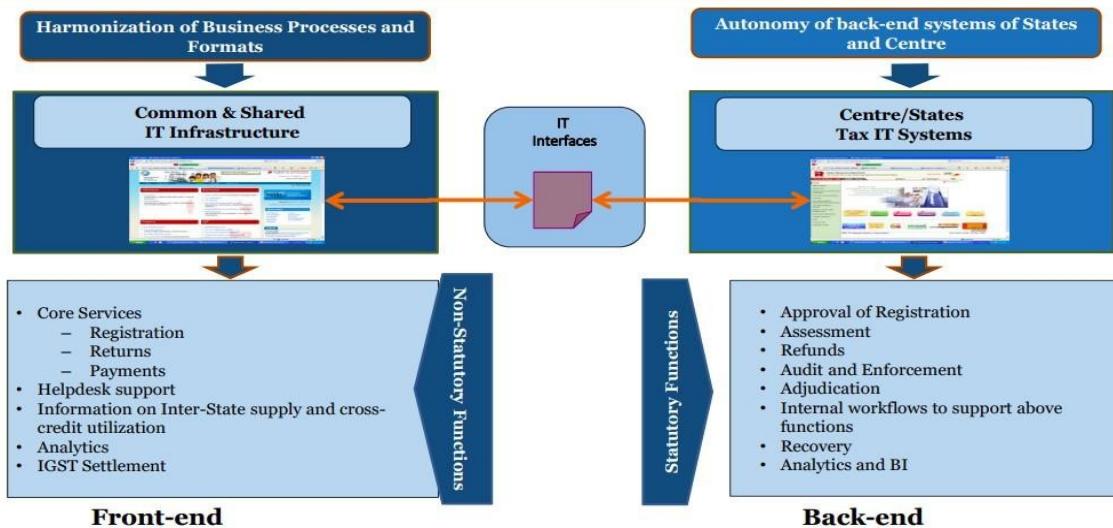
Part of GST but power to levy additional excise duty with Central Government



Entertainment tax levied by local bodies

Power to tax remains with local bodies

Goods and Service Tax Network (3/4)



Benefits of GST (1/2)



- 1 Reduction in Cascading of Taxes
- 2 Overall Reduction in Prices
- 3 Common National Market
- 4 Benefits to Small Taxpayers
- 5 Self-Regulating Tax System
- 6 Non-Intrusive Electronic Tax System

Decrease in Inflation

Ease of Doing Business

Decrease in “Black” Transactions

Benefits of GST (2/2)



- 7 Simplified Tax Regime
- 8 Reduction in Multiplicity of Taxes
- 9 Consumption Based Tax
- 10 Abolition of CST
- 11 Exports to be Zero Rated
- 12 Protection of Domestic Ind. - IGST

More informed consumer

Poorer States to Gain

Make in India

Economics

Government Budgeting & Fiscal Policy

Aditya Kalia

Brief Overview

-
- Government Budgeting – Techniques of Presenting and analysing budget
 - Components of Government Budget – Accounting for Revenue & Expenditure
 - Revenue and Capital Account classification
 - Plan - Non-Plan Classification
 - Deficits – Budget, Fiscal, Revenue, Effective Revenue
 - Taxes- Progressive/Rgressive; Direct/Indirect, Their types
 - Expenses- Central Sector, Central Assistance to states, Post 15th FC changes – Core scheme classification
 - Analytical part of Fiscal Policy – Debt Management and Debt Sustainability
 - Tax: GDP ratio – Tax Elasticity & Buoyancy, Laffer Curve, Tax Planning/Avoidance/Evasion

Government Budgeting

Line Item Budgeting

Simply presenting the items of expenditure. Maintain a list of items on which expense has been incurred. Pure accountancy concept. Does not convey much information about the objectives and their achievements.

E.g. For Health Department- 10Cr layout for vaccination of children under 5.

Performance Budgeting

Schemes/Programs are analysed based on their performance, i.e. efficiency – How much was budgeted, how much has been spent and were the targets met?

E.g. Out of 10 Cr. spent on vaccination, how many children were vaccinated? Budget for, say, all newborns v/s able to vaccinate only 50% of them

Outcome based budgeting

More than efficiency and output, outcomes are analysed- Does the expenditure achieve the ultimate objective for which it was laid out?

E.g. Vaccination received approval for expenditure to reduce child mortality. Did mortality of children come down after vaccination?

Government Budgeting

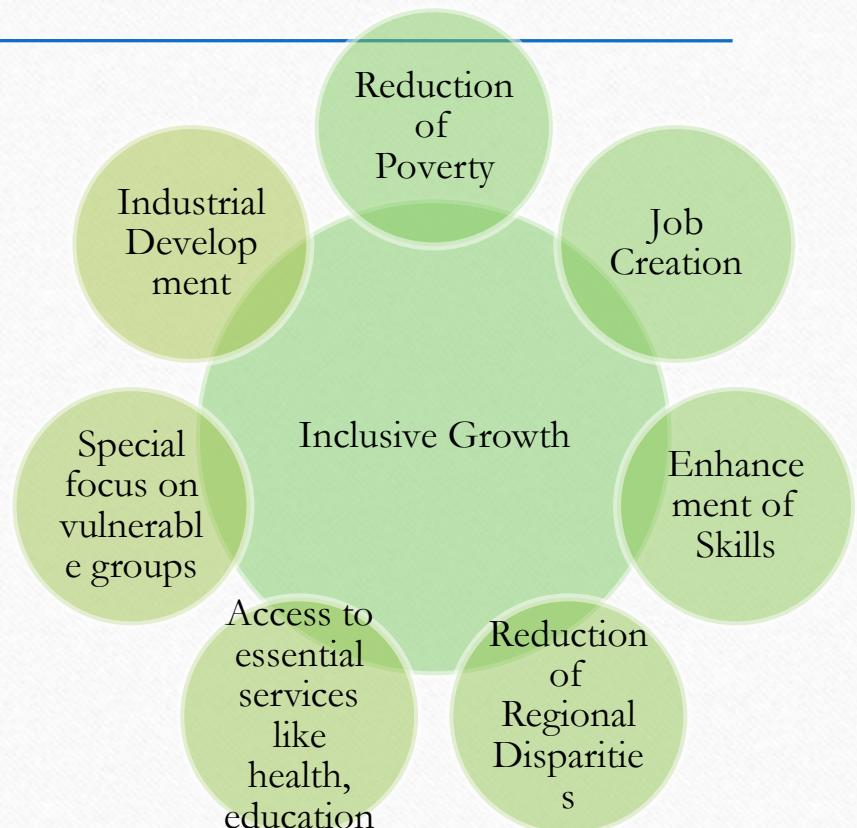
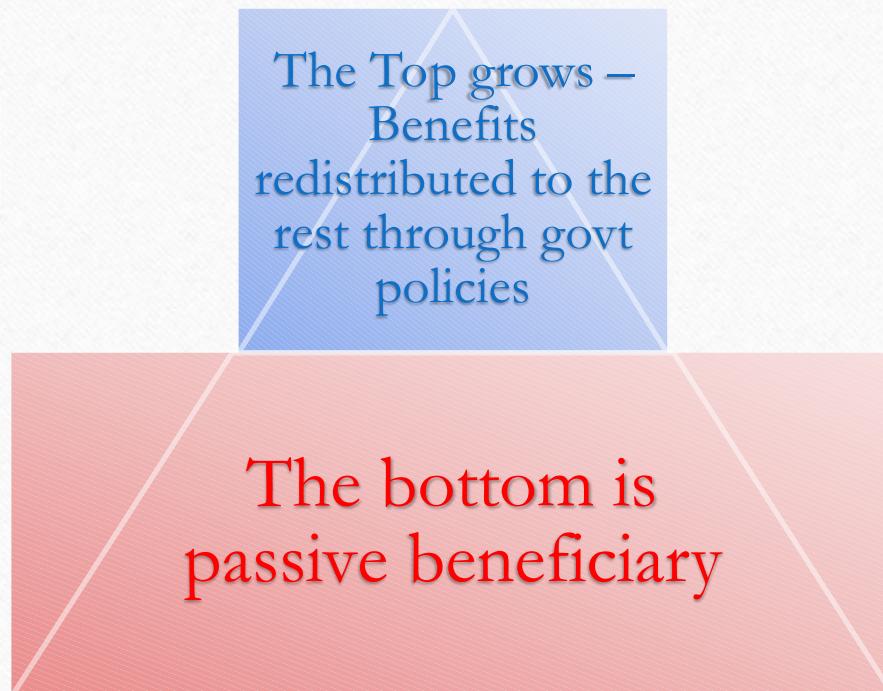
- Zero based Budgeting (ZBB) – Analysing every expenditure from base every year. Just because some scheme got allocation in a previous year does not mean that it will be continued and allocated new expenditure in subsequent year. It needs to be reanalysed every year afresh on its performance.
- Gender Budgeting (GB) – It is not simply a measurement of gender specific allocation in the budget. GB is analysing the budgetary allocation to various schemes from the point of view of differential impact that they will have on the basis of gender. It is gender incorporative analysis of budgetary allocations.

Objectives of the Government Budget

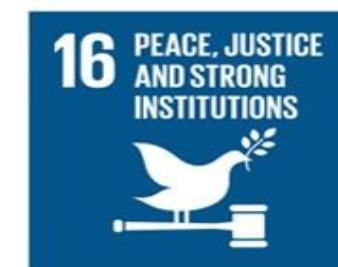
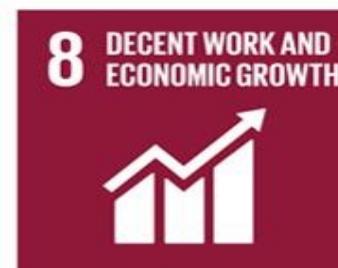
- Broadly, the government seeks to achieve the following from various aspects of Budget:-
 - Expenditure - Allocation function – allocation of public goods (non-rivalrous consumption)
 - Taxation - Distribution function – collecting taxes in a manner that a fair, equitable distribution of income can take place.
 - Extent of Expenditure and Taxes – The balance & the deficits – Stabilisation function – achieving a desirable level of inflation and creating conditions for growth.
 - These objectives themselves are not as important as the ways to achieve them. Budget is an exercise in which every government presents its vision and strategy to achieve these seemingly noble objectives.

Objectives of the Government Budget – Growth & Investment Models

Trickle Down Approach to Growth



Sustainable Development Goals



Investment Models

- Investment Models
 - Import Substitution
 - Harod- Domar Model – Savings, Investment & ICOR
 - Heavy industry led growth – Mahalanobis model:
 - Increasing investments
 - Directing public investments towards development of industries (Predominance of Public Sector in capital goods industry)
 - Import substitution for self-reliance
 - Elaborate system of controls and industrial licensing

Investment Models

- Export led growth
- Aatmnirbhar Bharat!
 - Schumpeter's model of economic transformation:
 - Growth from increase in factors of production - transition to industry from primary sector
 - Growth from increase in productivity of factors of production
 - Growth from invention of ways to increase productivity – Research & innovation led growth
- Public Private Partnership: - The need for Public-Private Partnership – thin spread of government resources and the need to include private sector in provision of those public goods which can be monetised.

Investment Models – PPP models

- 4 R to be decided for in any agreement:
 - Resources
 - Risks
 - Responsibilities
 - Rewards
- Some examples of standard PPP contracts:-
 - BOT contracts
 - EPC contracts
 - HAM based contracts
 - Swiss Challenge Model
 - Viability Gap Funding, etc.

Accounting in Government Budget

Constitutional requirement under Art 112 – To present before the parliament, a statement of *estimated* receipts and expenses of the govt for every financial year. This is the Annual Financial Statement, and the expenditure must distinguish expenses on Revenue account and other account.

- Revenue Acc. Budget and Capital Acc. Budget.
- Plan Budget and Non-Plan Budget (now abolished (since 2017) after recommendations of Rangarajan committee (2012))
- Railway budget was merged with general budget
- Date of presentation has now been preponed to 1st Feb

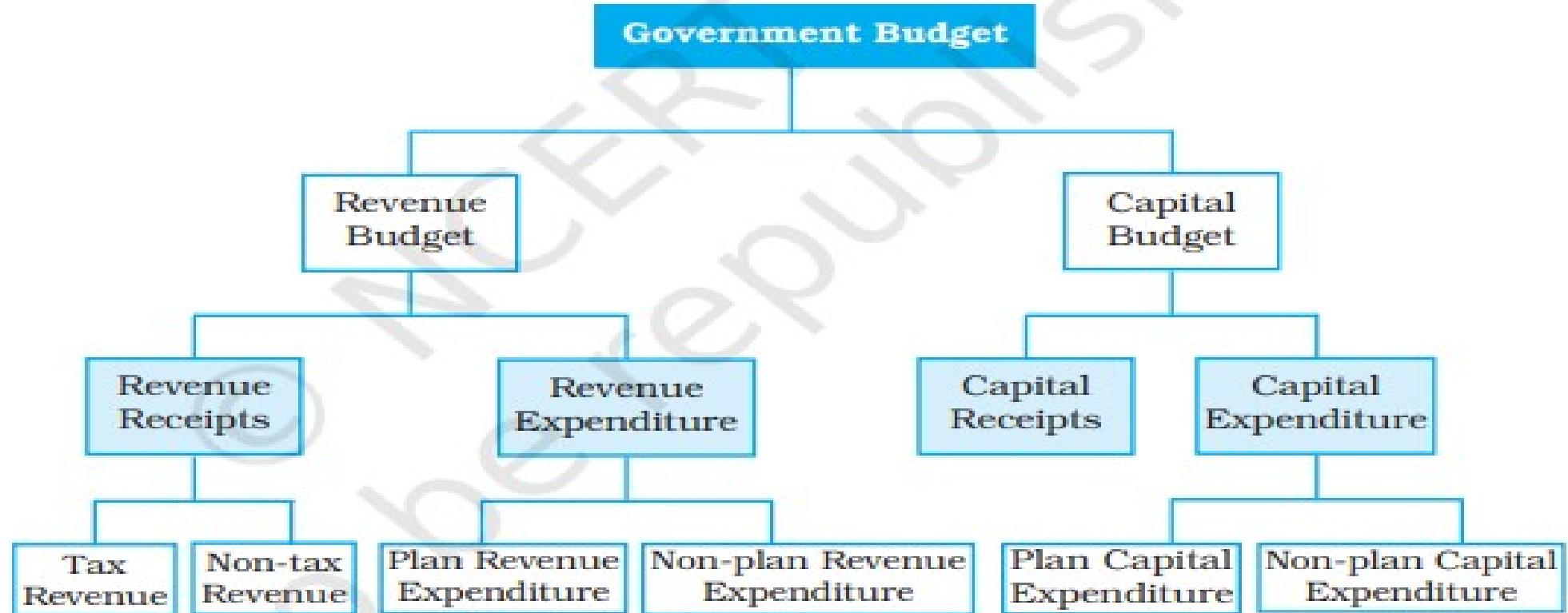


Chart 1: The Components of the Government Budget

Table 5.1: Receipts and Expenditures of the Central Government, 2012-13 (B.E.)

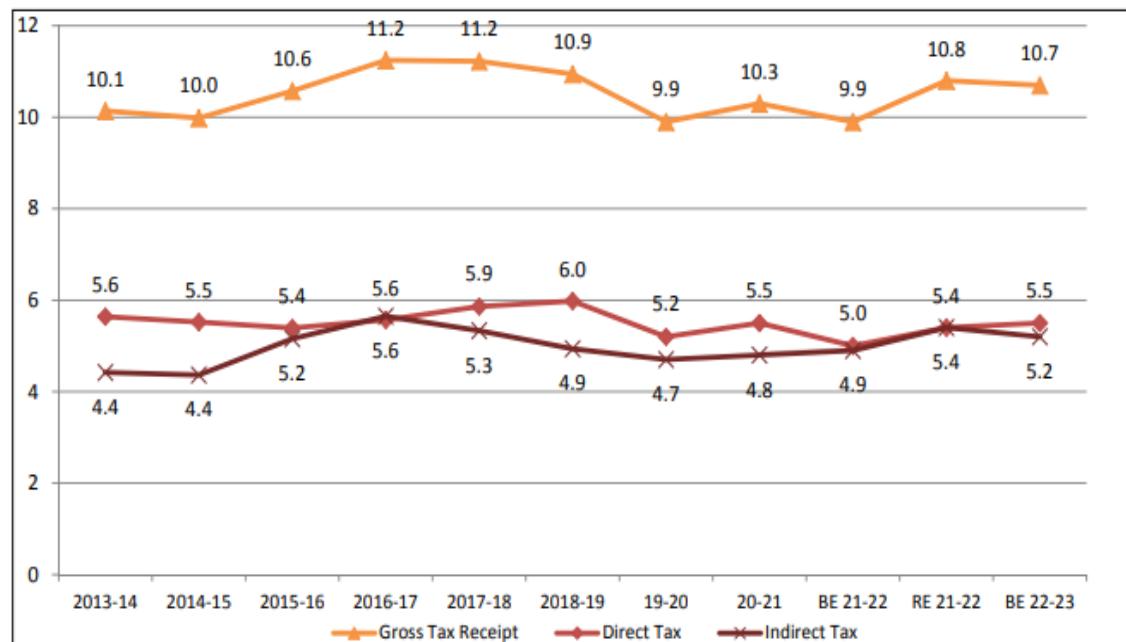
	<i>(As per cent of GDP)</i>
1. Revenue Receipts (a+b)	8.7
(a) Tax revenue (net of states' share)	7.3
(b) Non-tax revenue	1.4
2. Revenue Expenditure of which	12.3
(a) Interest payments	3.1
(b) Major subsidies	2.4
(c) Defence expenditure	1.1
3. Revenue Deficit (2-1)	3.6
4. Capital Receipts (a+b+c) of which	5.3
(a) Recovery of loans	0.2
(b) Other receipts (mainly PSU disinvestment)	0.3
(c) Borrowings and other liabilities	4.9
5. Capital Expenditure	1.6
6. Total Expenditure [2+5=6(a)+6(b)]	13.9
(a) Plan expenditure	4.1
(b) Non-plan expenditure	9.9
7. Fiscal deficit	4.9
8. Primary Deficit [7-2(a)]	1.8

प्राप्तियाँ Receipts

	(₹ करोड़) (In ₹ crore)					(₹ करोड़) (In ₹ crore)				
	2020-21 वास्तविक Actuals	2021-2022 बजट Budget Estimates	2021-2022 संशोधित Revised Estimates	2022-23 बजट Budget Estimates		2020-21 वास्तविक Actuals	2021-2022 बजट Budget Estimates	2021-2022 संशोधित Revised Estimates	2022-23 बजट Budget Estimates	
REVENUE RECEIPTS										
1. Tax Revenue										
Gross Tax Revenue	2027104	2217059	2516059	2757820		3. CAPITAL RECEIPTS				
a. Corporation Tax	457719	547000	635000	720000		A. Non-debt Receipts	57626	188000	99975	79291
b. Taxes on Income	487144	561000	615000	700000		(i) Recoveries of loans and advances@	19729	13000	21975	14291
c. Wealth Tax	12		(ii) Disinvestment Receipts	37897	175000	78000	65000
d. Customs	134750	136000	189000	213000		B. Debt Receipts*	1825479	1435428	1416902	1660444
e. Union Excise Duties	391749	335000	394000	335000		Total Capital Receipts (A+B)	1883105	1623428	1516877	1739735
f. Service Tax	1615	1000	1000	2000						
g. GST	548778	630000	675000	780000		4. Draw-Down of Cash				
- CGST	456334	530000	570000	660000		Balance	-7188	71383	174187	752
- IGST	7251		Total Receipts (1a+2+3)	3517025	3411853	3595813	3944157
- GST Compensation Cess	85192	100000	105000	120000						
h. Taxes of Union Territories	5336	7059	7059	7820						
Less - NCCD transferred to the NCCF/NDRF	5820	6100	6130	6400						
Less - State's share	594997	665563	744785	816649						
1a Centre's Net Tax Revenue	1426287	1545397	1765145	1934771						
2. Non-Tax Revenue										
Interest receipts	17113	11541	20894	18000						
Dividends and Profits	96877	103538	147353	113948						
External Grants	1752	747	1345	620						
Other Non Tax Revenue	90292	124671	141668	134276						
Receipts of Union Territories	1598	2531	2531	2807						
Total- Revenue Receipts (1a + 2)	1633920	1788424	2078936	2204422						

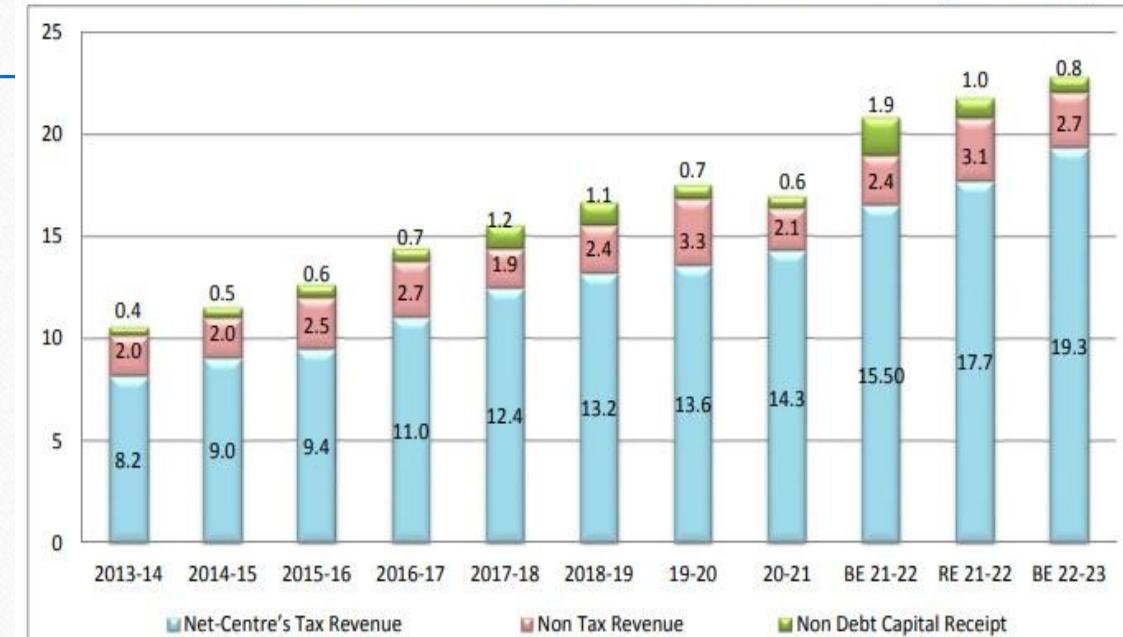
TREND IN TAX RECEIPTS

(% of GDP)



NET RECEIPT OF THE CENTRE

(₹ in lakh crore)



भारत सरकार का व्यय Expenditure of Government of India

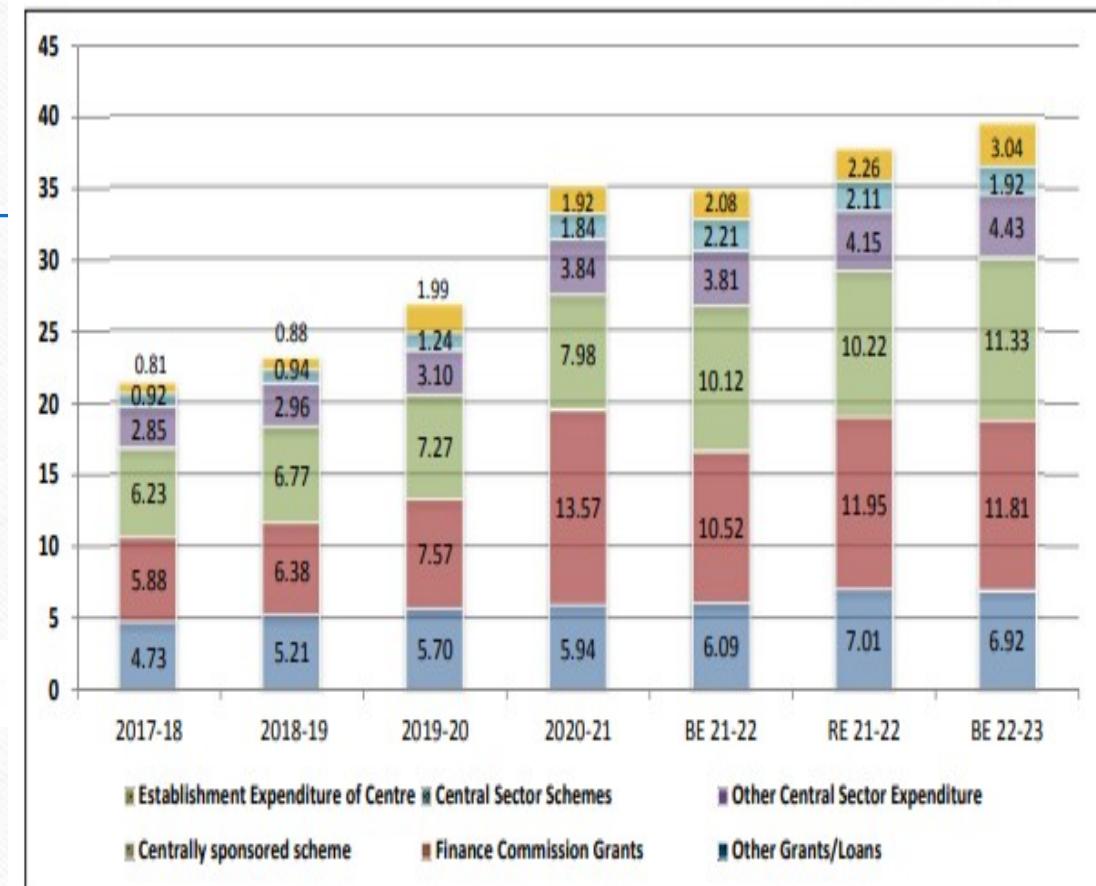
		(₹ करोड़) (In ₹ crore)			
		2020-2021 वास्तविक Actuals	2021-2022 बजट अनुमान Budget Estimates	2021-2022 संशोधित अनुमान Revised Estimates	2022-2023 बजट अनुमान Budget Estimates
क. केंद्र का व्यय	A. Centre's Expenditure				
I रथापना व्यय	I Establishment Expenditure	594449	609014	700541	692214
II केंद्रीय क्षेत्र की योजनाएं/ परियोजनाएं	II Central Sector Schemes/ Projects	1356817	1051703	1195078	1181085
III केंद्रीय क्षेत्र का अन्य व्यय जिसमें से ब्याज भुगतान	III Other Central Sector Expenditure <i>of which</i> <i>Interest Payments</i>	798274	1011887	1021631	1132813
		679869	809701	813791	940651
ख. अंतरण	B. Transfers				
IV केंद्रीय प्रायोजित योजनाएं	IV Centrally Sponsored Schemes	383976	381305	415351	442781
V वित्त आयोग के अनुदान	V Finance Commission Grants	184063	220843	211065	192108
VI अन्य अनुदान/ऋण/अंतरण	VI Other Grants/Loans/Transfers	192257	208484	226334	303908
कुल जोड़	Grand Total	3509836	3483236	3770000	3944909

सरकार का प्रभावी पूँजीगत व्यय Effective Capital Expenditure of the Government

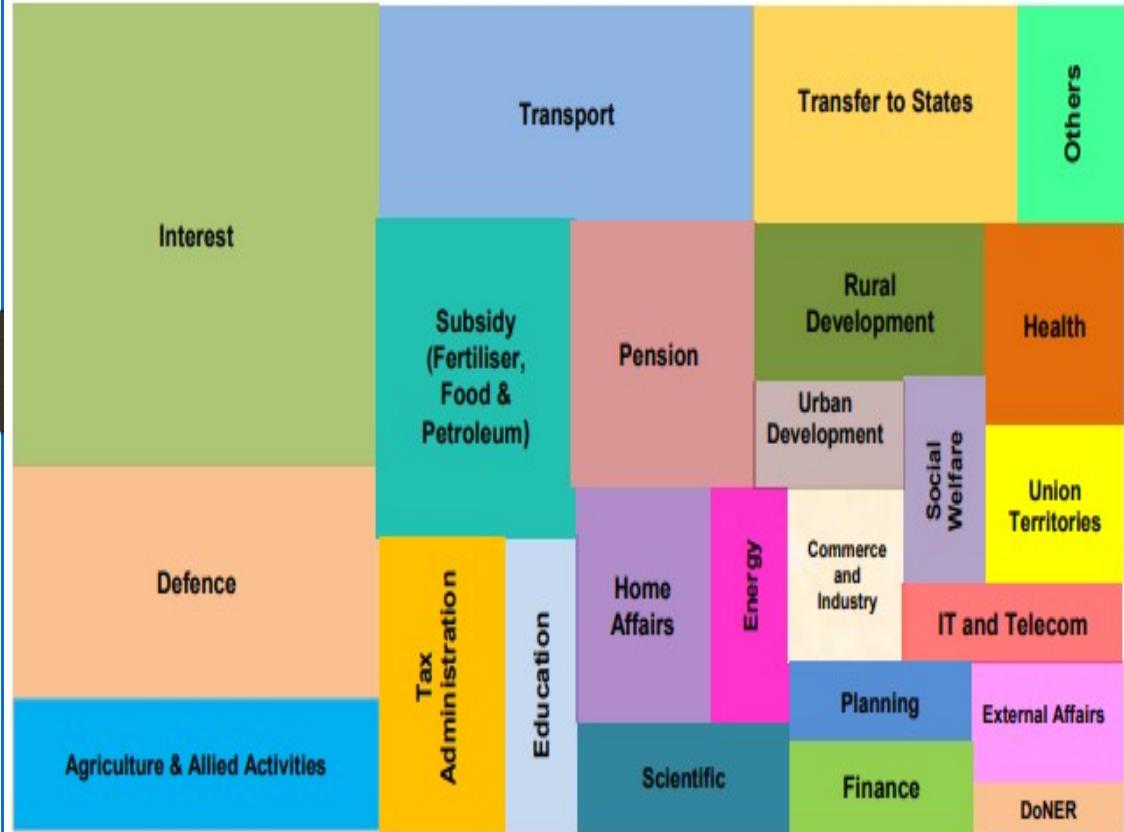
पूँजीगत व्यय ¹	Capital Expenditure ¹	426317	554236	602711	750246
पूँजीगत आस्तियों के सृजनों हेतु सहायता अनुदान ²	Grants in Aid for creation of capital assets ²	230865	219112	237685	317643
जोड़	Total	657182	773348	840396	1067889

COMPOSITION OF EXPENDITURE

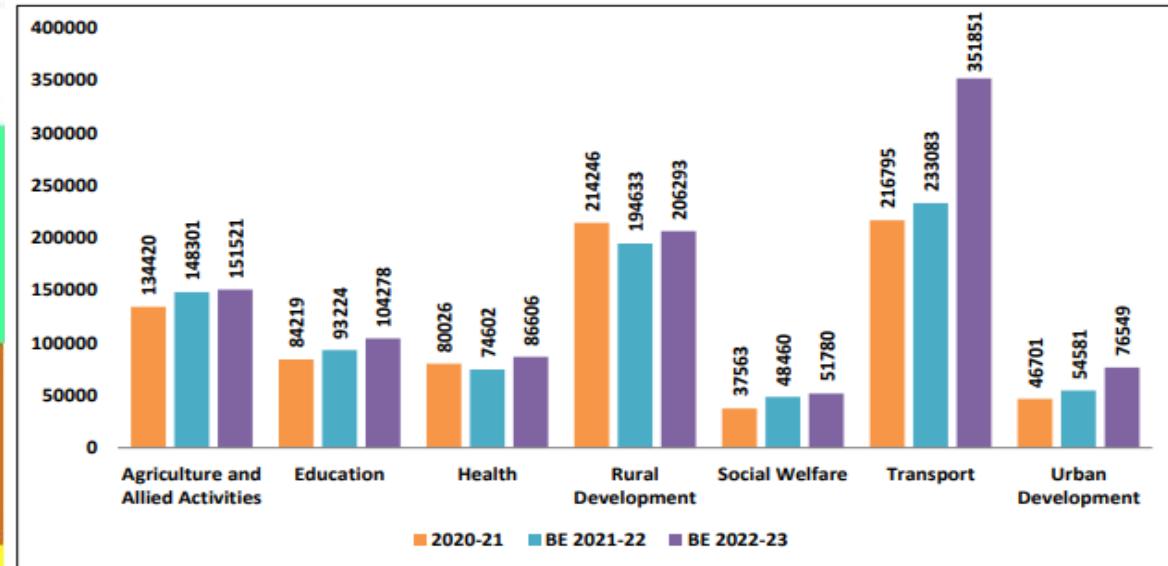
(₹ in lakh crore)



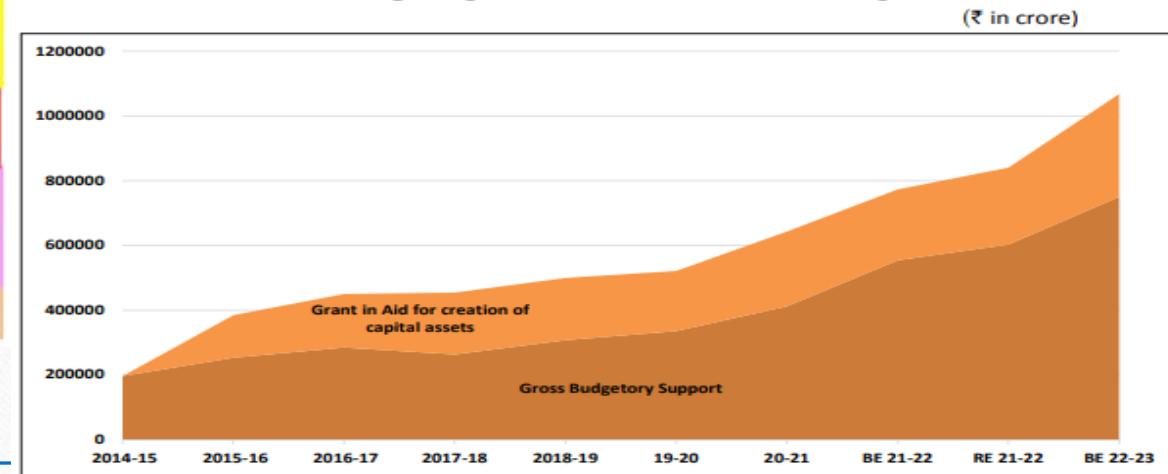
COMPOSITION OF EXPENDITURE



TREND OF MAJOR ITEMS OF EXPENDITURE

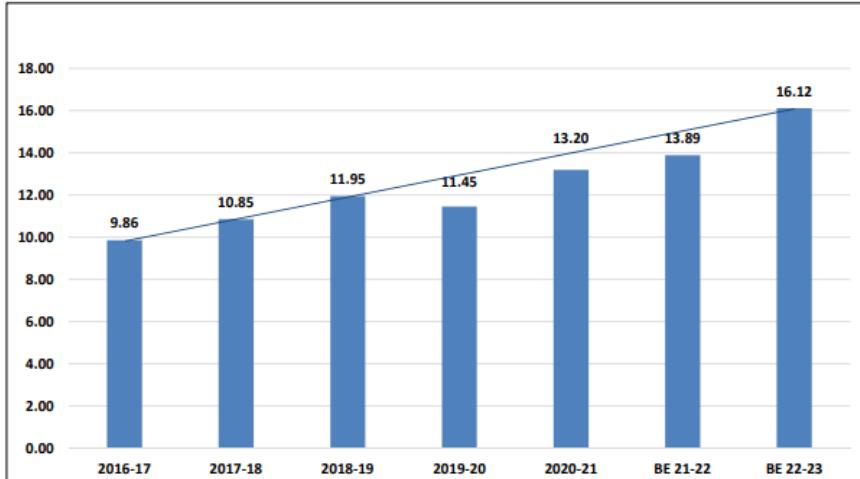


TREND OF CAPITAL EXPENDITURE



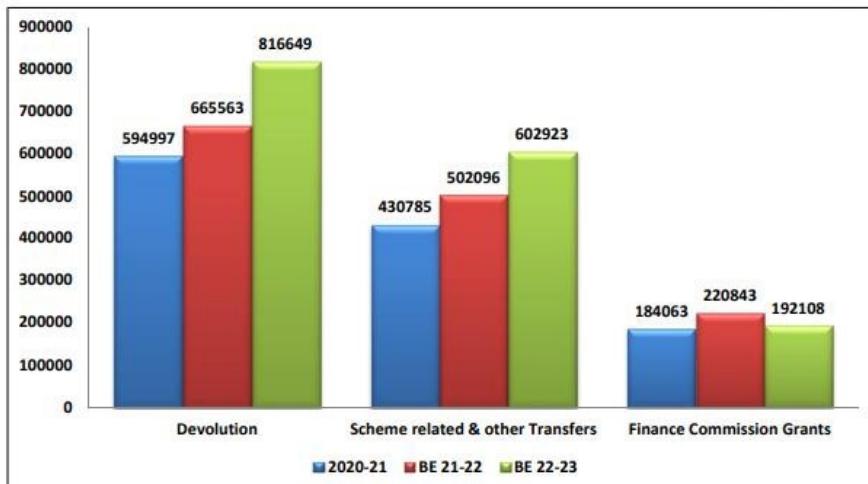
TOTAL TRANSFERS TO STATES AND UTs

(₹ in lakh crore)



COMPOSITION OF TRANSFERS TO STATES & UTs

(₹ in crore)



(₹ करोड़) (In ₹ crore)

	2020-2021 वार्षिक Actuals	2021-2022 संशोधित अनुमान Revised Estimates	2022-2023 बजट अनुमान Budget Estimates
I. Devolution of States share in taxes	594997	744785	816649
II. Some Important Items of Transfer	164873	221200	163710
1. Assistance to States from NDRF	8257	9000	10408
2. Back to Back Loans to States in lieu of GST Compensation Shortfall	110208	159000	0
3. Central Pool of Resources for North Eastern Region and Sikkim	197	405	0
4. Externally Added Projects - Grants	3431	4165	3722
5. Externally Aided Projects-Loan	26764	27000	32280
6. Schemes of North East Council	207	221	80
7. Schemes under Provision to Article 275(1) of the Constitution	800	750	1070
8. Special Assistance as Loan to States for Capital Expenditure	11830	15000	100000
9. Special Assistance under the demand - Transfers to States	1996	5000	15000
10. Special Central Assistance to Scheduled Castes under Demand-Department of Social Justice and Empowerment	387	0	0
11. Special Central Assistance to Tribal Area under the Demand - Ministry of Tribal Affairs	795	660	1150
III. Finance Commission Grants	184063	211065	192108
1. Grant for local bodies - Urban Bodies	26710	14614	22908
2. Grant for local bodies - Rural Bodies	60750	42623	46513
3. Grants for Health Sector	0	13192	13192
4. Grants-in-Aid for SDRF	22262	17747	18635
5. Grants-in-Aid for State Disaster Mitigation Fund	0	4437	4659
6. Post Devolution Revenue Deficit Grants	74340	118452	86201
IV. Total Transfer to States [Other than (I)+(II)+(III)]	325453	372829	383682
1. Under Centrally Sponsored Schemes (Revenue)	308306	326240	333086
2. Under Central Sector Schemes (Revenue)	16143	45123	49026
3. Under Other Categories of Expenditure (Revenue)	1003	1353	1466
4. Capital Transfers	2	113	103
V. Total Transfer to Delhi and Puducherry	50667	53476	55631
1. Under Centrally Sponsored Schemes (Revenue)	6874	8319	8500
2. Under Central Sector Schemes (Revenue)	1154	142	252
3. Under Other Categories of Expenditure (Revenue)	42639	45015	46879
4. Capital Transfers	0	0	0
Total Gross Transfer to States/UTs	1320053	1603356	1611781

Centrally Sponsored Schemes

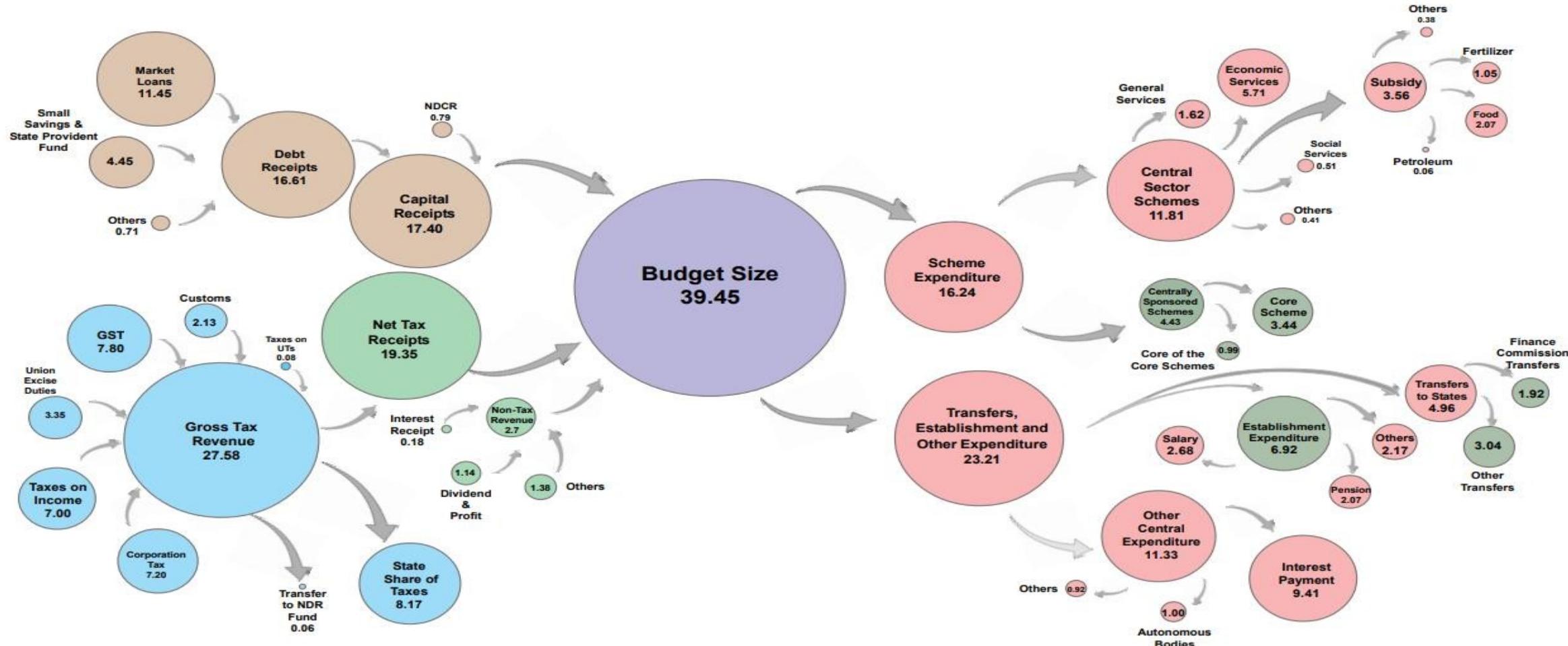
		(₹ करोड़) (In ₹ crore)			
	वार्षिक Actuals	बजट अनुमान Budget Estimates	संशोधित अनुमान Revised Estimates	बजट अनुमान Budget Estimates	
(A) Core of the Core Schemes					
1	Mahatma Gandhi National Rural Employment Guarantee Program	111170	73000	98000	
2	National Social Assistance Program	424443	9200	8730	
3	Umbrella Programme for Development of Minorities	1298	1564	1374	
4	Umbrella Programme for Development of Other Vulnerable Groups	1671	2140	1930	
5	Umbrella Programme for Development of Scheduled Tribes	3172	4303	3798	
6	Umbrella Scheme for Development of Schedule Castes	5876	6566	7322	
(B) Core Schemes					
7	Pradhan Mantri Jan Arogya Yojna (RSBY)	2681	6401	7500	
8	Blue Revolution	709	1015	1210	
9	Border Area Development Programme	64	566	222	
10	Environment, Forestry and Wildlife	552	766	670	
11	Green Revolution	9748	13408	8889	
12	Infrastructure Facilities for Judiciary	599	784	778	
13	Jai Jeevan Mission (JJM)/National Rural Drinking Water Mission	10998	50011	45011	
14	Jobs and Skill Development	3682	3482	2753	
15	Modernisation of Police Forces	2057	2803	3346	
16	National Education Mission	28088	34300	30796	
17	National Health Mission	37478	37130	34947	
18	National Livelihood Mission-Ajeevika	10025	14473	12505	
19	National Programme of Mid Day Meal in Schools	12878	11500	10234	
20	Pradhan Mantri Awas Yojna (PMAY)	40260	27500	47390	
21	Pradhan Mantri Gram Sadak Yojna	13688	15000	14000	
22	Pradhan Mantri Krishi Sinchay Yojna	7877	11588	12706	
23	Rashtriya Gram Swaraj Abhiyan (RGSA)	567	661	682	
24	Shyama Prasad Mukherjee Rurban Mission	369	600	375	
25	Swachh Bharat Mission	995	2300	2000	
26	Swachh Bharat Mission (Gramin)	4945	9994	6000	
27	Urban Rejuvenation Mission: AMRUT and Smart Cities Mission	9754	13750	13900	
28	ASPIRE (Accelerating State Education Program to Improve Results)	14100	
29	Development Programmes	...	1177	1394	
30	Exemplar	
31	India COVID-19 Emergency Response and Health System Preparedness Package(Phase-II) (DBS) (CSS)	12359	
32	Krishionnati Yojana	7183	
33	Mission Shakti (Mission for Protection and Empowerment for Women)	...	3109	2121	
34	Mission VATSALYA (Child Protection Services and Child Welfare Services)	...	900	830	
35	Pradhan Mantri Ayushman Bharat Health Infrastructure Mission (PMABHIM)	585	
36	Pradhan Mantri Poshan Shakti Yojna (PM POSHAN)	4177	
37	Prime Minister Formalisation of Micro Food Processing Enterprises Scheme (PM FME)	395	500	399	
38	Rashtriya Krishi Vikas Yojna	900	
39	Revision of norms for Central Assistance released to States/UTs for meeting expenditure on intra-state movement, handling of foodgrains and FPS dealers margin under NFSA	10433	
40	Saksham Anganwadi and POSHAN 2.0 (Umbrella ICDS - Anganwadi Services, Poshan Abhiyan, Scheme for Adolescent Girls)	6572	
41	Strengthening Teaching-Learning and Results for States (STARS)	92	20105	20000	
				20263	
				550	

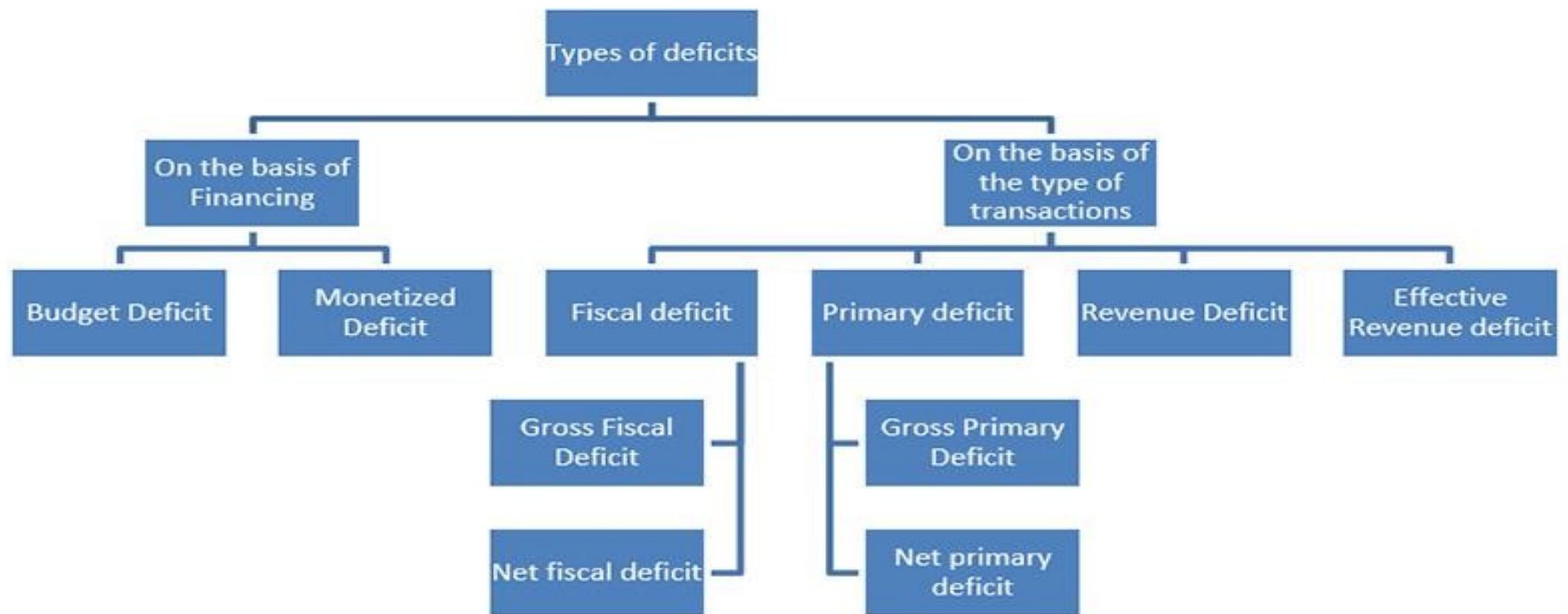
Central Sector Schemes

- Market Intervention Scheme (MIS) and Price support scheme
- PM-KISAN
- Crop Insurance Scheme
- Interest Subvention Scheme
- NBC
- BARC
- Ayushman Bharat
- FAME India
- Khelo India
-many more

(₹ लाख करोड में)
(In ₹ lakh crore)

बजट की रूपरेखा BUDGET PROFILE





राजकोषीय घाटा वित्तपोषण के स्रोत *Sources of Financing Fiscal Deficit*

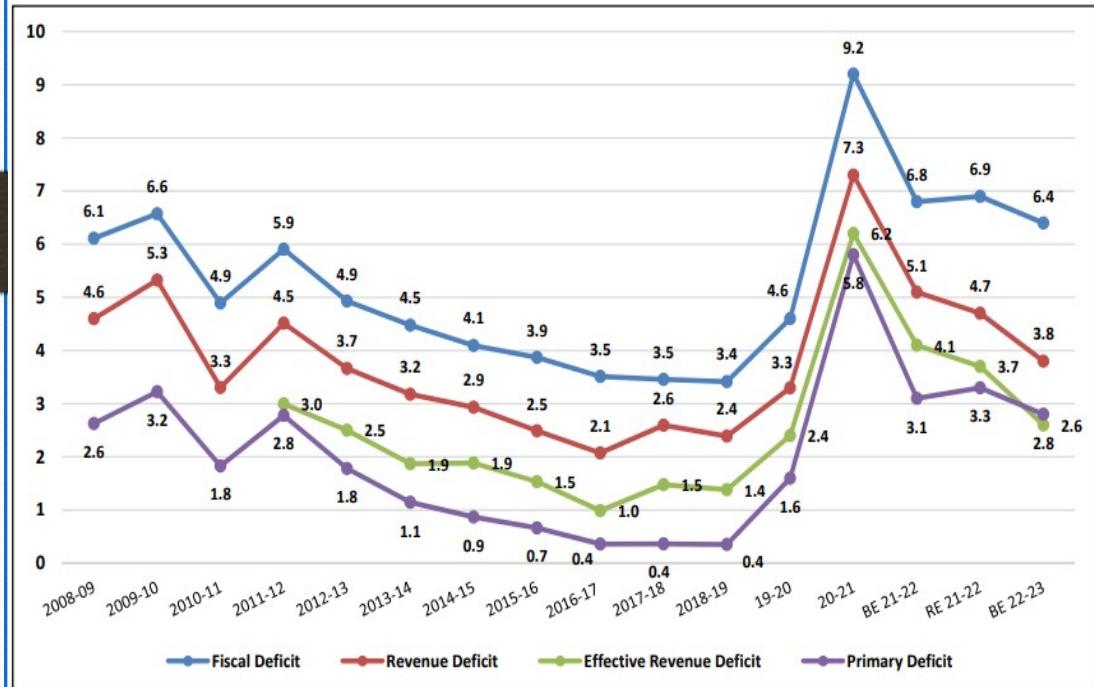
(₹ करोड़) (In ₹ crore)

घाटे का सार *Deficit Statistics*

	(₹ करोड़) (In ₹ crore)				वास्तविक अनुमान Budget Estimates	बजट अनुमान Budget Estimates	संशोधित अनुमान Revised Estimates	बजट अनुमान Budget Estimates	2020-2021 वास्तविक	2021-2022 बजट	2021-2022 संशोधित	2022-2023 बजट	2020-2021 वास्तविक	2021-2022 बजट	2021-2022 संशोधित	2022-2023 बजट
	2020-2021 वास्तविक	2021-2022 बजट	2021-2022 संशोधित	2022-2023 बजट					Actuals	Budget Estimates	Revised Estimates	Budget Estimates	2020-2021 वास्तविक	2021-2022 बजट	2021-2022 संशोधित	2022-2023 बजट
	1. Fiscal Deficit	1818291 (9.2)	1506812 (6.8)	1591089 (6.9)	1661196 (6.4)	1.	ऋण प्राप्तियां (निवल)	1. Debt Receipts (Net)	1825479	1435428	1416902	1660444	1.	ऋण प्राप्तियां (निवल)	1. Debt Receipts (Net)	1825479
1. Fiscal Deficit	1818291 (9.2)	1506812 (6.8)	1591089 (6.9)	1661196 (6.4)	1.	ऋण प्राप्तियां (निवल)	1. Debt Receipts (Net)	1825479	1435428	1416902	1660444	1.	ऋण प्राप्तियां (निवल)	1. Debt Receipts (Net)	1825479	
2. Revenue Deficit	1449599 (7.3)	1140576 (5.1)	1088352 (4.7)	990241 (3.8)	2.	बाजार उधार (सरकारी प्रतिमूलि+ राजकोषीय हँडी)	2. Market Borrowings (G-sec +T Bills)	1239737	967708	875771	1158719	2.	बाजार उधार (सरकारी प्रतिमूलि+ राजकोषीय हँडी)	2. Market Borrowings (G-sec +T Bills)	1239737	
3. Effective Revenue Deficit	1218734 (6.2)	921464 (4.1)	850667 (3.7)	672598 (2.6)	3.	अल्प बचतों के बदले प्रतिमूलियां	3. Securities against Small Savings	483733	391927	591524	425449	3.	अल्प बचतों के बदले प्रतिमूलियां	3. Securities against Small Savings	483733	
4. Primary Deficit	1138422 (5.8)	697111 (3.1)	777298 (3.3)	720545 (2.8)	4.	राज्य भविष्य निधियां	4. State Provident Funds	18514	20000	20000	20000	4.	राज्य भविष्य निधियां	4. State Provident Funds	18514	
					5.	अन्य प्राप्तियां (आंतरिक ऋण तथा लोक लेखा)	5. Other Receipts (Internal Debts and Public Account)	13315	54280	(-90140*)	37025	5.	अन्य प्राप्तियां (आंतरिक ऋण तथा लोक लेखा)	5. Other Receipts (Internal Debts and Public Account)	13315	
					6.	विदेशी ऋण	6. External Debt	70181	1514	19746	19251	6.	विदेशी ऋण	6. External Debt	70181	
					7.	नकदी शेष का कम आहरण	7. Draw Down of Cash Balance	(-)7188	71383	174187	752	7.	नकदी शेष का कम आहरण	7. Draw Down of Cash Balance	(-)7188	
					8.	कुल जोड़	8. Grand Total (1+7)	1818291	1506812	1591089	1661196	8.	कुल जोड़	8. Grand Total (1+7)	1818291	

DEFICIT TRENDS

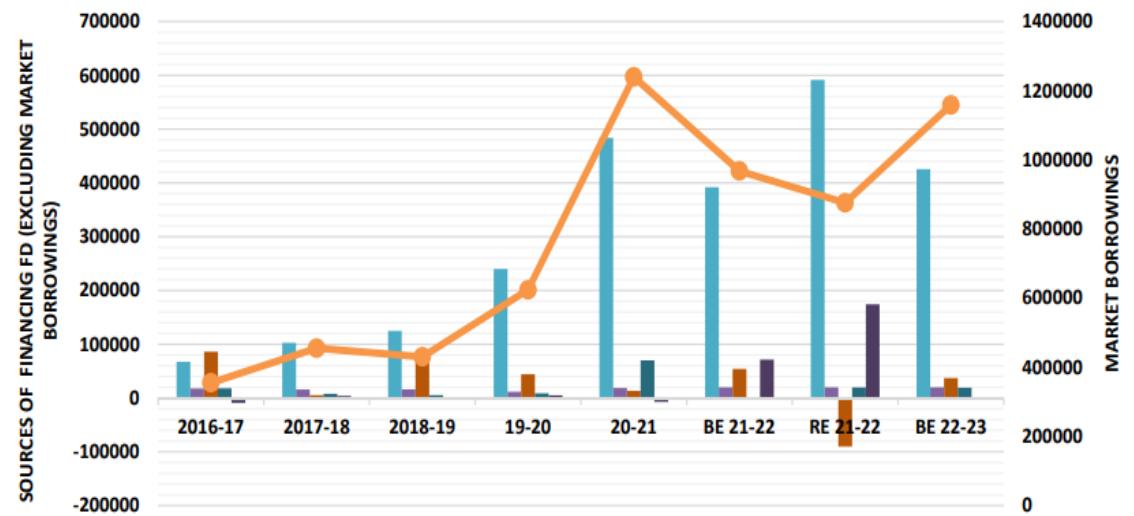
(% of GDP)



घाटा वित्तपोषण के स्रोत

LEGEND:

- Securities against small savings
- Other Receipts (Internal Debt and Public Account)
- Draw Down of Cash Balance
- State Provident Fund
- External Debt
- Market Borrowings



Liabilities of the Government- Public Debt & Other Liabilities

- Internal Debt – debt owed by the government to residents
- External Public Debt or Sovereign Debt – debt owed by government to non-residents (FIIs, foreign governments, etc.)
- Other Liabilities – Liabilities where govt holds money (and has to pay back, with interest) other than what it has explicitly borrowed, such as money held under the Public Provident Fund, Pension Fund like NPS, etc.
- **The term external debt is used to denote entire external debt of a country. This means it includes external debt of the government as well citizens towards the rest of the world. One large component of external debt is the external commercial borrowings (ECBs).

Sustainability of Debt

- Objectives of Debt management: Favourable terms and conditions
 - Low cost
 - Longer term maturity
 - Financed locally
 - External debt denominated in domestic currency
 - Ability to pay (Relationship with growth – Interest rate growth rate differential)
- NK Singh committee's recommendations on FRBM reforms
 - Target Debt along with deficit (Desirable Debt:GDP ratio of 60% (40% Centre, 20% States))

Taxation: Types of taxes

1. On the basis of distributive features:
 - Progressive Taxes
 - Proportional Taxes
 - Regressive Taxes
2. On the basis of bearer of burden:
 - Direct Taxes
 - Indirect Taxes
3. On the basis of method of levying
 - Tax levied on value – Ad valorem tax
 - Tax levied on some other specific character- Specific tax

Tax name	Event of Taxation	Levying entity	Responsibility to pay to the government	Actual Bearer of Burden	Tax Type	
Income tax	Earned income from any source	Centre	Earner	Earner	Direct	
Corporate Income Tax	Profits of the company reported under IT ACT	Centre	Company	Company		
Minimum Alternate Tax	Only if CIT<18% of the Profits reported under Companies Act	Centre	Company	Company		
Other direct tax examples- Wealth tax (Centre), Professional tax (States), Capital Gains Tax (part of IT)						
Excise Duty	Production	Centre	Producer	Buyer	Indirect	
Customs Duty	Change of International Boundary	Centre	Changer of boundary	Buyer		
Sales/VAT/Service Tax	Sale of a good/service	States	Goods seller/ Service provider	Buyer/Consumer		
Central Sales tax	Inter state sale of goods	Centre, *Given entirely to states				
Entry Tax/Octroi/etc.	Entry into a state/district/municipality	States, distt., municipalities				
GST	Sales of goods and services	Centre + State				

Goods and services Tax

- Destination based tax – i.e. tax is LEVIED at the place of consumption
- Value added tax – i.e. levied on value added during the transaction, not the entire value of transaction
- How to calculate the value added?
 - Collect tax on entire value
 - Let the depositor of tax declare value added by submitting the value of inputs on which tax was paid
 - Refund the difference through Input Tax Credit System (ITC)

Goods and Services Tax: Difference from earlier system

- Pooling of sovereign powers by centre and states to develop a better system of taxation.
- Combines most of the indirect taxes levied earlier separately by centre and states (except Customs). Why?
- Features of a good taxation system:
 - Incentive to comply with – less costly for someone who complies with it
 - Disincentive to not-comply with – Costly for those who do not comply with
 - Cost is determined not just in terms of penalty levied, more importantly in terms of ability of the system (and not the individual tax officer) to catch offenders.
- Brings synergy between the departments – now there is only 1 channel to report, collect and verify taxes paid – earlier their was centre and state had separate, independent mechanism.
- Now, the system catches an offender, not an individual (at least theoretically!)

Tax Evasion

- Tax Planning – Legal, legitimate way to reduce taxable income through certain acceptable expenses/investments
- Tax avoidance – May not be illegal, but certainly illegitimate
- Tax evasion – Illegal
- BEPS – Base erosion and profit shifting
- Related party transactions, Arm's length principle, Advanced pricing agreements
- Double taxation avoidance agreements (DTAA)
- General Anti-avoidance rules (GAAR)
- Money laundering, round tripping (Ref: Security Classes)

1. Consider the following statements.

1. GDP Deflator takes into account all the goods and services which are produced in a country, while CPI does not.

2. CPI includes the prices of imported goods, while GDP Deflator does not.

3. The weights assigned to goods and services are constant in GDP Deflator, while it is not in CPI.

Which of the statements given above are correct?

- | | |
|------------------|------------------|
| (a) 1, 2 and 3 | (b) 1 and 2 only |
| (c) 1 and 3 only | (d) 2 and 3 only |

2. Which of the following parameters are included in the Human Development Index (HDI), published by the United Nations Development Program (UNDP)?

1. GNI per capita
2. Expected years of schooling
3. Under five mortality rate
4. Mean years of schooling

Select the correct answer using the code given below.

- | | |
|---------------------|-------------------|
| (a) 1, 2 and 3 only | (b) 3 and 4 only |
| (c) 1, 2 and 4 only | (d) 1, 2, 3 and 4 |

3. Which one of the following statements correctly describes the meaning of legal tender money?

- (a) The money which is tendered in courts of law to defray the fee of legal cases
- (b) The money which a creditor is under compulsion to accept in settlement of his claims
- (c) The bank money in the form of cheques, drafts, bills of exchange etc.
- (d) The metallic money in circulation in a country

4. If a commodity is provided free to the public by the Government, then

- (a) the opportunity cost is zero.
- (b) the opportunity cost is ignored.
- (c) the opportunity costs is transferred from the consumers of the product to the tax-paying public.
- (d) the opportunity cost is transferred from the consumers of the product to the Government.

5. Increase in absolute and per capital real GNP do not connote a higher level of economic development, if

- (a) industrial output fails to keep pace with agricultural output.
- (b) agricultural output fails to keep pace with industrial output.
- (c) poverty and unemployment increase.
- (d) imports grow faster than exports.

6. Consider the following statements: Human capital formation as a concept is better explained in terms of a process which enables

1. individuals of a country to accumulate more capital.
2. increasing the knowledge, skill levels and capacities of the people of the country.
3. accumulation of tangible wealth.
4. accumulation of intangible wealth.

Which of the statements given above is/are correct?

- | | |
|-------------|----------------|
| (a) 1 and 2 | (b) 2 only |
| (c) 2 and 4 | (d) 1, 3 and 4 |

7. Despite being a high saving economy, capital formation may not result in significant increase in output due to

- (a) weak administrative machinery
- (b) illiteracy
- (c) high population density
- (d) high capital-output ratio

8. Consider the following statements:

1. The Reserve Bank of India manages and services Government of India Securities but not any State Government Securities.

2. Treasury bills are issued by the Government of India and there are no treasury bills issued by the state Governments.

3. Treasury bills offer are issued at a discount from the par value.

Which of the statements given above is/are correct?

9. Which of the following does not attract a Goods and Service Tax?

1. Solar Power
2. Milk
3. Print Media Advertisements
4. School Education

Select the correct answer using the code given below.

10. Which one of the following is not a sub-index of the World Bank's 'Ease of Doing Business Index'?

- (a) Maintenance of law and order
- (b) Paying taxes
- (c) Registering property
- (d) Dealing with construction permit

11. Consider the following statements:

1. Most of India's external debt is owed by governmental entities.
2. All of India's external debt is denominated in US dollars.

Which of the statements given above is/are correct?

12. Which of the following is not included in the assets of a commercial bank in India?

- (a) Advances
 - (b) Deposits
 - (c) Investments
 - (d) Money at call and short notice

13. In the context of India, which of the following factors is/are contributor/ contributors to reducing the risk of a currency crisis?

1. The foreign currency earnings of India's IT sector
 2. Increasing the government expenditure
 3. Remittances from Indians abroad

14. Which one of the following *is not* the most likely measure the Government/ RBI takes to stop the slide of Indian rupee?

- (a) Curbing imports of non-essential goods-and promoting exports
 - (b) Encouraging Indian borrowers to issue rupee denominated Masala Bonds
 - (c) Easing conditions relating to external commercial borrowing
 - (d) Following an expansionary monetary policy

15. The money multiplier in an economy increases with which one of the following?

- (a) Increase in the cash reserve ratio
 - (b) Increase in the banking habit of the population
 - (c) Increase in the statutory liquidity ratio
 - (d) Increase in the population of the country

16. In the context of Indian economy, which of the following statements is/are correct?

1. GDP growth rate of India has always been directly proportional to the rate of growth of employment since the 1991 reforms.

2. The rate of growth of employment has always been lower than the rate of GDP growth.

Select the correct answer using the code given below.

17. The Global Competitiveness Report is published by the

- (a) International Monetary Fund
 - (b) United Nations Conference on Trade and Development
 - (c) World Economic Forum
 - (d) World Bank

18. In a given year in India, official poverty lines are higher in some States than in others because

- (a) poverty rates vary from State to State
 - (b) price levels vary from State to State
 - (c) Gross State Product varies from State to State
 - (d) quality of public distribution varies from State to State

19. If another global financial crisis happens in the near future, which of the following action/policies are most likely to give some immunity to India?

1. Not depending on short - term foreign borrowings
 2. Opening up to more foreign banks
 3. Maintaining full capital account convertibility

Select the correct answer using the code given below:

20. If you withdraw Rs. 1,00,000 in cash from your Demand Deposit Account at your bank, the

immediate effect on aggregate money supply in the economy will be

- (a) to reduce it by Rs. 1,00,000
 - (b) to increase it by Rs. 1,00,000
 - (c) to increase it by more than Rs. 1,00,000
 - (d) to leave it unchanged

21. "Gold Tranche" (Reserve Tranche) refers to

- (a) a loan system of the World Bank
 - (b) one of the operations of a Central Bank
 - (c) a credit system granted by WTO to its members
 - (d) a credit system granted by IMF to its members

22. In India, which of the following can be considered as public investment in agriculture?

1. Fixing Minimum Support Price for agricultural produce of all crops.
 2. Computerization of Primary Agricultural Credit Societies
 3. Social Capital development
 4. Free electricity supply to farmers
 5. Waiver of agricultural loans by the banking system
 6. Setting up of cold storage facilities by the government

Q. Setting up of cold storage facilities by the governments.

Select the correct answer using the code given below.

- (a) 1, 2 and 5 only
 - (b) 1, 3, 4 and 5 only
 - (c) 2, 3 and 6 only
 - (d) 1, 2, 3, 4, 5 and 6

23. Consider the following statements:

1. The weightage of food in Consumer Price Index (CPI) is higher than that in Wholesale Price Index (WPI).

2. The WPI does not capture changes in the prices of services, which CPI does.
 3. Reserve Bank of India has now adopted WPI as its key measure of inflation and to decide on changing the key policy rates.

TEST WHAT YOU HAVE LEARNT (ECONOMICS)

Which of the statements given above is/are correct?

24. With reference to Foreign Direct Investment in India, which one of the following is considered its major characteristic?

- (a) It is the investment through capital instruments essentially in a listed company.
 - (b) It is a largely non-debt creating capital flow.
 - (c) It is the investment which involves debt-servicing.
 - (d) It is the investment made by foreign institutional investors in the Government Securities.

25. With reference to the international trade of India at present, which of the following statements is/are correct?

1. India's merchandise exports are less than its merchandise imports.
 2. India's imports of iron and steel, chemicals, fertilisers and machinery have decreased in recent years.
 3. India's exports of services are more than its imports of services.
 4. India suffers from an overall trade/current account deficit.

Select the correct answer using the code given below:

26. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do?

1. Cut and optimise the Statutory Liquidity Ratio
 2. Increase the Marginal Standing Facility Rate
 3. Cut the Bank Rate and Repo Rate

Select the correct answer using the code given below:

27. With reference to the Indian economy after the 1991 economic liberalization, consider the following statements:

1. Worker productivity (rs. per worker at 2004 -05 prices) increased in urban areas while it decreased in rural areas.
 2. The percentage share of rural areas in the workforce steadily increased.
 3. In rural areas, the growth in non -farm economy increased.
 4. The growth rate in rural employment decreased

Which of the statements given above is/are correct?

- (a) 1 and 2 only (b) 3 and 4 only
(c) 3 only (d) 1, 2 and 4 only

28. Purchasing Power Parity and market exchange rates are the two most common methods for comparing GDP of countries. With reference to this, consider the following statements.

1. PPP rates are relatively stable over time while market rates are more volatile.

2. India has a greater share in the world economy using PPP rates than market based rates.

Which of the statements given above is/are correct?

29. Which among the following steps is most likely to be taken at the time of an economic recession?

- (a) Cut in tax rates accompanied by increase in interest rate
 - (b) Increase in expenditure on public projects
 - (c) Increase in tax rates accompanied by reduction of interest rate.
 - (d) Reduction of expenditure on public projects

TEST WHAT YOU HAVE LEARNT (ECONOMICS)

30. Consider the following statements: Other things remaining unchanged, market demand for a good might increase if

1. price of its substitute increases
2. price of its complement increases
3. the good is an inferior good and income of the consumers increases
4. its price falls

Which of the above statements are correct?

- | | |
|------------------|----------------|
| (a) 1 and 4 only | (b) 2, 3 and 4 |
| (c) 1, 3 and 4 | (d) 1, 2 and 3 |

31. Indian Government Bond Yields are influenced by which of the following?

1. Actions of the United States Federal Reserve
2. Actions of the Reserve bank of India
3. Inflation and short-term interest rates

Select the correct answer using the code given below.

- | | |
|------------------|----------------|
| (a) 1 and 2 only | (b) 2 only |
| (c) 3 only | (d) 1, 2 and 3 |

32. Consider the following:

1. Foreign currency convertible bonds
2. Foreign institutional investment with certain conditions
3. Global depository receipts
4. Non-resident external deposits

Which of the above can be included in Foreign Direct Investments?

- | | |
|----------------|-------------|
| (a) 1, 2 and 3 | (b) 3 only |
| (c) 2 and 4 | (d) 1 and 4 |

33. Consider the following statements: The effect of devaluation of a currency is that it necessarily

1. improves the competitiveness of the domestic exports in the foreign markets.
2. increases the foreign value of domestic currency
3. improves the trade balance

Which of the above statements is/are correct?

- | | |
|------------|-------------|
| (a) 1 only | (b) 1 and 2 |
| (c) 3 only | (d) 2 and 3 |

34. Which one of the following is likely to be the most inflationary in its effects?

- (a) Repayment of public debt
- (b) Borrowing from the public to finance a budget deficit
- (c) Borrowing from the banks to finance a budget deficit
- (d) Creation of new money to finance a budget deficit

35. With reference to Indian economy, demand-pull inflation can be caused/increased by which of the following?

1. Expansionary policies
2. Fiscal stimulus
3. Inflation-indexing wages
4. Higher purchasing power
5. Rising interest rates

Select the correct answer using the code given below.

- | | |
|------------------------|----------------------|
| (a) 1, 2 and 4 only | (b) 3, 4 and 5 |
| (c) 1, 2, 3 and 5 only | (d) 1, 2, 3, 4 and 5 |

36. Consider the following statements regarding taxation in India:

1. Professional tax is an indirect tax that is levied by states.
2. Corporate Tax is a direct tax that is levied by the center as per the Companies Act 2013.
3. Corporate tax is paid by the companies on their net income.
4. Both Advalorem and specific taxes can be levied on a single product

Choose the correct answer from the codes given below

- (a) Only one statement is correct
- (b) Only two statements are correct
- (c) None of the statements are correct
- (d) All the statements are correct

37. Which of the following items will be excluded in national income?

1. Construction of a new house
2. Winning a lottery prize
3. Increase in prices of stock lying with a trader
4. Profit earned by foreign banks in India
5. Intermediate goods that are used to produce other final goods.

Select the correct answer using the codes given below:

- (a) 1 and 5 only
- (b) 2, 3, 4 and 5
- (c) 1, 2, 3 and 4 only
- (d) 1, 2, 3 and 4 and 5

38. Consider the following data

1. Grants to states for capital formation = 2% of GDP

2. Primary deficit = 1.1% of GDP

3. Revenue deficit = 3.4 % of GDP

In this scenario, the effective revenue deficit (ERD) will be:

- (a) 1.4%
- (b) 2.3%
- (c) 0.9%
- (d) Insufficient data

39. Which of the following is correct with respect to National Income (NI) with respect to India?

(a) NI = NNP (Factor Cost) = NNP (Market Price) - Indirect Taxes + Subsidies

(b) NI = NNP (Market Price) = NNP (Factor Cost) - Indirect Taxes + Subsidies

(c) NI = GDP (Factor Cost) = GDP (Market Price) - Indirect Taxes + Subsidies

(d) None of the Above

40. In 2015, the union government made some changes to the GDP calculation method. Which of the following is/are correct with regards to these changes?

1. The base year for the calculation of GDP was changed to 2011-12 from 2004-05.
2. GDP will be measured by using gross value added (GVA) at market price, rather than factor cost.
3. The change in the method of calculation has brought Indian GDP calculations more in line with global practice.

Select the correct codes using the options given below:

- (a) 1 and 3 only
- (b) 1 and 2 only
- (c) 2 and 3 only
- (d) All of the above

41. Which one of the following best describes the term "Merchant Discount Rate" sometimes seen in news?

- (a) The incentive given by a bank to a merchant for accepting payments through debit cards pertaining to that bank.
- (b) The amount paid back by banks to their customers when they use debit cards for financial transactions for purchasing goods or services.
- (c) The charge to a merchant by a bank for accepting payments from his customers through the bank's debit cards.
- (d) The incentive given by the Government to merchants for promoting digital payments by their customers through Point of Sale (PoS) machines and debit cards

TEST WHAT YOU HAVE LEARNT (ECONOMICS)

42. Fiscal Responsibility and Budget Management (FRBM) Act provides for escape clause on which of the following grounds?

- 1. National security
- 2. Collapse of agricultural output
- 3. Dispute with trading partners
- 4. National calamity

Select the correct answer using the code given below.

- (a) 2 and 3 only
- (b) 1, 2 and 4 only
- (c) 1 and 4 only
- (d) 1, 2, 3 and 4

43. Pooja who is a Ph.D. scholar was working as an clerk in the government school. But after working for six months, she realized that this job is not suitable for her and she resigned from the job. Then, she filled form for the post of assistant professor whose exam is gonging to be conducted next month. In the above passage, Pooja faced which types of unemployment?

- 1. Seasonal unemployment
- 2. Frictional unemployment
- 3. Underemployment
- 4. Structural unemployment

Select the correct answer using the code given below.

- (a) 1, 2 and 3 only
- (b) 1, 3, and 4 only
- (c) 2 and 3 only
- (d) 2 and 4 only

44. Consider the following statements.

- 1. A base year is used for comparison in the measure of economic indices like GDP or CPI.
- 2. A change in the base year is essential to track structural changes in an economy.
- 3. Currently, in India the base year for GDP calculation is 2011-12 and for CPI calculation is 2010.

Which of the statements given above is/are correct?

- (a) 1, 2 and 3
- (b) 1 and 3 only
- (c) 1 and 2 only
- (d) 1 only

45. Consider the following statements:

- 1. Product Taxes and Subsidies are independent of volume of production.
- 2. Production Taxes and Subsidies are paid or received per unit or product.

Which of the statements given above is/are correct?

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

46. In the context of economics, what are Negative interest rates?

- (a) It is an unconventional policy used by Central Bank to push up inflation rates by reducing interest rates past zero.
- (b) Negative interest rates is an unconventional policy used by Central Banks to attract foreign investors.
- (c) Negative interest rates is an unconventional policy used by Central Banks to control high inflation rates.
- (d) Negative interest rates is an unconventional policy used by Central Banks to increase the cost of borrowing

47. Consider the following statements regarding Gross Capital Formation (GCF):

- 1. It is the outlay on addition to fixed assets including the net change in inventories.
- 2. Increase in GCF may lead to rise in GDP.
- 3. GCF of India has been declining in the last 15 years.

Which of the statements given above is/are correct?

- (a) 2 only
- (b) 1 and 2 only
- (c) 1 and 3 only
- (d) 1, 2 and 3

TEST WHAT YOU HAVE LEARNT (ECONOMICS)

48. Which of the statements best describes “skewflation”?

- (a) It refers that there is meagre rise of inflation in the economy due to slow economic growth.
- (b) It is measure of inflation by excluding commodities whose prices are more volatile.
- (c) It is a situation in which price levels of few goods increases at a faster rate compared to others.
- (d) It is inflation caused by the changes in monetary policy

49. Arrange the following taxes in increasing order of their respective collection (actuals) as per Budget 2022-23.

- 1. Union Excise Duties
- 2. Corporation Tax
- 3. Central Goods and Services Tax (CGST)
- 4. Securities Transaction Tax

Select the correct answer using the code given below.

- (a) 4-2-3-1
- (b) 4-1-2-3
- (c) 1-4-3-2
- (d) 4-1-3-2

50. Which of the following correctly describes the phenomenon of Fiscal Drag?

- (a) Widening of government deficit due to dependency on borrowings for fueling economic growth.
- (b) Movement of taxpayers into higher tax brackets owing to inflation.
- (c) Lower purchasing power of domestic currency due to higher dependency on imports.
- (d) Loss of government revenue due to the emigration of people.

51. Consider the following statements with reference to monetisation of deficit:

- 1. It involves financing of such extra expenses by borrowing money from the market.
- 2. It is a type of debt financing.
- 3. In India, it is currently not allowed.

Which of the statements given above is/are correct?

- (a) 1 and 2 only
- (b) 2 and 3 only
- (c) 3 only
- (d) 1 and 3 only

1. B- In order to compare the GDP figures, we take the help of real GDP. Real GDP is calculated in a way such that the goods and services are evaluated at some constant set of prices (or constant prices). Since these prices remain fixed, if the Real GDP changes we can be sure that it is the volume of production which is undergoing changes. Nominal GDP, on the other hand, is simply the value of GDP at the current prevailing prices. • The ratio of nominal GDP to real GDP gives us an idea of how the prices have moved from the base year (the year whose prices are being used to calculate the real GDP) to the current year. In the calculation of real and nominal GDP of the current year, the volume of production is fixed. Therefore, if these measures differ it is only due to change in the price level between the base year and the current year. The ratio of nominal to real GDP is a well known index of prices. This is called GDP Deflator. Thus $\text{GDP deflator} = \text{Nominal GDP} / \text{Real GDP}$. • There is another way to measure change of prices in an economy which is known as the Consumer Price Index (CPI). This is the index of prices of a given basket of commodities which are bought by the representative consumer. CPI is generally expressed in percentage terms. • CPI (and analogously WPI) may differ from GDP deflator because : • The goods purchased by consumers do not represent all the goods which are produced in a country. GDP deflator takes into account all such goods and services. Hence statement 1 is correct. CPI includes prices of goods consumed by the representative consumer, hence it includes prices of imported goods. GDP deflator does not include prices of imported goods. Hence statement 2 is correct. The weights are constant in CPI – but they differ according to production level of each good in GDP deflator. Hence statement 3 is not correct.
2. C - The HDI was created by the United Nations Development Programme (UNDP) to emphasize that people and their capabilities should be the ultimate criteria for assessing the development of a country, not economic growth alone. The HDI can also be used to question national policy choices, asking how two countries with the same level of GNI per capita can end up with different human development outcomes. • The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions. • The health dimension is assessed by life expectancy at birth, the education dimension is measured by mean of years of schooling for adults aged 25 years and more and expected years of schooling for children of school entering age. The standard of living dimension is measured by gross national income per capita. The HDI uses the logarithm of income, to reflect the diminishing importance of income with increasing GNI. The scores for the three HDI dimension indices are then aggregated into a composite index using geometric mean. • Hence option (c) is the correct answer.
3. B - Legal tender is any official medium of payment recognized by law that can be used to extinguish a public or private debt, or meet a financial obligation. A creditor is obligated to accept legal tender toward repayment of a debt. Legal tender can only be issued by the national body that is authorized to do so.
4. C - Opportunity cost is the cost of choosing one alternative over another and missing the benefit offered by the forgone opportunity, investing or otherwise. Opportunity cost refers to a benefit that a person could have received, but gave up, to take another course of action. Stated differently, an opportunity cost represents an alternative given up when a decision is made. Opportunity cost is also called the economic cost.

5. C - An essential aspect of development is to enable the maximum number to experience the fruits of development. Concepts of per capita income (per capita GDP or per capita NSDP) are not able to capture this aspect of development. There may be a case wherein increase in absolute and per capita GNP is reflective of growth in income of a small section of society and that majority of the population is poverty stricken and unemployed. Multi-dimensional non-monetary social indicators are better reflectors of overall economic development in the society.
6. C- Human capital formation indicates, “the process of acquiring and increasing the number of persons who have the skills, education and experience which are critical for the economic and the political development of the country. Human capital formation is thus associated with investment in man and his development as a creative and productive resource.” Hence, statement 1 is correct. Intangible wealth consists of factors such as the trust among people in a society, an efficient judicial system, clear property rights, effective government, and good education system etc. Human capital formation enables accumulation of intangible wealth. Hence, statement 4 is correct
7. D - Capital formation means increasing the stock of real capital in a country. In other words, capital formation involves making of more capital goods such as machines, tools, factories, transport equipment, materials, electricity, etc., which are all used for future production of goods. For making additions to the stock of Capital, saving and investment are essential. Capital output ratio is the amount of capital needed to produce one unit of output. For example, suppose that investment in an economy, investment is 32% (of GDP), and the economic growth corresponding to this level of investment is 8%. Here, a Rs 32 investment produces an output of Rs 8. Capital output ratio is $32/8$ or 4. In other words, to produce one unit of output, 4 unit of capital is needed. Hence, if the capital-output ratio is high, there will not be significant increase in output despite high savings and investment.
8. C - The Reserve Bank of India manages public debt and issues Indian currency denominated loans on behalf of the central and the state governments under the powers derived from the Reserve Bank of India Act. The RBI is the debt manager for both the Central Government and the State Governments. RBI manages the debt of state governments on the basis of separate agreements. Hence, statement 1 is not correct. Treasury bills or T-bills, which are money market instruments, are short term debt instruments issued by the Government of India and are presently issued in three tenors, namely, 91 day, 182 day and 364 day. Treasury bills are zero coupon securities and pay no interest. They are issued at a discount and redeemed at the face value at maturity. For example, a 91 day Treasury bill of ₹100/- (face value) may be issued at say ₹98.20, that is, at a discount of say, ₹1.80 and would be redeemed at the face value of ₹100/-. The return to the investors is the difference between the maturity value or the face value (that is ₹100). Hence, statement 2 and 3 are also correct
9. A - Goods and Services Tax (GST) is an indirect tax (or consumption tax) used in India on the supply of goods and services. It is a comprehensive, multistage, destination-based tax: comprehensive because it has subsumed almost all the indirect taxes except a few state taxes. Multi-staged as it is, the GST is imposed at every step in the production process, but is meant to be refunded to all parties in the various stages of production other than the final consumer and as a destination-based tax, it is collected from point of consumption and not point of origin like previous taxes. • The tax came into effect from 1 July 2017 through the implementation of the One Hundred and First Amendment of the Constitution of India by

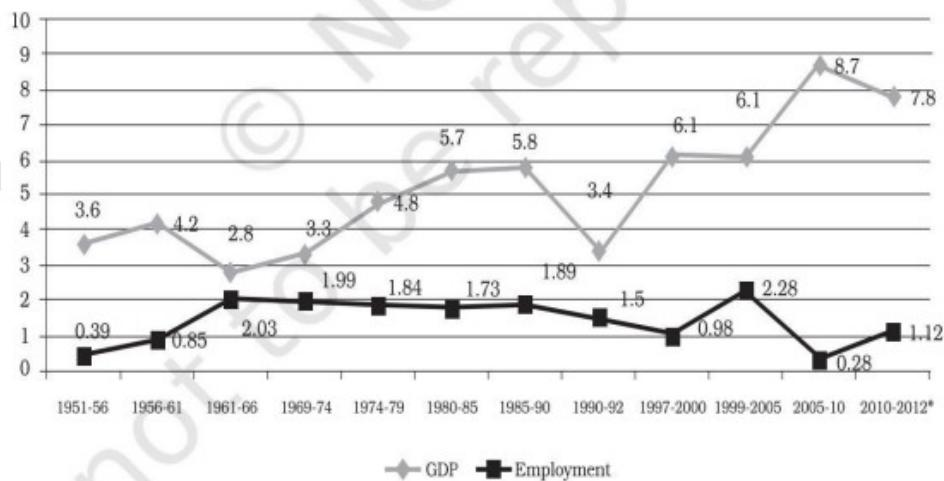
the Indian government. The GST replaced existing multiple taxes levied by the central and state governments. • Goods and services are divided into five different tax slabs for collection of tax - 0%, 5%, 12%, 18% and 28%. • However, petroleum products, alcoholic drinks, and electricity (including solar power) are not taxed under GST and instead are taxed separately by the individual state governments, as per the previous tax system. Hence option 1 is correct. • Some industries and products were exempted by the government and remain untaxed under GST, such as dairy products, products of milling industries, fresh vegetables & fruits, meat products, and other groceries and necessities. Hence option 2 is correct. • in case of newspaper, sale of newspaper to customers is exempt from GST, however selling of advertisement space in print media attract 5 and 18 percent GST, depending on the terms of the contract between the newspaper, advertisement agency and the client. Hence option 3 is not correct. • Schooling up to higher secondary and most of the services provided to educational institutions are exempt from taxation under GST. Mid-day meal scheme as well as security, cleaning and housekeeping services performed in educational institutions up to higher secondary are also exempt from GST. Services relating to admission and examination up to higher secondary are exempt under GST. Hence option 4 is correct.

(Ans to a similar UPSC ques) The Goods and Services Tax (GST) in India was implemented on July 1, 2017. While cereals, eggs, fish etc. are exempted from GST, the question mentions 'cooked' and 'processed' which in all likelihood will be available at restaurants and factories. These are therefore not exempted from the purview of GST. With reference to newspapers containing advertisements, government has recently published a clarification that these will be taxed under GST. The newspaper would have to pay 5 per cent GST on the revenue earned from space selling but can avail of input tax credit for the tax paid by the advertisement agency on commission received.

10. A - Doing Business measures regulations affecting 11 areas of the life of a business. Ten of these areas are included in this Doing Business 2019 ranking on the ease of doing business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. Doing Business also measures labor market regulation, which is not included in this year's ranking.
11. D - As per the Government report on External debt by December 2018-Commercial borrowings are the largest component of external debt with a share of 37.1 percent, followed by NRI deposits (23.9 percent) and short term trade credit (19.9 percent). Hence, Statement 1 is not correct. • US dollar denominated debt continued to be the largest component of India's external debt with a share of 45.9 percent at end December 2018, followed by the Indian rupee (24.8 percent), SDR (5.1 percent), yen (4.9 percent) and euro(3.1 percent). Hence, Statement 2 is not correct.
12. B - A bank places its funds in assets to earn profits. The assets include investments, loans and advances, money at call and short notice, bills discounted and purchased. It also includes the cash in hand with the banks and also the cash held with the RBI. • The liabilities include deposits (both time and demand) and borrowings. • Hence (b) is the correct answer.
13. B - Currency crisis is brought on by a decline in the value of a country's currency. This decline in value negatively affects an economy by creating instabilities in exchange rates, meaning that one unit of a certain currency no longer buys as much as it used to in another currency.

- A substantial amount of foreign exchange reserves can help to cushion against any risks of currency crisis.
 - The foreign current earnings of India's IT sector and remittances from abroad would lead more inflow of foreign currencies in the economy and boost the foreign exchange reserves. Hence, Statements 1 and 3 are correct.
 - Statement 2 is not correct as increasing the government expenditure is not related to change in foreign exchange reserves or any currency fluctuations
14. D - Expansionary monetary policy is when the RBI would use its tools to stimulate the economy. That increases the money supply, lowers interest rates, and increases aggregate demand.
- Lower interest rates will also tend to reduce the value of the currency. If domestic interest rates fall relative to elsewhere, it becomes less attractive to save money in domestic banks.
 - Therefore, it will lead to outflow of foreign currency and therefore, slide of Indian Rupee.
15. B - Money Multiplier is the ratio of the stock of money to the stock of high powered money. It is the relationship between the monetary base and money supply of an economy. It explains the increase in the amount of cash in circulation generated by the banks' ability to lend money out of their depositors' funds. Therefore, it refers to how an initial deposit can lead to a bigger final increase in the total money supply.
- For example, if the commercial banks gain deposits of Rs 1 Lakh and this leads to a final money supply of Rs 10 lakh. The money multiplier is 10. Therefore, increase in banking habit of the population would lead to more deposits and hence increase in Money Multiplier. Hence (b) is the correct answer.
16. B- If you look at the graph given below no concrete relationship exists between employment and GDP growth rate.
- Thus, the GDP growth rate is neither directly nor inversely proportional to the employment growth rate. Hence statement 1 is not correct.
 - As is evident from the graph, the employment growth rate has always been lower than the rate of growth of the GDP. The dark line has always been below the white line. Hence statement 2 is correct.
 - The graph thus presents the story of the economic growth of India which has always been called 'jobless growth'.

Chart 7.3: Growth of Employment and Gross Domestic Product, 1951-2012 (%)



17. C- The Global Competitiveness Report (GCR) is a yearly report published by the World Economic Forum
18. B

19. A - If a global financial crisis happens in the future, lesser exposure to the foreign financial markets is likely to give some immunity to India. Option 1 is correct: Short -term borrowings would lead to the burden of paying back the debt, and could result in stressful conditions for the borrowing economy/ India. Option 2 is not correct: Opening up to more foreign banks would lead to an enhanced exposure to the global economy, and hence an increased risk. Option 3 is not correct - It is more risky, as the foreign investors can withdraw all their money at once which called capital flight. Risks associated with full capital account convertibility: • It increases the vulnerability of the domestic economy to external economic shocks.
20. D- $M_1 = C + DD$
21. D - A reserve tranche is a portion of the required quota of currency each member country must provide to the International Monetary Fund (IMF) that can be utilized for its own purposes without a service fee or economic reform conditions. The IMF is funded through its members and their quota contributions. The reserve tranche is basically an emergency account that IMF members can access at any time without agreeing to conditions or paying a service fee
22. C- Public Investment here refers to the creation of either physical infrastructure or intangible capital. Hence in this context, investment is understood as either infrastructure -related capital as given in options 2 and 6 or social capital as given in option 3. Subsidies and loan waivers are not investments. Hence option 1 is not correct (There is scope for elimination here). Hence option c) is the correct answer. Similarly, option 4 (subisdy) and 5 are not correct.
23. A
24. B - Foreign Direct Investment (FDI) is the investment by a non-resident entity/person resident outside India in the capital of an Indian company under Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017. The investment is done through capital instruments in (1) an unlisted Indian company; or (2) 10% or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company. Hence, option a is incorrect. The investment can be made in equities or equity linked instruments or debt instruments issued by the company. Thus, FDI isn't directly associated with government securities, and hence option (d) is incorrect. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets, including establishing ownership or controlling interest in a foreign company (investments linked with equities), transfer of technology. This means they aren't just bringing money with them, but also knowledge, skills and technology. Debt servicing is the regular repayment of interest and principal on a debt for a particular period. Thus, option c is incorrect. A non-debt creating capital flow is the one where there is no direct repayment obligation for the residents. FDI is largely a non-debt creating capital flow, and therefore option (b) is correct.
25. D- 1. Merchandise trade deficit is the largest component of India's current account deficit. As per RBI's data, India's Merchandise exports during April-August 2019-2020 was USD 133.14 billion, as compared to USD 210.39 billion of imports during the same period. Hence statement 1 is correct. 2. Commodity-wise composition of imports between 2011-12 and 2018-19 shows that imports of iron and steel, organic chemicals, industrial machinery have registered positive growth rates as % of share in imports. Hence statement 2 is incorrect. 3.

India's net services (service exports - service imports) has been in surplus. India's Service exports during April-August 2019- 2020 was USD 67.24 billion, as compared to USD 39.25 billion of imports during the same period. Hence statement 3 is correct. 4. Current Account Deficit (CAD) or trade deficit is the shortfall between exports and imports. As per Economic Survey 2019-20, India's CAD was 2.1% in 2018-19, and 1.5% of GDP in H1 of 2019-20. Hence statement 4 is correct. Therefore, the correct answer is (d) 1, 3 and 4 only

26. B
27. B - In NITI Aayog's paper "Changing Structure of Rural Economy of India Implications for Employment and Growth 2017", following observations were made: 1. The absolute level of income per worker i.e. worker productivity has increased for both rural and urban areas. For rural areas it was Rs. 37273 in 2004 -05 and Rs. 101755 in 2011 -12, while for urban areas it was Rs. 120419 in 2004 -05 and Rs. 282515 in 2011 -12. Hence statement 1 is incorrect . 2. As per 2011 Census, 68.8% of India's population and 72.4% of workforce resided in rural areas. However, steady transition to urbanization over the years has led to a decline in the rural share in the workforce, from 77.8% in 1993 -94 to 70.9% in 2011 -12. Hence statement 2 is incorrect . 3. About two third of rural income is now generated in non -agricultural activities. Non -farm economy has increased in rural areas. The share of agriculture in rural economy has decreased from 57% in 1993 -94 to 39% in 2011 -12. Hence statement 3 is correct . 4. After 2004 -05, the rural areas have witnessed negative growth in employment inspite of high growth in output. The growth rate of rural employment was 1.45% during 1994 -2005, which fell to -0.28% between 2005 -12. Hence statement 4 is correct .
28. C- One of the two main methods of conversion of GDP uses market exchange rates—the rate prevailing in the foreign exchange market (using either the rate at the end of the period or an average over the period). The other approach uses the purchasing power parity (PPP) exchange rate—the rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in each country.
- To facilitate price comparisons across countries, the International Comparisons Program (ICP) was established by the United Nations and the University of Pennsylvania in 1968. PPPs generated by the ICP are based on a global survey of prices. To understand PPP, let's take a commonly used example, the price of a hamburger. If a hamburger is selling in London for £2 and in New York for \$4, this would imply a PPP exchange rate of 1 pound to 2 U.S. dollars.
 - PPP versus market rates o Advantages of PPP: The main one is that PPP exchange rates are relatively stable over time. By contrast, market rates are more volatile, and using them could produce quite large swings in aggregate measures of growth even when growth rates in individual countries are stable. Hence, statement 1 is correct. o Another drawback of market-based rates is that they are relevant only for internationally traded goods. Nontraded goods and services tend to be cheaper in low-income than in high-income countries. A haircut in New York is more expensive than in Lima; the price of a taxi ride of the same distance is higher in Paris than in Tunis; and a ticket to a cricket game costs more in London than in Lahore. Indeed, because wages tend to be lower in poorer countries, and services are often relatively labor intensive, the price of a haircut in Lima is likely to be cheaper than in New York even when the cost of making tradable goods, such as machinery, is the same in both countries. Drawbacks of PPP: The biggest one is that PPP is harder to measure than market-based rates. o There is a large gap between market- and PPP-based rates in emerging market and developing countries, for most of which the ratio of the

market and PPP U.S. dollar exchange rate is between 2 and 4. But for advanced economies, the market and PPP rates tend to be much closer. As a result, developing countries get a much higher weight in aggregations that use PPP exchange rates than they do using market exchange rates. The weights of China and India in the world economy are far greater using PPP exchange rates than market-based weights. Hence, statement 2 is correct

29. B
30. A
31. D
32. A - In Capital Account of Balance of Payment, we can classify into Investment, Borrowings and External Assistance. Investment includes Equity flow in the economy. Foreign Currency Convertible Bonds (FCCB), Foreign Institutional Investment with certain conditions (subject to the overall limit of 24%), and Global Depository Receipts (GDR) are the instruments for the foreign investment in India. Hence options 1, 2 and 3 are correct. Non-Resident external deposits are a 'debt creating' flow in balance of payments accounts and therefore, not part of Foreign Direct investments. Hence options 4 is not correct.
33. A
34. D - Borrowing from public and banks will lead to a decrease in the money supply in market as in both the options money in hand is reduced for public and money to lend is reduced for banks. Creation of new money to finance a budget deficit will have more inflationary effect than repayment of debt, as it will lead to an increase in total money supply in the market.(as new money is being created). Hence option (d) is the correct answer. During last fiscal year, option of monetization of deficit was explored but idea was dropped due to likely inflationary pressure.
35. A- Demand Pull Inflation- This type of inflation is caused by increase in demand and when the demand in the economy outgrows the supply in the economy. This kind of inflation can be described by "too much money chasing too few goods". One of the reasons for demand pull inflation can be the increase in money supply, by way of increased salary, increased government expenditure etc
36. A
37. B
38. A
39. A
40. D
41. C - Merchant Discount Rate is a fee charged from a merchant by a bank for accepting payments from customers through credit and debit cards in their establishments. It compensates the card issuing bank, the lender which puts the PoS terminal and payment gateways such as Mastercard or Visa for their services. MDR charges are usually shared in pre-agreed proportion between the bank and a merchant and is expressed in percentage of transaction amount.
42. B - Fiscal Responsibility and Budget Management (FRBM) became an Act in 2003. The objective of the Act is to ensure inter-generational equity in fiscal management, long run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in fiscal operation of the Government. • FRBM Act provides a legal institutional framework for fiscal consolidation. It is now mandatory for the Central government to take measures to reduce fiscal deficit, to eliminate revenue deficit and to generate revenue

surplus in the subsequent years. The Act binds not only the present government but also the future Government to adhere to the path of fiscal consolidation. • The Government can move away from the path of fiscal consolidation in certain cases as prescribed by the law or other exceptional grounds which Central Government may specify. • The subsection 4 (2) of the Act says about various grounds on which the FRBM's fiscal deficit target may be exempted during a year.

- o National security, act of war
- o National calamity
- o Collapse of agriculture severely affecting farm output and incomes
- o Structural reforms in the economy with unanticipated fiscal implications
- o Decline in real output growth of a quarter by at least three per cent points below its average of the previous four quarters

• Hence option (b) is the correct answer.

43. C - Unemployment can be defined as a state of worklessness for a person who is fit and willing to work at the current wage rate. It is a condition of involuntary and not voluntary idleness. Involuntary unemployment can be further divided into cyclical unemployment, seasonal unemployment, structural unemployment, frictional unemployment, the natural rate of unemployment, disguised unemployment and underemployment.
- Seasonal unemployment occurs in a particular time of the year or season and thus is known as seasonal unemployment. Seasonal unemployment is most common in industries like agriculture, tourism, hotel, catering etc. Hence option 1 is not correct.
 - Frictional unemployment occurs as a result of people voluntarily changing jobs within an economy. After a person leaves a company, seeking a better job or being fired from a current job. Hence option 2 is correct.
 - Underemployment occurs when a person is employed but not in a befitting position or salary corresponding to his qualification. Hence option 3 is correct.
 - Structural unemployment comes about through a technological change in the structure of the economy in which labour markets operate. It is a mismatch between the supply and demand for certain skills in the labour market. For e.g. Technological changes such as the replacement of bicycle by automobiles or the automation of manufacturing—lead to unemployment among workers displaced from the bicycle sector. Hence option 4 is not correct.
44. C - A base year is the first of a series of years in an economic or financial index. It is typically set to an arbitrary level of 100. New, up-to-date base years are periodically introduced to keep data current in a particular index. Any year can serve as a base year, but analysts typically choose recent years.
- A base year is used for comparison in the measure of a business activity or economic index. Hence, statement 1 is correct.
 - A revision in the base year is essential for better policymaking. It is meant to track structural changes in an economy and improve or update macroeconomic indicators that reflect the economic performances of a country. Hence, statement 2 is correct.
 - Currently, the base year for GDP calculation is 2011-12 and the base year for CPI calculation is 2012. Hence, statement 3 is not correct.
45. D - Product Taxes and subsidies and Production Taxes and subsidies are used by CSO (now NSO) in the calculation of GVA at basic prices and GVA at market prices. Gross value added (GVA) is an economic productivity metric that measures the contribution of a corporate subsidiary, company or municipality to an economy, producer, sector or region.
- Production taxes and subsidies are paid or received in relation to production and are independent of the volume of production such as land revenues, stamp and registration fee. Hence, statement 2 is not correct.
 - Product taxes and subsidies, on the other hand, are paid or received per unit

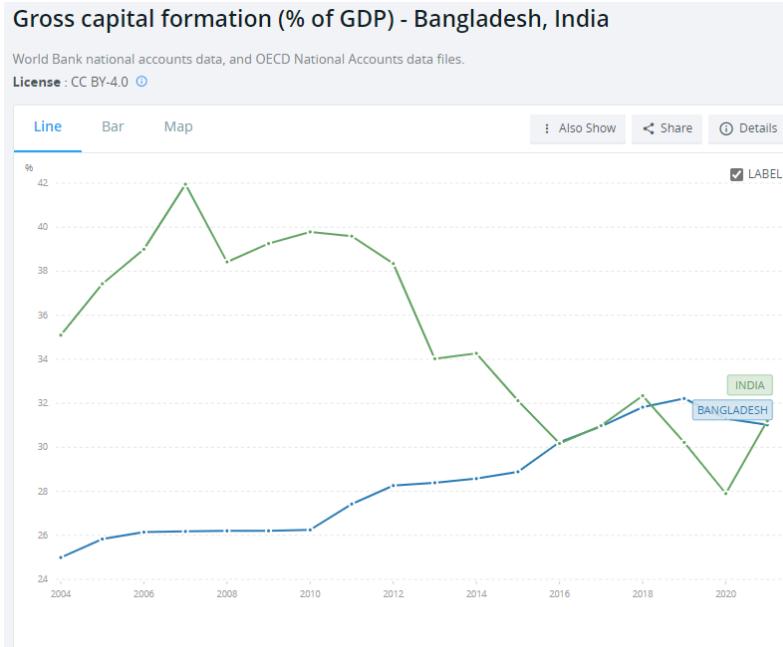
or product, e.g., excise tax, service tax, export and import duties etc. Hence, statement 1 is not correct. • GVA at factor costs + Net production taxes = GVA at basic prices + Net product taxes = GVA at market prices

46. A - Interest rates are a monetary policy tool used by central banks to influence inflation throughout an economy. In case of a negative interest rate a central bank attempts to combat deflation by reducing interest rates past zero, into negative rates. • In this situation instead of receiving money on deposits in the form of interest, depositors must pay regularly to keep their money with the bank. Impacts of Negative interest rates on the economy: • lower borrowing costs as banks are willing to lend money more freely. • Negative rates weaken currency which would encourage exports. • Negative rates would discourage investment in domestic markets and investors tend to search for better returns in foreign markets.
47. D - Gross capital formation is defined as outlays on additions to fixed assets, plus the net change in inventories. Fixed assets include plant, machinery, equipment, and buildings, all used to create goods and services. Inventory includes raw materials and goods available for sale. Hence statement 1 is correct. • Countries need capital goods to replace the older ones that are used to produce goods and services. If a country cannot replace capital goods as they reach the end of their useful lives, production declines. Generally, the higher the capital formation of an economy, the faster an economy can grow its aggregate income. So, if additional capital goods are utilized, it will lead to increase in goods and services. Hence statement 2 is correct. • GCF of India and neighbouring countries, according to World Bank

Gross capital formation (% of GDP) - Bangladesh, India

World Bank national accounts data, and OECD National Accounts data files.

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48. C - In India, food prices rose steadily during the last months of 2009 and the early months of 2010, even though the prices of non-food items continued to be relatively stable. As this somewhat unusual phenomenon stubbornly persisted, and policymakers conferred on how to bring it to an end, the term 'skewflation' made an appearance in the Economic Survey 2009-10, Government of India, Ministry of Finance. • Given that it is sector specific, it is not evident that it calls for monetary or fiscal policy action. On the other hand, given its

sustained nature, it is not possible for government to ignore it, since causes stress to consumers. • Skewflation means the skewness of inflation among different sectors of the economy - some goods and services are facing huge inflation, some none and some deflation. In other words, it means "when there is a price rise of one or a small group of commodities over a sustained period of time while Inflation in the remaining goods and services remain usual". • Hence option (c) is the correct answer.

49. D

Table 2: Break up of central government receipts in 2022-23 (Rs crore)

	Actuals 2020-21	Budgeted 2021-22	Revised 2021-22	Budgeted 2022-23	% change (RE 2021-22 to BE 2022-23)
Gross Tax Revenue	20,27,104	22,17,059	25,16,059	27,57,820	9.6%
<i>of which:</i>					
Corporation Tax	4,57,719	5,47,000	6,35,000	7,20,000	13.4%
Taxes on Income	4,87,144	5,61,000	6,15,000	7,00,000	13.8%
Goods and Services Tax	5,48,778	6,30,000	6,75,000	7,80,000	15.6%
Customs	1,34,750	1,36,000	1,89,000	2,13,000	12.7%
Union Excise Duties	3,91,749	3,35,000	3,94,000	3,35,000	-15.0%
Service Tax	1,615	1,000	1,000	2,000	100.0%
A. Centre's Net Tax Revenue	14,26,287	15,45,397	17,65,145	19,34,771	9.6%
Devolution to States	5,94,997	6,65,563	7,44,785	8,16,649	9.6%
B. Non Tax Revenue	2,07,633	2,43,028	3,13,791	2,69,651	-14.1%
<i>of which:</i>					
Interest Receipts	17,113	11,541	20,894	18,000	-13.9%
Dividend and Profits	96,877	1,03,538	1,47,353	1,13,948	-22.7%
Other Non-Tax Revenue	93,641	1,27,948	1,45,544	1,37,703	-5.4%
C. Capital Receipts (excl. borrowings)	57,626	1,88,000	99,975	79,291	-20.7%
<i>of which:</i>					
Disinvestment	37,897	1,75,000	78,000	65,000	-16.7%
Receipts (without borrowings) (A+B+C)	16,91,546	19,76,425	21,78,911	22,83,713	4.8%
Borrowings	18,18,291	15,06,812	15,91,089	16,61,196	4.4%
Total Receipts (including borrowings)	35,09,836	34,83,236	37,70,000	39,44,909	4.6%

Indirect taxes: The total indirect tax collections are estimated to be Rs 13,30,000 crore in 2022-23. Of this, the government has estimated to raise Rs 7,80,000 crore from GST. Out of the total tax collections under GST, 85% is expected to come from central GST (Rs 6,60,000 crore), and 15% (Rs 1,20,000 crore) from the GST compensation cess.

- **Corporation tax:** The collections from taxes on companies are expected to increase by 13% in 2022-23 to Rs 7,20,000 crore. The revised estimates of 2021-22 indicate an increase in corporate tax collections to Rs 6,35,000 crore from Rs 5,47,000 crore at the budget estimate stage.
- **Income tax:** The collections from income tax are expected to increase by 14% in 2022-23 to Rs 7,00,000 crore. According to the revised estimate for 2021-22, income tax collection will be of Rs 6,15,000 which is 9.6% higher than Rs 5,61,000 at the budget estimate stage.
- **Non-tax receipts:** Non-tax revenue consists of interest receipts on loans given by the centre, dividends and profits, external grants, and receipts from general, economic, and social services,

among others. In 2022-23, non-tax revenue is expected to decrease by 14% over the revised estimates of 2021-22 to Rs 2,69,651 crore. This is due to a decline of 14% in interest receipts and a decline of 23% in dividend and profits.

- **Disinvestment target:** The disinvestment target for 2022-23 is Rs 65,000 crore. This is 17% lower than the revised estimate of 2021-22 (Rs 78,000 crore).

50. B - Fiscal drag is an economic term whereby inflation or income growth moves taxpayers into higher tax brackets. This in effect increases government tax revenue without actually increasing tax rates. The increase in taxes reduces aggregate demand and consumer spending from taxpayers as a larger share of their income now goes to taxes, which leads to deflationary policies, or drag, on the economy. • Fiscal drag is essentially a slowing in the growth of the economy caused by a lack of spending as increased taxation slows the demand for goods and services. When an economy is rapidly expanding, inflation results in higher income and therefore individuals moving into higher tax brackets and paying more of their income in taxes. This is particularly the case in economies with progressive taxes, or tax brackets, which stipulate that the higher income an individual makes the higher the tax they pay and thus they move into a higher tax bracket. • Moving into a higher tax bracket and paying a larger portion of income in taxes, as mentioned prior, results in an eventual slowing of the economy as there is now less income available for discretionary spending. • It is common to view fiscal drag as a natural economic stabilizer as it tends to keep demand stable and the economy from overheating. This is generally viewed as a mild deflationary policy and a positive aspect to fiscal drag. • Hence option (b) is the correct answer.
51. C - If the expenditure of the government exceeds its income, the government is said to have incurred a fiscal deficit. This deficit financing has to be done either by borrowing from the market or monetisation of deficit through RBI. • Monetisation of Deficit: It involves the financing of such extra expenses with money, instead of debt to be repaid at some future dates. So, it is a form of non-debt financing. As a result, under monetization, there is no increase in net (not gross) public debt. Hence statement 1 and 2 are not correct. It can occur only through one of two modalities: o Direct Monetization o Indirect Monetization • Direct Monetization (DM): Under this method, RBI prints new currency and purchases government bonds directly from the primary market (from the government) using this currency. As a result, this supports the spending needs of the government. • Indirect monetization (IM): In this method, deficits are monetized as the government issues bonds in the primary market and the RBI purchases an equivalent amount of government bonds from the secondary market in the form of Open Market Operations (OMO). • Monetisation of deficit was in practice in India till 1997, whereby the central bank automatically monetised government deficit through the issuance of ad-hoc treasury bills. • In 1994 and 1997, two agreements were signed between the government and RBI to completely phase out funding through ad-hoc treasury bills. • Later on, with the enactment of Fiscal Responsibility and Budget Management (FRBM) Act, 2003, RBI was completely barred from subscribing to the primary issuances of the government. It was agreed that henceforth, the RBI would operate only in the secondary market through the OMO (open market operations) route. Hence statement 3 is correct.

Economics Class Handout

1. NABARD
2. NBFCs

NABARD

The importance of institutional credit in boosting rural economy has been clear to the Government of India right from its early stages of planning. Therefore, the Reserve Bank of India (RBI) at the insistence of the Government of India, constituted a Committee to Review the Arrangements For Institutional Credit for Agriculture and Rural Development (CRAFICARD) to look into these very critical aspects. The Committee was formed on 30 March 1979, under the Chairmanship of Shri B. Sivaraman, former member of Planning Commission, Government of India.

The Committee's interim report, submitted on 28 November 1979, outlined the need for a new organisational device for providing undivided attention, forceful direction and pointed focus to credit related issues linked with rural development. Its recommendation was formation of a unique development financial institution which would address these aspirations and formation of National Bank for Agriculture and Rural Development (NABARD) was approved by the Parliament through Act 61 of 1981.

NABARD came into existence on 12 July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then Agricultural Refinance and Development Corporation (ARDC). Consequent to the revision in the composition of share capital between Government of India and RBI, NABARD today is fully owned by Government of India.

MISSION

Promote sustainable and equitable agriculture and rural development through participative financial and non-financial interventions, innovations, technology and institutional development for securing prosperity.

FUNCTIONS

Categorized broadly into three heads: Financial, Developmental and Supervision- touch almost every aspect of rural economy.

- Providing refinance support, building rural infrastructure
- Preparing district level credit plans, guiding and motivating the banking industry in achieving these targets
- Supervising Cooperative Banks and Regional Rural Banks (RRBs), helping them develop sound banking practices and onboarding them to the CBS platform
- Designing new development schemes, implementation of Government of India's development schemes
- Training handicraft artisans, providing them a marketing platform for selling these articles.

The SHG Bank Linkage Project launched by NABARD in 1992 has blossomed into the world's largest micro finance project. Kisan Credit Card, designed by NABARD has become source of comfort for crores of farmers. It has financed one fifth of India's total rural infrastructure and was a pioneer in the field of watershed development as a tool for sustainable climate proofing.

1. Financial functions:

Direct Finance:

- Loans for Food Parks and units, warehouses, cold storage and cold chain infrastructure
- Credit Facilities to Marketing Federations
- Rural Infrastructure Development Fund , NABARD infrastructure Development Assistance
- Direct Refinance to Cooperative Banks, supporting Producer Organisations

Indirect Finance: Making contributions to Alternative Investment Funds invested in rural sectors

- **Long Term Irrigation Fund**

Setup in 2016, a dedicated Long Term Irrigation Fund (LTIF) in NABARD with an initial corpus of `20,000 crore for funding and fast tracking the implementation of incomplete major and medium irrigation projects. A Mission has been established in the Ministry of Water Resources, River Development and Ganga Rejuvenation (MoWR, RD & GR) for overall implementation of the scheme. The Long Term Irrigation Fund (LTIF) aims to bridge the resource gap and facilitate completion of these projects during 2016-2020. 23 projects (priority-I) have been identified to be completed by 2016-17, 31 projects (priority –II) have been identified to be completed by 2017-18 and balance 45 projects (priority – III) have been identified to be completed by 2019-20.

- **Pradhan Mantri Aawas Yojana - Grameen (PMAY-G)**

PMAY-G aims at providing a pucca house, with basic amenities, to all houseless households and those households living in kutcha and dilapidated house, by 2022. The implementation of PMAY-G is being done by the Ministry of Rural Development (MoRD), Government of India (GoI). Around 2.95 crore houses are to be constructed under PMAY-G by 2022 in a phased manner, out of which one crore houses are expected to be completed by March 2019.

Out of the total financial requirement of Rs.81,975 crore for construction of one crore houses in a period of 3 years (2016-17 to 2018-19), an amount of Rs.60,000 crore are expected to be met from budgetary sources and the balance financial requirement of Rs.21,975 crore are proposed to be met through borrowings from NABARD.

During 2017-18, an amount of Rs.9,000 crore was sanctioned by NABARD to NRIDA for funding central share under PMAY-G.

- **Refinance**
 - o Off-farm refinance: E.g. for rural housing, renewable energy, rural MSMEs, etc.
 - o Short Term Refinance

It is linked operationally with productivity and other services, i.e. production and productivity, marketing and raising the level of surplus and savings are the desired objectives to be met.

- o **Long Term Refinance (LTF)**

Investment credit leads to capital formation through asset creation. It induces technological upgradation resulting in increased production, productivity and incremental income to farmers and entrepreneurs. NABARD provides Long Term and Medium Term Refinance to banks for providing adequate credit for taking up investment activities by farmers and rural artisans etc. The loan period is upto a maximum of 15 years. It is intended to create income generating assets in the following sectors:

- Agriculture and allied activities
- Artisans, small scale industries, Non-Farm Sector (Small and Micro Enterprises), handicrafts, handlooms, powerlooms, etc.
- Activities of voluntary agencies and self-help groups working among the rural poor

State cooperative Agricultural & Rural development Banks, RRBs, Commercial banks, NBFC, etc. are all eligible to access refinance facility.

LTR is given for both farm and non-farm sectors. Farm sector includes Agriculture and allied activities such as minor irrigation, farm mechanisation, land development, soil conservation, dairy, sheep/goat rearing, etc. Non-farm sector includes artisans, handicrafts, handlooms, MSME, etc.

2. DEVELOPMENTAL

Institutional Development

More than 50% of the rural credit is disbursed by the Co-operative Banks and Regional Rural Banks. NABARD is responsible for regulating and supervising the functions of Co-operative banks and RRBs. In this direction NABARD has been taking various initiatives in association with Government of India and RBI to improve the health of Co-operative banks and Regional Rural Banks.

As part of its Institutional Development (ID) initiatives, NABARD supports the following institutions:

- Rural Credit Cooperatives
- State Cooperative Banks (StCBs)
- Central Cooperative Banks (CCBs)
- Primary Agricultural Credit Societies (PACS)
- State Cooperative Agriculture and Rural Development Banks (SCARDBs)
- Primary Cooperative Agriculture and Rural Development Banks (PCARDBs)

Farm Sector:

- Farm Sector Development Department (FSDD)
- Farm Sector Policy Department (FSPD)

Off Farm Sector:

- Financial Inclusion
- Micro Credit Innovation
- Women Self-Help groups and Joint Liability groups, SHG-Bank Linkage programme.
- Microfinance to various bodies

E.g. RUDSETI / RUDSETI Type of Institutions / RSETIs

As an effort to institutionalize the Entrepreneurship and Skill Development initiatives, NABARD provides support to specialised institutions viz., RUDSETI/RUDSETI type of Institutions & RSETIs, which provide entrepreneurship development and training to rural youth/women on various skills, which can generate better livelihood options. Assistance is provided to these institutions, which comply with the criteria stipulated by NABARD.

Research & Development functions

Climate Change

Adaptation Fund under United Nations Framework Convention on Climate Change (UNFCCC)

The Adaptation Fund (AF) was set up under the Kyoto Protocol of the United Nations Framework Convention on Climate Change (UNFCCC). It was established in 2001 and officially launched in 2007 at COP 7 in Marrakech, Morocco. It aims to finance concrete projects and programmes that help vulnerable communities in developing countries that are Parties to the Kyoto Protocol to adapt to climate change. The Fund is financed in part by government and private donors, and also from a two percent share of proceeds of Certified Emission Reductions (CERs) issued under the Protocol's Clean Development Mechanism (CDM) projects.

The Adaptation Fund headquartered in Washington, USA is supervised and managed by the Adaptation Fund Board (AFB). The AFB is composed of 16 members and 16 alternates and holds periodic meetings throughout the year. The World Bank serves as trustee of the Adaptation Fund on an interim basis.

Ministry of Environment, Forest & Climate Change, Govt. of India is the National Designated Authority (NDA) for Adaptation Fund and proposals are submitted with endorsement of NDA.

NABARD has been accredited as National Implementing Entity (NIE) for Adaptation Fund in July 2012 and is the only NIE for India. The NIEs are those national legal entities nominated by Parties (to the Kyoto Protocol) that are recognized by the Board as meeting the fiduciary standards established by the Board. The NIEs bear full responsibility for the overall management of the projects and programmes financed by the Adaptation Fund and have all financial, monitoring, and reporting responsibilities.

Green Climate Fund

The Green Climate Fund has been designated as an operating entity of the financial mechanism of the UNFCCC. The decision to set up the Green Climate fund (GCF) was taken at COP 16 in Cancun on December 2010 and the GCF was operationalized in COP 17 in Durban in 2011. The GCF is head quartered in Songdo, Incheon City, Republic of Korea.

In the context of sustainable development, the Fund aims to promote a paradigm shift towards low emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change, taking into account the needs of those developing countries particularly vulnerable to the adverse effects of climate change.

NABARD is accredited as National Implementing Entity

National Adaptation Fund for Climate Change

The National Adaptation Fund for Climate Change (NAFCC) was established in August, 2015 to meet the cost of adaptation to climate change for the State and Union Territories of India that are particularly vulnerable to the adverse effects of climate change. Government has set up a budget provision of Rs.350 crores for the year 2015-16 and 2016-17, with an estimated requirement of Rs. 181.5 crores for financial year 2017-18 for NAFCC. The projects under NAFCC prioritizes the needs that builds climate resilience in the areas identified under the SAPCC (State Action Plan on Climate Change) and the relevant Missions under NAPCC (National Action Plan on Climate Change).

Considering the existing arrangement with NABARD as National Implementing Entity (NIE) for Adaptation Fund (AF) under Kyoto Protocol and its presence across the country, NABARD has been designated as National Implementing Entity (NIE) for implementation of adaptation projects under NAFCC by Govt. of India. Under this arrangement, NABARD would perform roles in facilitating identification of project ideas/concepts from State Action Plan for Climate Change (SAPCC), project formulation, appraisal, sanction, disbursement of fund, monitoring & evaluation and capacity building of stakeholders including State Governments.

Climate Change Fund

In keeping with the commitment of NABARD to address impact of climate change the “**Climate Change Fund**” was created out of the profit of NABARD during 2016-17 for facilitating attempts to address impacts of climate change especially towards fostering sustainable development. NABARD contributes annually from its profit towards the corpus of the fund.

Institution of the “Climate Change Fund” is a unique initiative of NABARD as a Development Financial Institution to foster sustainable development and contribute meaningfully towards national priorities. The objective of this fund is to promote and support activities aimed towards addressing

climate change impacts, adaptation and mitigation measures, awareness generation, knowledge sharing and facilitate sustainable development.

3. Supervision functions

Section 35(6) of the Banking Regulation Act, 1949, empowers NABARD to conduct inspection of State Cooperative Banks (StCBs), Central Cooperative Banks (DCCBs) and Regional Rural Banks (RRBs). In addition, NABARD has also been conducting periodic inspections of state level cooperative institutions such as State Cooperative Agriculture and Rural Development Banks (SCARDBs), Apex Weavers Societies, Marketing Federations etc., on a voluntary basis.

Objectives of Supervision

- To protect the interest of present and future depositors
- To ensure that the business conducted by these banks is in conformity with the Provisions of the relevant Acts/Rules, regulations/Bye-Laws
- To ensure observance of rules, guidelines, etc., formulated and issued by NABARD/RBI/Government
- To examine the financial soundness of the banks and
- To suggest ways and means for strengthening the institutions so as to enable them to play a more efficient role in purveying rural credit

NBFCs

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Q. NBFCs are doing functions similar to banks. What is difference between banks & NBFCs?

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

- i. NBFC cannot accept demand deposits;
- ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
- iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

Q. What are systemically important NBFCs?

NBFCs whose asset size is of ₹ 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

Q. Is it necessary that every NBFC should be registered with RBI?

In terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial company can commence or carry on business of a non-banking financial institution without a) obtaining a certificate of registration from the Bank and without having a Net Owned Funds of ₹ 25 lakhs (₹ Two crore since April 1999). However, in terms of the powers given to the Bank, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under Section 620A of the Companies Act, 1956, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982, Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

Q. Does the Reserve Bank regulate all financial companies?

No. Housing Finance Companies, Merchant Banking Companies, Stock Exchanges, Companies engaged in the business of stock-broking/sub-broking, Venture Capital Fund Companies, Nidhi Companies, Insurance companies and Chit Fund Companies are NBFCs but they have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions. Housing Finance Companies are regulated by National Housing Bank, Merchant Banker/Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India, and Insurance companies are regulated by Insurance Regulatory and

Development Authority. Similarly, Chit Fund Companies are regulated by the respective State Governments and Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India. Companies that do financial business but are regulated by other regulators are given specific exemption by the Reserve Bank from its regulatory requirements for avoiding duality of regulation. It may also be mentioned that Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934. Core Investment Companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration with the RBI.

Q. What are the different types/categories of NBFCs registered with RBI?

NBFCs are categorized a) in terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs, b) non deposit taking NBFCs by their size into systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND) and c) by the kind of activity they conduct. Within this broad categorization the different types of NBFCs are as follows:

- Asset Finance Company (AFC) : An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors
- Investment Company (IC) : IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,
- Infrastructure Finance Company (IFC): IFC is a non-banking finance company a) which deploys at least 75 per cent of its total assets in infrastructure loans, b) has a minimum Net Owned Funds of ₹ 300 crore, c) has a minimum credit rating of 'A' or equivalent d) and a CRAR of 15%.
- Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC) : IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.
- Systemically Important Core Investment Company (CIC-ND-SI): CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the some conditions.
- Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI): NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets and satisfy some other criteria.
- Non-Banking Financial Company – Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.
- Mortgage Guarantee Companies (MGC) - MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹ 100 crore
- NBFC- Non-Operative Financial Holding Company (NOFHC) is financial institution through which promoter / promoter groups will be permitted to set up a new bank .It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

Q. What is a Residuary Non-Banking Company (RNBC)? In what way it is different from other NBFCs?

Residuary Non-Banking Company is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are required to maintain investments as per directions of RBI, in addition to liquid assets. The functioning of these companies is different from those of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds as per Directions. Besides, Prudential Norms Directions are applicable to these companies also. every RNBC has to ensure that the amounts deposited with it are fully invested in approved investments.

Q. We understand that there is no ceiling on raising of deposits by RNBCs, then how safe is deposit with them?

It is true that there is no ceiling on raising of deposits by RNBCs. However, every RNBC has to ensure that the amounts deposited with it are fully invested in approved investments. In other words, in order to secure the interests of depositor, such companies are required to invest 100 per cent of their deposit liability into highly liquid and secure instruments, namely, Central/State Government securities, fixed deposits with scheduled commercial banks (SCB), Certificate of Deposits of SCB/FIs, units of Mutual Funds, etc.

Q. What are the various prudential regulations applicable to NBFCs?

The RBI has issued detailed directions on prudential norms, vide Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007, Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 and Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. Applicable regulations vary based on the deposit acceptance or systemic importance of the NBFC.

The directions inter alia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for NBFCs predominantly engaged in business of lending against gold jewellery, besides others. Deposit accepting NBFCs have also to comply with the statutory liquidity requirements. Details of the prudential regulations applicable to NBFCs holding deposits and those not holding deposits is available in the section 'Regulation – Non-Banking – Notifications - Master Circulars' in the RBI website.

Q. NBFCs are charging high interest rates from their borrowers. Is there any ceiling on interest rate charged by the NBFCs to their borrowers?

Reserve Bank of India has deregulated interest rates to be charged to borrowers by financial institutions (other than NBFC- Micro Finance Institution). The rate of interest to be charged by the company is governed by the terms and conditions of the loan agreement entered into between the borrower and the NBFCs. However, the NBFCs have to be transparent and the rate of interest and manner of arriving at the rate of interest to different categories of borrowers should be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter etc.

Q. Which entities can legally accept deposits from public?

Banks, including co-operative banks, can accept deposits. Non-bank finance companies, which have been issued Certificate of Registration by RBI with a specific licence to accept deposits, are entitled to accept public deposit. In other words, not all NBFCs registered with the Reserve Bank are entitled to accept deposits but only those that hold a deposit accepting Certificate of Registration can accept deposits. They can, however, accept deposits, only to the extent permissible. Housing Finance Companies, which are again specifically authorized to collect deposits and companies authorized by Ministry of Corporate Affairs under the Companies Acceptance of Deposits Rules framed by Central Government under the Companies Act can also accept deposits also upto a certain limit. Cooperative Credit Societies can accept deposits from their members but not from the general public. The Reserve Bank regulates the deposit acceptance only of banks, cooperative banks and NBFCs.

It is not legally permissible for other entities to accept public deposits. Unincorporated bodies like individuals, partnership firms, and other association of individuals are prohibited from carrying on the business of acceptance of deposits as their principal business. Such unincorporated bodies are prohibited from even accepting deposits if they are carrying on financial business.

Q. Can all NBFCs accept deposits? Is there any ceiling on acceptance of Public Deposits? What is the rate of interest and period of deposit which NBFCs can accept?

All NBFCs are not entitled to accept public deposits. Only those NBFCs to which the Bank had given a specific authorisation and have an investment grade rating are allowed to accept/ hold public deposits to a limit of 1.5 times of its Net Owned Funds. All existing unrated AFCs that have been allowed to accept deposits shall have to get themselves rated by March 31, 2016. Those AFCs that do not get an investment grade rating by March 31, 2016, will not be allowed to renew existing or accept fresh deposits thereafter. In the intervening period, i.e. till March 31, 2016, unrated AFCs or those with a sub-investment grade rating can only renew existing deposits on maturity, and not accept fresh deposits, till they obtain an investment grade rating.

However, as a matter of public policy, Reserve Bank has decided that only banks should be allowed to accept public deposits and as such has since 1997 not issued any Certificate of Registration (CoR) to new NBFCs for acceptance of public deposits.

Presently, the maximum rate of interest an NBFC can offer is 12.5%. The interest may be paid or compounded at rests not shorter than monthly rests. The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.

Q. Why is the RBI so restrictive in allowing NBFCs to raise public deposits?

The Reserve Bank's overarching concern while supervising any financial entity is protection of depositors' interest. Depositors place deposit with any entity on trust unlike an investor who invests in the shares of a company with the intention of sharing the risk as well as return with the promoters. Protection of depositors' interest thus is supreme in financial regulation. Banks are the most regulated financial entities. The Deposit Insurance and Credit Guarantee Corporation pays insurance on deposits up to ₹ One lakh in case a bank failed.

Collective Investment Schemes (CIS) and Chit Funds

Chit Funds / Chitty / Kuri/ Miscellaneous Non-banking Company

Chit funds are essentially saving institutions. They are of various forms and lack any standardised form. Chit funds have regular members who make periodical subscriptions to the fund. The periodic collection is given to some member of the chit funds selected on the basis of previously agreed criterion. The beneficiary is selected usually on the basis of bids or by draw of lots or in some cases by auction or by tender. In any case, each member of the chit fund is assured of his turn before the second round starts and any member becomes entitled to get periodic collection again.

Chit funds are the Indian versions of Rotating Savings and Credit Associations found across the globe.

Official Definition

As per Section 2 (b) of the Chit Funds Act 1982, chit means “a transaction whether called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical instalments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount. A transaction is not a chit within the meaning of this clause, if in such transaction, -
some alone, but not all, of the subscribers get the prize amount without any liability to pay future subscriptions; or
all the subscribers get the chit amount by turns with a liability to pay future subscriptions;

Regulatory framework

Chit fund business is regulated under the Central Act of Chit Funds Act, 1982 and the Rules framed under this Act by the various State Governments for this purpose. Central Government has not framed any Rules of operation for them. Thus, Registration and Regulation of Chit funds are carried out by State Governments under the Rules framed by them.

Functionally, Chit funds are included in the definition of Non-Banking Financial Companies by RBI under the sub-head *miscellaneous non-banking company*(MNBC). But RBI has not laid out any separate regulatory framework for them.

Cheating by Chit Fund company through fraudulent schemes is an offence under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. The power to investigate and prosecute lies with the State Governments.

For better identification of Chit Fund Companies, Rule 8(2)(b)(iii) of Companies (Incorporation) Rules, 2014 framed under the Companies Act, 2013, provides that if the company's main business is that of a chit fund, its incorporation will not be allowed unless its name is indicative of that financial activity, viz., Chit Fund

Q. What is the difference between acceptance of money by Chit Funds and acceptance of deposits?

Deposits are defined under the RBI Act 1934 as acceptance of money other than that raised by way of share capital, money received from banks and other financial institutions, money received as security deposit, earnest money and advance against goods or services and subscriptions to chits. All other amounts, received as loan or in any form are treated as deposits. Chit Funds activity involves contributions by members in instalments by way of subscription to the Chit and by rotation each member of the Chit receives the chit amount. The subscriptions are specifically excluded from the definition of deposits and cannot be termed as deposits. While Chit funds may collect subscriptions as above, they are prohibited by RBI from accepting deposits with effect from August 2009.

Q. Is the conducting of Chit Fund business permissible under law?

The chit funds are governed by Chit Funds Act, 1982 which is a Central Act administered by state governments. Those chit funds which are registered under this Act can legally carry on chit fund business.

Q. If Chit Fund companies are financial entities, why are they not regulated by RBI?

Chit Fund companies are regulated under the Chit Fund Act, 1982, which is a Central Act, and is implemented by the State Governments. RBI has prohibited chit fund companies from accepting deposits from the public in 2009. In case any Chit Fund is accepting public deposits, RBI can prosecute such chit funds.

Money Circulation/Multi-Level Marketing (MLM)/ Ponzi Schemes/ Unincorporated Bodies (UIBs)

Q. There are some companies like Multi-Level Marketing companies, Direct Selling Companies, Online Selling Companies. Do they come under the purview of RBI?

No, Multi-Level Marketing companies, Direct Selling Companies, Online Selling Companies do not fall under the purview of RBI. Activities of these companies fall under the regulatory/administrative domain of respective state government.

Q. Are Collective Investment Schemes (CIS) regulated by the Reserve Bank of India?

No. CIS are schemes where money is exchanged for units, be it time share in resorts, profit from sale of wood or profits from the developed commercial plots and buildings and so on. Collective Investment Schemes (CIS) do not fall under the regulatory purview of the Reserve Bank.

Q. Which is the authority that regulates Collective Investment Schemes (CIS)?

SEBI is the regulator of CIS. Information on such schemes and grievances against the promoters may be immediately forwarded to SEBI as well as to the EOW/Police Department of the State Government.

Q. What are money circulation/Ponzi/multi-level marketing schemes?

Money circulation, multi level marketing / Chain Marketing or Ponzi schemes are schemes promising easy or quick money upon enrollment of members. Income under Multi level marketing or pyramid structured schemes do not come from the sale of products they offer as much as from enrolling more and more members from whom hefty subscription fees are taken. It is incumbent upon all members to enroll more members, as a portion of the subscription amounts so collected are distributed among the members at the top of the pyramid. Any break in the chain leads to the collapse of the pyramid, and the members lower in the pyramid are the ones that are affected the most. Ponzi schemes are those schemes that collect money from the public on promises of high returns. As there is no asset creation, money collected from one depositor is paid as returns to the other. Since there is no other activity generating returns, the scheme becomes unviable and impossible for the people running the scheme to meet the promised return or even return the principal amounts collected. The scheme inevitably fails and the perpetrators disappear with the money.

Q. Is acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structured schemes allowed? Does RBI regulates such schemes?

No. Acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structured schemes and Ponzi schemes is not allowed as acceptance of money under those schemes is a cognizable offence under the Prize Chit and Money Circulation (Banning) Act 1978 and are hence banned. The Reserve Bank has no role in implementation of this Act, except advising and assisting the Central Government in framing the Rules under this Act.

Q. Then who regulates entities that run such schemes?

Money Circulation/Multi-level Marketing /Pyramid structured schemes are an offence under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. The Act prohibits any person or individual to promote or conduct any prize chit or money circulation scheme or enrol as member to its schemes or anyone to participate in it by either receiving or remitting any money in pursuance of such chit or scheme. Contravention of the provisions of this Act, is monitored and dealt with by the State Governments.

CHART - I

Overview of Regulators of Non-Banking Companies

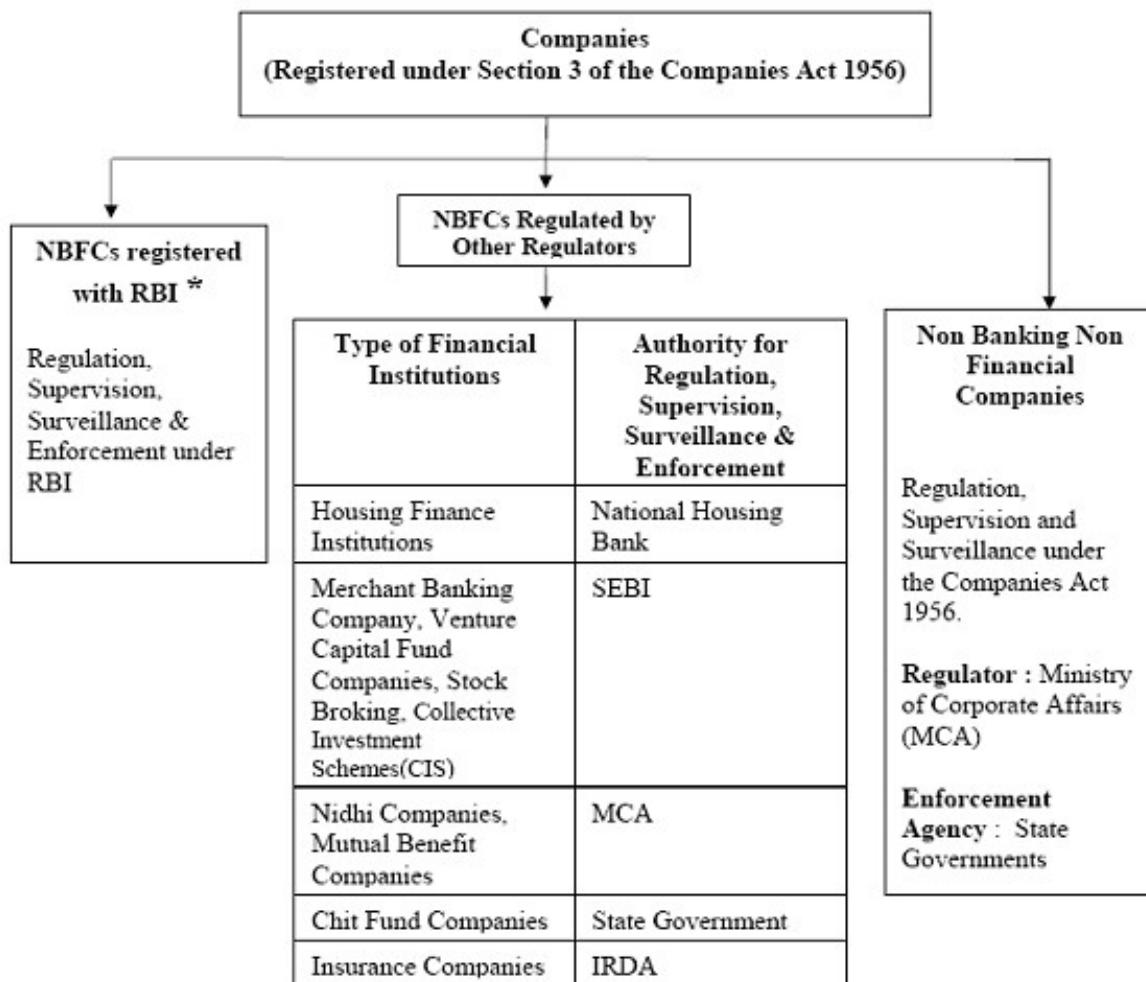
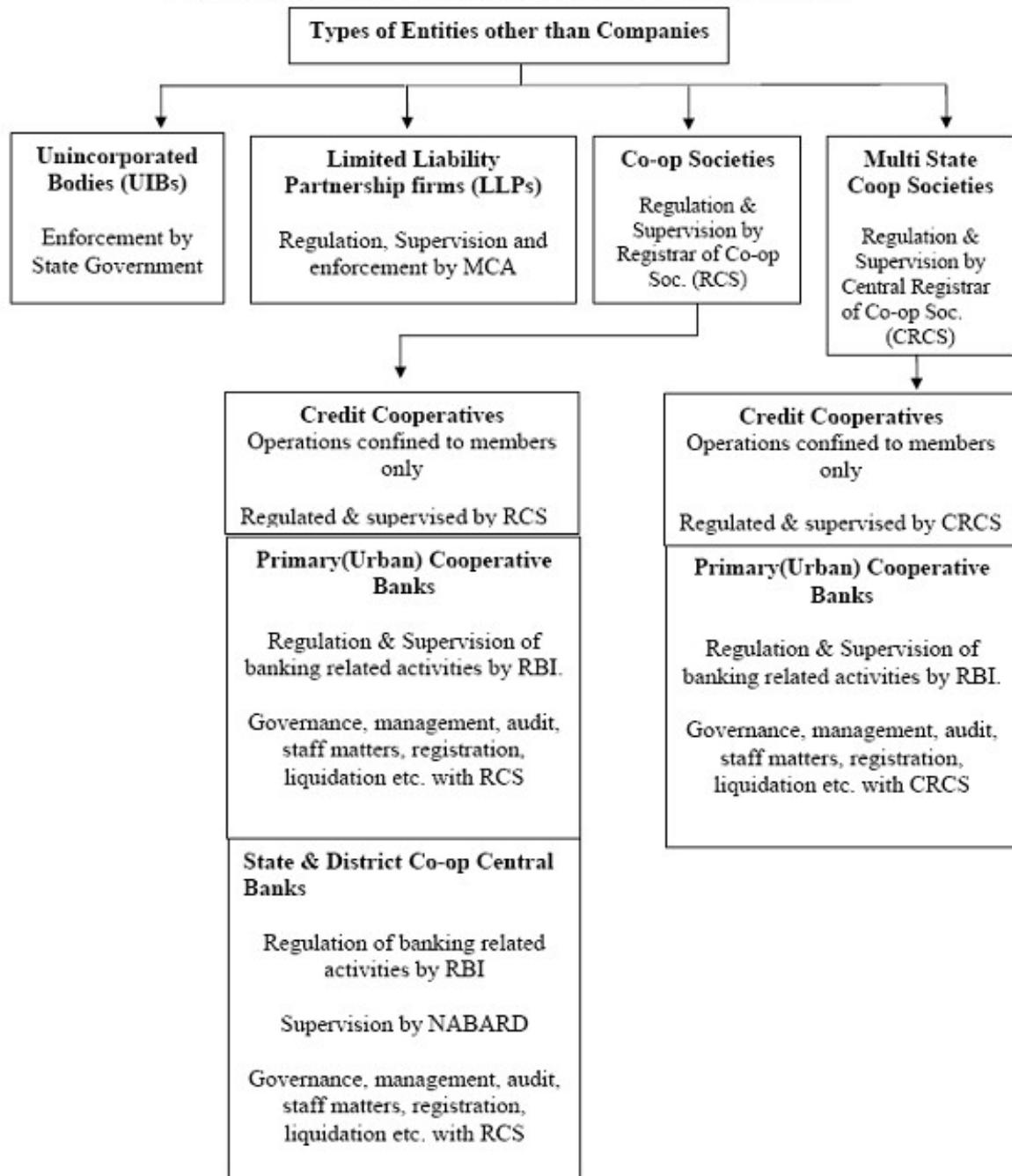


CHART II

Overview of Regulators of Entities other than Companies



Economics

Banking

Aditya Kalia

Types of Banks

- Universal v/s Differentiated –
 - Small Finance Banks, Payment Banks, Wholesale Banks, Custodian Banks, etc.
- Commercial v/s Cooperative (Urban, Rural)
- Scheduled v/s Non-scheduled
- Merchant/Investment Banks
- Regional Banks
- Regional Rural Banks
- Lead Bank Scheme

Important Aspects Banks

- Priority Sector Lending and shortfalls in PSL:
 - RIDF of NABARD
 - PSLCs
- Bank Nationalisation
- Financial Inclusion:
 - Part of Formal financial System
 - Availability of choice
 - Choice exercisable at affordable cost and requisite time
 - Ability to make a choice (Financial Education)
- Size of Banks – Bank Merger – Narsimhan committee recommendation

Health of Banking System

- NPAs – Non Performing Assets
 - Reasons
 - Classification
 - Remedy – 4Rs
 - Recognise
 - Resolve
 - Recapitalise
 - Reform

Remedy of NPAs

- Recognise: AQR
- Resolution:
 - Debt Restructuring
 - RDDB Act, 1993 – Sets up Debt Recovery Tribunal and Appellate tribunal. An Act to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.
 - SARFAESI Act, 2002
 - Insolvency and Bankruptcy code, 2017

SARFAESI Act, 2002

- *Only for secured loans, not applicable to agriculture loans
- Securitisation – Converting a loan into a marketable security through issue of security receipts
- Asset reconstruction – converting non-performing to performing asset
- Enforcement of security interest:
 - Take possession of pledged interest
 - Take over its management, appoint someone competent
 - Ask the debtors of the borrower to pay their dues

Insolvency and Bankruptcy Code, 2017

Insolvency & Bankruptcy Code 2016: Salient Features						
Clear & Speedy Process for early Identification & Resolution of Financial Distress for corporates & Limited Liability Partnerships (LLP)	2 distinct resolution processes: <ul style="list-style-type: none">▪ Fresh Start▪ Insolvency Resolution	Adjudication Authorities: National Company Law Tribunal (for companies and LLP) & Debt Recovery Tribunal (for individuals and unlimited partnership firms)	Information Utilities: To process financial information to be used in insolvency & bankruptcy proceedings	Insolvency Professionals (IPs): To handle commercial aspects of Insolvency Resolution Process (IRP)	Insolvency Professional Agencies: To develop professional standards & code of ethics for IPs	Regulator: Insolvency & Bankruptcy Board of India for IPs, IPAs & Information Utilities

Insolvency and Bankruptcy Code, 2017

On Day 1 of the default, a creditor or a borrower can approach NCLT/ DBT to initiate insolvency proceedings. NCLT/DBT has to accept or reject the plea within 14 days

Once the case is admitted, lenders will constitute committee of creditors (CoC), appoint an IP which will run the borrowers' company in the interim period

Within 180 days, the CoC has to decide on a debt recast plan. Lenders will be given additional 90 days to arrive at a final resolution plan

If the lenders agree (by voting), the CoC would go ahead with debt restructuring. Otherwise, after 180 days, the company's/borrower's assets will be liquidated

Refer:-

<https://pib.gov.in/PressReleaseDetail.aspx?PRID=1601261>

<https://thedailyguardian.com/the-essar-steel-resolution-an-ibc-success-story/>

<https://www.bloombergquint.com/business/behind-indias-largest-ibc-recovery-the-essar-steel-story>

<https://economictimes.indiatimes.com/news/economy/policy/ibc-has-changed-lender-borrower-dynamics-economic-survey/articleshow/80586467.cms?>

More on SARFAESI and IBC

The act was framed in order to address the problem of Non-Performing Assets (NPAs) or bad assets of banks/financial institutions through different mechanisms.

It **allows only secured creditors** (lenders whose loans are backed by a security such as mortgage) to take possession over a collateral security if the debtor defaults in repayment.

The act provides procedure for registration and regulation of asset reconstruction company (ARC) and allows them to carry out the business of-

o **Asset reconstruction:** It is the activity of converting a NPAs or bad assets into performing assets. The ARCs can acquire financial assets (NPAs) from banks and try to recover dues through measures such as:

- ✓ the proper management of the business of the borrower, by changing or taking over the management
- ✓ the sale or lease of a part or whole of the business
- ✓ rescheduling of payment of debts payable etc.

o **Securitization:** It is the process of conversion of existing loans into marketable securities by ARCs through issue of security receipts.

o **Enforcement of Security interests** by lenders without the intervention of the Court: After giving a notice period of 60 days to the defaulting borrower, banks/financial institutions can-

- o take possession of the pledged assets of the borrower,
- o take over the management of such assets,
- o appoint any person to manage them or
- o ask debtors of the borrower to pay their dues too, with respect to the asset.

More on SARFAESI and IBC

- **Creation of a Central Registry:** by the Central Government for the purposes of registration of transaction of securitization and reconstruction of financial assets and creation of security interest.

- **Application against measures to recover secured debts:** can be filed by borrowers/lenders with Debt Recovery Tribunal (with appeal to Debts Recovery Appellate Tribunal) established under Recovery of Debts due to Banks and Financial Institutions Act, 1993.

- **Provisions of this Act not applicable to:**
 - o any security interest created in agricultural land
 - o any case in which the amount due is less than twenty per cent of the principal amount and interest
 - o any security interest for securing repayment of any financial asset less than one lakh rupees.

Insolvency and Bankruptcy Code (IBC), 2016 and SARFAESI Act

- The **IBC, 2016** was formulated to consolidate various laws, regulations and rules concerning insolvency, bankruptcy and liquidation of **non-financial entities**, systematically and comprehensively.
 - o **Insolvency** is the inability of an entity to pay its bills as and when they become due and payable.
 - o **Bankruptcy** is a situation when an entity is declared incapable of paying their due and payable bills.
- It did away with overlapping provisions contained in various laws—
 - o Sick Industrial Companies (Special Provisions) Act, 1985, Recovery of Debts Due to Banks and Financial Institutions Act, 1993, **SARFAESI Act**, 2002 and Companies Act, 2013.
- The IBC created a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms to facilitate a **formal and time bound insolvency resolution process and liquidation**.

Differences between IBC and SARFAESI Act:

- SARFAESI Act, 2002 covers **only secured financial creditors** while IBC protects the rights and interests of **both secured and unsecured creditors**.
- **Section 14(1)(c)** of the IBC, 2016 provides that during the insolvency resolution process as defined in the Code, the Code takes precedence over the SARFAESI Act.
- IBC provides for **separate adjudication authorities** for companies and Limited Liability Partnerships (LLP) (dealt by the National Company Law Tribunal (NCLT)) and individuals and unlimited partnership firms (under jurisdiction of DRT).
 - o While the SARFAESI Act assigns **DRT as the adjudication authority** on matters pertaining to the act.

Capital Markets



Market Participants:

- Money raiser and money provider
- Enablers of this transaction:
 - Exchange – Stock exchange, Over the Counter (OTC) exchange, Gas exchange, power exchange, etc., etc...
 - Brokers
 - Advisors

Capital Markets

- Key Terms:
 - Angel Investor, Venture Capitalist
 - Initial Public Offer (IPO) – Primary Market v/s Secondary Market
 - Investment v/s Trading, Short selling
 - Different type of instruments that are available on exchanges:
 - Equity shares
 - Debt instruments – bonds, securities, commercial papers (short term, unsecured)
 - Commodities

Capital Markets

- Key Terms:
 - Index of a stock market – SENSEX, S&P Nifty 50, Nifty Smallcap, etc.
 - Bluechip companies
 - Mutual Funds – Corpus, Objective, Fund manager, fund fee, Units
 - Exchange Traded Funds
 - Alternate investment Funds- Hedge Funds
 - ADRs and GDRs

Regulation of Capital Markets

- Role of SEBI: acts as a watchdog for all the capital market participants and its main purpose is to provide such an environment that facilitates efficient and smooth working of the securities market
 - Protective Function- Protecting the interests of investors
 - Check price rigging, preventing insider trading, etc.
 - Regulatory Function-
 - Conducting audits, registration of intermediaries, laying down guidelines
 - Development Functions
 - Imparting training, promotion of fair trading practices, carry out research, etc.