



MRUNAL ECONOMY
HANDOUT
LECTURE 1- 22



INSTRUCTIONS FOR LIVE CLASS

1. If audio/video stuck then refresh page by **Ctrl+SHIFT+R**; If electricity / internet outage, fear not, because recording will be available in your account.
2. Keep four things ready before the class 1) Handout Print 2) Two pens of different colors 3) Unruled A4 sized pages 4) One report file- to store printouts & papers.
3. If doubts in lecture itself-> Google query form, available in the discussion group.

UPSC Prelims-2019: Essential Reading List for GS

<p>Geography</p> <ul style="list-style-type: none"> - NCERT: First class 11-12's four textbooks on physical, Indian & human geography. Then NCERT 7-10 Social Science- only those chapters which are not covered in Class 11-12. - Rajtanil's Geography Lecture series. - Goh Cheng Leong: All chapters EXCEPT 4 to 10. - Majid Hussain's Geography of India: All chapters EXCEPT 1, 4, 5, 6, 9, 14, 15, 16. - If time, IYB-2019 ch. 1 and 30, else ignore it. <p>Agriculture</p> <ul style="list-style-type: none"> - NCERT Geography, Science Textbooks. - Budget, Eco survey, Yojana, Kurukshestra <p>Environment</p> <ul style="list-style-type: none"> - NIOS PDF on Environment - ShankarIAS's Book, IYB19 Ch. 12 - NCERT Chemistry Class 11: Chapter on Environmental Chemistry. - NCERT Biology 11-12: selective study of chapters related to flora-fauna, biotech <p>Economy</p> <ul style="list-style-type: none"> - Theory, Contemporary, and Current issues from Mrunal's lecture series and its handouts. - No need for NCERT 9-10 or Class 12 Micro/Macroeconomics or Old NCERT. - But, to cultivate vocabulary & expression skills for Mains, read following: <ul style="list-style-type: none"> - NCERT Class 11 Indian Economic Development. - Introductions and conclusions of Last 3 years' economic surveys from http://indiabudget.gov.in/ - Chief Editor's Desk (Preface) of last 2 years' Yojana & Kurukshestra magazines from http://yojana.gov.in/Recent_archive_2018.asp (change year number for getting previous Archives) - Refer to Topicwise Papers & Trend analysis available: Mrunal.org/Prelims and Mrunal.org/Mains 	<p>Polity</p> <ul style="list-style-type: none"> - Indian Polity by M. Laxmikanth - Governance in India by Laxmikanth. - IYB19: ch. 2, 3, 20, 28. - Current: Notable judgements, Committees, appointments. - PrsIndia.org: passed acts - if time permits: NCERT Social Sci and PolSci <p>International Relations</p> <ul style="list-style-type: none"> - IR groups theory: any GS Manual's reference table. Followed by CA from Newspaper/PDF/Mags. <p>History-Culture</p> <ul style="list-style-type: none"> - No need for old NCERTs. - TN Class 11-12, new NCERT - Nitin Singhania, Spectrum, Pratik's Lecture series. <p>Science Tech</p> <ul style="list-style-type: none"> - Ravi Agrahari's Science-Tech book. - (then, If time permits) Read all chapters: NCERT 7-10. (then, If time permits) Read only selective: NCERT 11-12, and GS Manual. <p>Current Affairs (CA)</p> <ul style="list-style-type: none"> - Any one newspaper: Daily Indian Express or the Hindu. Not both! Only one. - Make newspaper NOTES ONLY FOR Optional Subject, Cases Quotable for Essay / GSM4, & factoids imp. for UPSC interview i.e. about your home-state, hobbies, graduation. - Any one PDF/Mag compilation: VisionIAS, DrishtiIAS, insights, GKT, iasbaba etc. - It's true that not many Qs are coming from PDF/Mag compilation, but if you manually try to make your own current affairs notes, you'll never finish other parts of syllabus.
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Economy for UPSC

Economy 6 Pillars™	Prelims Paper-1 (GS) (out of 100 Qs)			Mains GSM-1-2-3 (Out of 750 Marks)			Remarks
	2016	2017	2018	2016	2017	2018	
1_Money Banking, Finance & Insurance	6	6	7	25	0	0	Most useful in Prelims but less in Mains
2_Budget, FC, GST	3	3	4	12.5	30	25	Second lowest utility after 5_Infra
3_Intl_Trade, BoP	11	4	4	25	0	30	Third lowest utility after 2_Budget.
4_Sectors, GDP, Inflation	4	8	3	25	60	50	Useful for both prelims and Mains.
5_Infra	2	4	1	37.5	10	15	Lowest utility among 6 pillars.
6_HRD	3	4	6	50	40	60	Useful for both prelims and Mains.
Total	29 Qs	29 Qs	25 Qs	175m	140m	180m	

PILLAR #1-A) MONEY

1.1 BARTER SYSTEM & ITS DISADVANTAGES: (वस्तु विनिमय प्रणाली)

- Double co-incidence of _____ (आवश्यकताओं का दोहरा संयोग).
- Search Cost / Cost of Transaction is high.
- Storage of perishable commodities is difficult, results in loss of value.
- Doesn't encourage specialization and division of labour.
- Divisibility & **Fungibility** problems:
 - Fungible item= Division & Mutual substitution possible e.g. Gold bars, Currency Notes & Coins. Non-fungible items examples: _____

1.2 MONEY: FUNCTIONS OF (पैसे के कार्य)

Table 1: Money was invented to overcome the limitations of barter system.

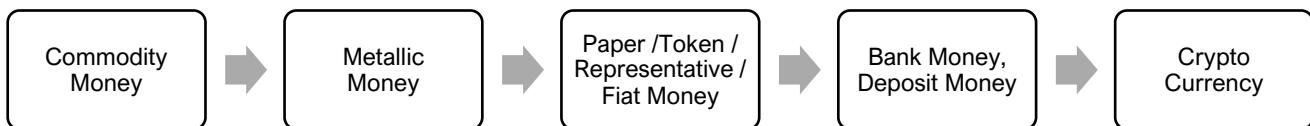
Primary [प्राथमिक]	Secondary (S-T-D) [सहायक]	Contingent [प्रासंगिक]
1. ----- (मूल्य का मापक). gm=wt, ml=vol, ₹=value	1. ----- of Value (मूल्य का संचय) 2. ----- of Value (मूल्य का स्थानांतरण). Soldier in Kashmir to parents in Kanyakumari	1. Basis of credit system, Financial markets 2. Employing factor inputs 3. Creation & Redistribution of National Income
2. ----- (विनिमय का माध्यम). Buy & Sell	3. Deferred Payments (स्थगित भुगतानों का मानक). Airtel buy iphoneX @3499 only per month x 24 months.	

Food Essay for thought: Money is not the root of all evil, greed is. पैसा नहीं, लोभ सभी बुराईओं का मूल है.



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1.3 MONEY: EVOLUTION & TYPES



1.3.1 Commodity Money (Intrinsic value? Yes)



- Iron Nails, Bear Pelts, Cocoa Beans, Whale Teeth, Gold Nuggets
- **Problems?** Perishable, not uniform, not pure, foreigners may not accept. can cause hyperinflation.

1.3.2 Metallic Money (Intrinsic value? Yes)

- Traders & Kings: stamped their marks on gold nuggets for uniformity & trust.
- Indo Greek kings & Kushana kings issued gold coins, but Gupta Gold coins most spectacular- king is playing Veena, shooting animals, standing with wife, taking selfies.
- Delhi Sultanate Kings: Silver Tanka. Sher Shah Suri Rupiyah silver coin. Akbar: Muhr.
- **More SELF STUDY:** *History of Indian coins from Nitin Singhania (2nd Ed.) Ch.23*



Gupta Coin: ~8 gm GOLD
Full Bodied Coins

50 paisa modern coin: ~4 gm steel
Token Coins (प्रतीककात्मक)

<p>Value (अंतर्भूत मूल्य) is MORE than its <u> </u> Value (अंकित मूल्य)</p> <p>Debasement: decreasing the amount of metal in coins. Usually happens when king's treasury gets poor e.g. Aurangzeb, Roman Kings.</p> <p>Coinage Act 2011 prohibits melting of coins.</p>	<p>is LESS</p> <p>1330s: Tughlaq's Token coin experimentation = #EPICFAIL because Thomas Grisham's Law- good money drives out bad money.</p> <p>Cupronickel metal used to discourage melting.</p>
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1.3.3 Paper Money (Intrinsic Value? No)

- **Fiat money (वैधानिक मुद्रा):** Fiat = issued by the legally binding command / order of the Government / King.

	<ul style="list-style-type: none"> - Government issues: All coins upto Rs.1,000. Rs. 1 Note signed by Finance Secretary. Under Coinage Act. - Rs. 1 note doesn't contain "I promise to pay bearer..."
	<ul style="list-style-type: none"> - RBI issues: Currency notes signed by Governor. Presently Rs.10 to Rs. 2,000. Under RBI Act. - Currency notes have Governor's sign: "I promise to pay bearer..."

- When fiat money (currency/ coins) is legally valid for all debts & transactions throughout the country, it's called a **Legal Tender**.
- G-Sec, T-Bill, Shares, Bonds, DD, Cheque, ATM, Cards, Kirana coin, Casino coin, Commemorative coin, Bitcoins: Are they fiat money or legal Tenders? Ans. Yes / No



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Table 2: Fiat Money: Two types of legal tenders

A) Limited legal tenders (सीमित वैधानिक निविदा)	B) Unlimited legal tenders: (असीमित वैधानिक निविदा)
	
Payment beyond a limit _____ refused. <ul style="list-style-type: none"> - Coinage Act 2011 - Rs. 1 / above => upto Rs.1000 - 50 paisa x 20 coins=>upto Rs.10 - Below 50 paisa withdrawn (2011) 	Payment beyond a limit _____ refused. <ul style="list-style-type: none"> - RBI Act 1934- Section 26: Every bank note is legal tender in India. Settle any amount of debt. - But Finance Act 2017: "cash transactions for less than Rs.2 lakh only," Beyond that use Cheque, DD, NEFT etc. else penalty= entire amount.

MCQ: Which one of the following correctly describes the meaning of legal tender money?(Asked in UPSC-Pre-2018)

- (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

MCQ: Consider the following statements (Asked in UPSC-CDS-2011-II)

1. In India the minimum denomination coin acceptable for transaction is 50 paise.
2. Coins below 50 praise is not a legal tender for payment.

Which of the statements given above is/are correct?

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

1.3.4 (NEW) Mahatma Series Currency Notes in India

₹ 10	Sun Temple, Konark, Odisha. 13 th Century Narsimhadev-I
₹ 20	(update when/if released)
₹ 50	Humpi Chariot from Vittala Temple, Karnataka
₹ 100	Lavender color. Rani ki Vav on Saraswati river, Patan. Rani Udaymati for King Bhima-I of Chalukya / Solanki dynasty in 11 th century, UNESCO Heritage site
₹ 200	Sanchi Stupa, Madhya Pradesh.
₹ 500	Red Fort, Delhi by Shah Jahan. 26 th January parade chief guests= 2018: 10 ASEAN leaders; 2019: South Africa president Cyril Ramaphosa
₹ 1000	(update when/if released)
₹ 2000	Mangal Yaan / Mars Orbiter Mission, 2013
New rupee symbol	- ₹: through competition by Dept of Eco.Affairs in 2010. Designed by D.Udaya Kumar (Associate Professor @IIT Guwahati)
Nation Symbol	- Lion Emblem: Sarnath Pillar, Uttar Pradesh. - "Satyamev Jayate": Mundaka Upanishad
Languages	While 8 th Schedule has 22 languages, but currency note has only 17
Visually impaired	old series notes have square (50), triangle (100), circle (500) diamond (1000) new series notes have bleed lines, raised printing of Gandhi etc.

You can read more about currency notes' features at <https://paisabolhai.rbi.org.in>

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1.3.5 “I promise to pay the bearer...”: Meaning?

Currency note is zero interest, anonymous bearer bond. This bond's promise means...

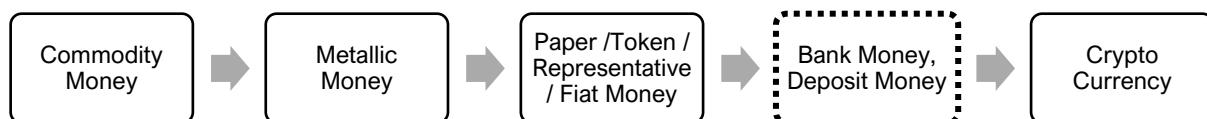


Colonial / old times: Promised to convert into full bodied gold or silver bars / coins worth the equal value in weight. E.g. 1 US Dollar = ~14 grams of gold. 1 British pound = ~73 grams of gold.

Modern times: Conversion into other notes and “token coins” of equal face value. ₹ 2000 = 500 x 4 Nos.= 100 x 20 Nos etc.
Not inflation adjusted value. Not linked with weight of gold or silver.
Not bound to honor this promise for demonetized notes after 31/12/16.

1.3.5.1 Demonetization of Fiat Money (विमुद्रीकरण: Previously 1946, 1978)

- 8/Nov/2016: FinMin-> Dept of Economic Affairs gazette notification to ban the “Special Bank Notes” (SBN) of Mahatma Gandhi series Rs.500 and 1000.
- Specified Bank Notes (Cessation of Liabilities) Act 2017: RBI not required to honor “I promise to pay...”. Old notes can't be kept except for research or numismatics or museum- and that too in limited amount!



1.4 BANK MONEY / DEPOSIT MONEY & DIGITAL PAYMENT SYSTEMS

1.4.1 Paper orders: Cheque, Demand Draft (DD)

- Viceroy Ripon's Negotiable Instruments Act, 1881 (परक्रान्त लिखत अधिनियम):
- Objective? _____
- 2017 Amendment: 20% interim compensation @ Trial court (विचारण न्यायालय) 20% deposit before appeal in higher court (अपील न्यायालय)
- **THREE parties in a cheque:** 1) Drawer (Sender), 2) Drawee (Bank), 3) Payee (Recipient)
- **THREE Types of cheques:** 1) **Stale:** Not withdrawn in 3 months, 2) **Post-dated:** After a specific date, 3) **Anti-Dated:** Before a specific date.
- **Open / bearer cheque:** No ‘crossing’. Anyone can encash.
- **Outstation Cheque:** collection charges outside home branch. **At par cheque:** no such collection charges.
- **IFSC code:** Indian financial system code- 11 alphanumeric numbers to identify the bank branch, just like PINCODE identifies an area.
- **MICR code:** Magnetic Ink Character Recognition. 9 digits code written in Iron Oxide ink for automated clearance.
- **NPCI's CTS-2010:** Cheque Truncation System- scanned image of cheque sent to the drawee branch for faster clearance without theft or tempering. MICR readers NOT required.
- **Demand Draft:** can't be dishonored because amount is prepaid.
- **Over Draft:** When person's bank balance goes zero, still he's allow to draw money (as a loan). Pradhan Mantri Jan-Dhan account has Overdraft upto Rs 5,000/- with certain conditions.



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1.5 ELECTRONIC ORDERS / DIGITAL PAYMENT / CASHLESS ECONOMY



1.5.1 CBS (full form): _____

It's a banking software with web-platform for centralized data management & branchless banking. Finacle (Infosys); BanCS (TCS); E-Kuber (RBI)

MCQ: The term 'Core Banking Solutions' correct term? (Asked in UPSC Prelims-2016)

1. It is a networking of a bank's branches which enables customers to operate their accounts regardless of where they open their accounts.
2. It is an effort to increase RBI's control over commercial banks through computerization.
3. It is a detailed procedure by which a bank with huge non-performing assets is taken over by another bank.

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

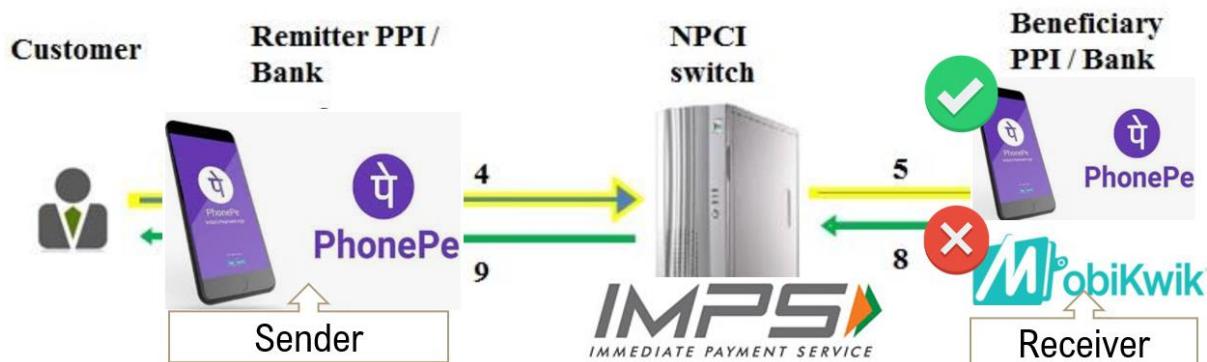
Table 3: Digital Payment Systems

Real time / Instant Settlement	Delayed / Batch Settlement
RBI's RTGS: <ul style="list-style-type: none"> - Full form: - Transfer minimum 2 lakh to Rs. 2000 crores (SBI). - Meant for corporates and high value transactions. - Only in working hours. - Service fee + GST applicable 	RBI's NEFT: <ul style="list-style-type: none"> - Full form: - Transfer upto Rs.10 lakhs (SBI). Settles net amount between banks at the interval of _____ minutes / hour. - Total ___ settlements from 8 am to 7 pm on working days. - Service fee + GST applicable
NPCI's IMPS: <ul style="list-style-type: none"> - Full form: - 24x7 via mobile, internet. - Min. Rs.1 to 2 lakhs - While RTGS/NEFT require IFSC code so can be offered only by BANKS, but IMPS can be offered by Banks as well as Prepaid Payment Instruments (PPI) / mobile-wallet companies such as Phonepe, MobiKwik etc. - Service fee + GST applicable 	Clearing Services: <ul style="list-style-type: none"> - RBI's National Electronic Clearing Service (ECS) & NPCI's National Automated Clearing House (NACH) for - Monthly utility bills, salaries, premiums etc. automatically paid from bank account. Card payment Gateways: <ul style="list-style-type: none"> - Mastercard, VisaCard, NPCI's Rupay etc. They're not free. MDR charges applicable.



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1.5.2 Interoperability Problem (इंटरोऑपरेबिलिटी)



- (Definition)** Interoperability is the ability of customers to transact across commercially and technically independent payment platforms.
- Legal complications under Payment & settlement system act 2007, so, we don't have full interoperability; we can't transfer money between one wallet to another, can't use wallet to pay all type of taxes, fees, insurance premiums etc.
- This is an obstacle to 'cashless-economy'. So, 2018-October, RBI issued guidelines for interoperability with KYC check, customer grievances mechanism etc.

1.5.3 What is NPCi?

_____ is a "Not for Profit Company" 10 promoter banks with 100 crore capital to provide cost-effective payment solutions for banks (in 2008).

Table 4: NPCi has built following mechanisms / platforms / systems / apps:

AEPS	<ul style="list-style-type: none"> Aadhar enabled payment system. Useful for Direct Benefit Transfer (DBT) into beneficiary's account for MNREGA wages, LPG subsidy, scholarship etc. It's also required for Bankmitra-MicroATM system. 2017: IDFC Bank launched the IDFC Aadhaar Pay app- India's first Aadhaar-linked cashless merchant solution. Customer simply gives Aadhar number, merchant takes his thumbprint on mobile app, money transaction completed without any MDR charges.
BBPS	Bharat Bill Payment system for automated monthly payments of utility bills
NACH	National Automated Clearing House for bulk monthly payments of utility bills, dividends, salaries, pension / insurance premiums etc.
NFS	National Financial switch runs the ATM network, IMPS, UPI and BHIM
CTS	Cheque Truncation System (2010) learned in previous section 1.4.
UPI 1.0 (2016)	<p>Full Form: It's a technology for building digital payment apps based on IMPS with following features:</p> <ul style="list-style-type: none"> QR Scan & Pay to merchants. You can link Current Account (CA) Savings Account (SA) for direct transfer of money without storing in 'wallet' first. (unlike PayTM) Such app can have Push transaction (e.g. Remittance to family), Pull Transaction (e.g. monthly bill deduction by DTH) or even Bill sharing among friends. Examples of UPI based app: SBI's SBIBuddy, Axis Bank's AxisPay and NPCi's own BHIM.
UPI 2.0 (2018 Aug)	Upgraded version with following features: <ul style="list-style-type: none"> Overdraft Account linked [until now only CA,SA] Cash on Delivery, User mandate for future date e.g. DTH / Gym. Invoice in the inbox. QR authenticity – whether merchant verified or not?



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BHIM (2016)	<p>Full form:</p> <ul style="list-style-type: none"> - It works on android, ioS/Apple mobile phones as an APP, and even on non-smart (basic) phones using *99# USSD- Unstructured Supplementary Service Data. - Bank to bank / peer to peer transaction using mobile phone (xyz@upi). No need to install multiple apps for each bank account (SBI Buddy, AxisPay etc) just one BHIM app to use all such bank accounts. App has 3 factor authentication system. - Your money stays in bank account and earns interest. It's not stored in 'wallet outside bank', like PayTM. No cards involved so no MDR or such hidden charges. - Sweden has "Swish" app to make their country 100% cashless by 2020.
BharatQR (2016)	While PayTM QR code will not work with Phonepe app (interoperability issue), the BharatQR Quick Response code works with all UPI based bank apps and BHIM app.
RuPay (2016)	<ul style="list-style-type: none"> - Rupee + Payment = RuPay card is world's 7th payment gateway similar to Mastercard, Visacard, China's Union Pay- but at less service charges. - Works in 3 channels: ATM, PoS, Online. Used by banks, railway and even dairies. Rupay debit card comes free with PMJDY (Jan Dhan) account.

1.5.4 Types of Cards

1. **Magnetic Card:** 60s technology. Data on magnetic strip. Data can be duplicated, cloned, skimmed while swiping the card = fraud. So, RBI stopped such cards from 1/1/2019 using powers from Payment & Settlement Act.
 2. **EMV card:** Full form: _____ chip infrastructure with encryption. RBI had ordered migration in 2013- finally effective from 1/1/2019. Two sub-types **(A) EMV-Contact:** cards must remain in Point of Sale (PoS) Terminal during transaction. **(B) EMV-contactless cards:** simply tap the card on terminal using RFID technology.

HomeWork: Read about *RFID & NFC* from Sci-Tech book

1.5.5 Types of ATMs: Full form _____

Bank label	bank itself runs the network
Brown label	
White label	
Micro-ATM	Bankmitra manually makes entries of deposit and withdrawal for customer. He uses handheld device for using card & Aadhar biometrics. NPCi's AEPS technology gives backend support.

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1.5.6 What is Payment Regulatory Board (PRB)?

- 1998: Banking Reforms / Narsimhan-II Committee suggested regulatory framework for e-banking, card payment etc.
- 2007: Payment & Settlement Systems Act -> RBI -> Board for Regulation and Supervision of Payment and Settlement Systems. (BPSS). All Payment system providers have to register with RBI's BPSS- Whether bank, non-bank, wallet-PPI etc.
- 2016: Ratan Watal Committee on digital payment suggested replacing this BPSS with a Payments Regulatory Board (PRB) in RBI, to look after Interoperability, Consumer protection, Innovation, R&D in digital payments.
- 2017-Budget accepted Ratan Watal proposal. 2018: draft Payment and Settlement System Bill to implement it.
- But, RBI vs Government difference of opinion about who should be chairman, how many members from Government side etc. <Blank space for update in future>

1.5.7 MDR: Full form: _____

- MDR is the fee that a merchant must pay to a bank for every credit / debit card transaction. MDR hurts merchants' profit margin, discourages them from adopting PoS terminals, digital payment system.
- 2017-18: RBI put ceilings on MDR fees to encourage digital economy.
- WEF 1/1/18: Ministry of _____ started MDR-subsidy on payments made via Debit card, BHIM or Aadhar enabled payment system for bills upto Rs.2,000. Scheme valid for 2 years. **Direct benefit:** Encourage digital payments ecosystem. **Indirect Hidden benefit:** _____

1.5.7.1 Notable measures to promote cashless economy Post-demonetization

- **During 2016-17:**
 - o **Ratan Watal** Committee to Finance Ministry for medium term recommendations to strengthen digital payment ecosystem.
 - o **Chandrababu Naidu** chief ministers' Committee to PM to promote digital payment.
 - o HRD ministry's **Vittiya Saksharta Abhiyan** wherein college students explain people about digital transactions.
 - o NITI+NPCI launched lottery / cashback schemes for customers (**Lucky Grahak**) and merchants (**Digi Dhan Vyapar**). Government itself launched further referral bonus, cashback schemes.
- **Budget-2017:** imposed ceilings the cash transactions, provided depreciation / deduction incentives to companies for using digital transactions, reduced custom duties on ATM related devices.
- **Budget-2018:** promised to explore blockchain technology [of cryptocurrencies] for promoting digital economy.
- <Blank space for update more initiatives in future>



Q. Mains GSM3: Explain these two terms with respect to 'less cash economy' (1) MDR (2) Interoperability. (150 words, 10 marks) 'कम नगदी वाले अर्थतंत्र' के परिपेक्ष्य में इन दो शब्दों को समझाइए: (1) एमडीआर (2) इंटरओपरेबिलिटी (3) ब्लॉकचेन टेक्नोलोजी.

1.5.7.2 Essay: Cashless Economy- Charms and Challenges

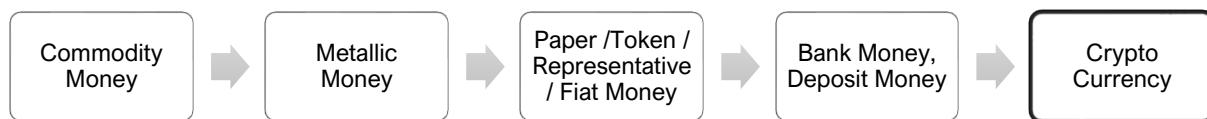
- **(Definition)** A cashless economy is an economy where financial transactions are not conducted with money in the form of physical banknotes or coins, but rather through electronic methods such as ____ <insert examples>.
- **(Origin)** In ancient times, people used to trade with each other using barter system. But its limitations ____ <give evolution story>.

Stakeholder	Body: Charms	Body: Challenges
 Shanti Kanta Das	<ul style="list-style-type: none"> - Saves cost of printing new currency (Rs.27 billion a year) – environment, - Better efficacy of monetary policy updates, NPA/fraud surveillance. 	<ul style="list-style-type: none"> - MDR, Interoperability, Fintech companies evolving more rapidly than legal framework. - KYC: Aadhar vs privacy debate
 Govt.	<ul style="list-style-type: none"> - Better tax surveillance, checks on fake counterfeit currency terror finance, - targeted delivery of agri-loans and subsidies/ DBT: Annually Rs. 1 lakh crore saved. - Can save farmers from moneylenders, and poor families from Ponzi schemes. 	<ul style="list-style-type: none"> - Power, telecom infrastructure not available everywhere. - Government itself must become a role model first in handling tax, tender, tolls, procurements through digital payment. - To encourage digital payment if subsidy, tax breaks, lotteries given for perpetual time -> fiscal deficit. - Post-Demonetization, digital transactions ↑ but then again ↓ so, punitive measures = 😞
 Household	Secure, difficult to steal, time, convenience, financial inclusion.	<ul style="list-style-type: none"> - Digital divide, Low financial literacy-notion of security associated with holding physical currency. - Frauds, Card cloning, service fees on NEFT / card payments.
 Businessman	homework	homework

Conclusion: Digital payment is not a panacea, nor is cash all bad. For a developing country like India, "Less cash" economy better than "Cashless" economy.



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1.6 CRYPTO-CURRENCY & BLOCKCHAIN TECHNOLOGY

- **[Definition] Cryptocurrency:**
- **[Definition] Blockchain:** A secured decentralized database that maintains a continuously growing list of records / transactions. Old entries can't be deleted, new entries will be visible to all. Mainly used for running cryptocurrency network.
- **[Origin]** Anarchist groups lost faith in **FIAT MONEY / LEGAL TENDERS** because Subprime Crisis (2007) eroded the purchasing power of US Dollar. They also dislike **BANK MONEY / DEPOSIT MONEY** because of transaction charges on e-banking, card payments, MDR, interoperability issues.
- **2009:** An anonymous user Satoshi Nakamoto launched a cryptocurrency 'Bitcoin', total 21 million coins, wherein 1 Bitcoin (BTC) = -----
- Ethereum, Litecoin, Digicoin, Laxmicoin, Ripple etc. are also cryptocurrencies.

3 ways to obtain Cryptocurrency	Negative Points / Challenges
1)	<ul style="list-style-type: none"> - Graphics cards demand & price hike: 2x-4x times due to bitcoin mania. E-waste generation. Thermal Electricity wastage worth 20 megatone CO₂ - If quantum computer invented it'll solve it in seconds, thus crashing the value of Bitcoins.
2)	<ul style="list-style-type: none"> - Bitcoin wallets have "public address" (like an email) & private key (like a password): but not traceable unlike an email. So, Narcotics, illegal trade, Terror finance. - Selling goods/services in exchange of bitcoins= Government deprived of GST, Custom duty, Income tax on merchant's profit. - Scam: can't get justice under Consumer Protection Act.
3)	<ul style="list-style-type: none"> - For traditional Rupee to dollar exchange, Forex dealers have to register with RBI under FEMA Act. They're monitored with KYC, PMLA, Enforcement Directorate. - If rupee or \$ exchanged with Bitcoin = terror finance, sending black money to tax havens. - Dollar to Bitcoin exchange rate: speculation, volatility, Government deprived of Capital Gains Tax (CGT) - Ponzi investment frauds- hence Government came up with Banning of Unregulated Deposit Schemes Bill, 2018. Read on PRSIndia once bill is passed.

MCQ. Find correct statement(s) about Bitcoin? [UPSC-CDS-2017-I]

1. It is a decentralized virtual currency.
2. It is generated through complex computer software systems.
3. The Reserve Bank of India recognized it as a legal tender in January 2016.

Answer Codes

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



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1.6.1 Cryptocurrency legality in India & elsewhere

India is neither the first nor the only country to restrict cryptocurrencies. Nepal, Bangladesh, Morocco, Algeria, Equator, Bolivia et al already banned it.

 Shanti Kanta Das	<ul style="list-style-type: none"> - Since 2013, RBI had been warning people. 2018: RBI directed all banks/PPP/mobile-wallet cos. to stop relations with any Cryptocurrency company. - However, RBI's Institute for Development and Research in Banking Technology (IDRBT)- studying how to use blockchain technology for promoting digital economy.
	<ul style="list-style-type: none"> - 2017: Dinesh Sharma Committee to FinMin suggested total ban on cryptocurrencies. But activists challenged in SC. So Government sets up new Committee. Subhash Chandra Garg committee to FinMin has been working on Draft law & framework for cryptocurrencies. Both Dinesh & Subhash were Secretary in Department of Economic Affairs. - 2018: Budget says Crypto-currencies are not legal tenders. We'll eliminate use of these crypto-currencies in financing illegitimate activities or as part of the payment systems.
World Bank	<ul style="list-style-type: none"> - 2018-Aug: World Bank launched World's first blockchain bond called " _____ " in Australia -> public invests, gets ~2% interest after 2 years. This money is loaned to developing countries. - Blockchain bond requires less cost in server / database /paperwork maintenance unlike traditional bonds.
_____ Islands	<ul style="list-style-type: none"> - Capital Majuro, Sovereign state having free association with USA (for Defense, social security, budget), Legal Tender was U\$D. But, - 2018-Feb: became first country to launch sovereign cryptocurrency named "Sovereign" [SOV]. So, now two legal tenders: U\$D and SOV. No anonymity unlike Bitcoins.
	<ul style="list-style-type: none"> - Bolivars have little value in _____ country due to hyperinflation, and failed economy. - So, President Nicholas Maduro launched "Petro"- a fiat cryptocurrency whose price is linked with market price of 1 oil barrel. - Can be bought using Dollar, Euro, even other cryptocurrencies. Sale began in 2018-Nov.

<space for self-update>

Mains-Answer-Writing/GSM3:

"While regulatory clearance to cryptocurrencies can open Pandora's box, the underlying blockchain technology holds panacea for various areas of governance and economy". Explain in context of India. (250 words, 15 marks)

क्रिप्टोकरंसी को अनुमति देने से विनाश की परिस्थिति का निर्माण, जबकि अंतर्रिहित ब्लाकचेईन टेक्नोलॉजी प्रशासन और अर्थव्यवस्था के विभिन्न क्षेत्र के लिए रामबाण हो सकती है।"। मानकस्तान भारत के संदर्भ में समझाएं।

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2 MONEY: DEMAND, SUPPLY & CREATION

2.1 DEMAND OF MONEY: LIQUIDITY PREFERENCE THEORY (तरलता अधिमान)

John Maynard Keynes (Book: *The General Theory of Employment, Interest and Money*) noted that people prefer to keep a part of assets in liquid form (cash money) with 3 motives:

1. **Transaction motive** (संव्यवहार उद्देश्य): For using money as a medium of exchange e.g. for buying daily milk, veggies, fruits.
2. **Precautionary motive** (एहतियाती): To protect against sudden / unforeseen expenditure e.g. medical emergency or impulsive purchase during a holiday trip.
3. **Speculative motive** (सट्टा-उद्देश्य): Investors hold cash to make the best use of any investment opportunity that arises later e.g. waiting for bond/gold/land prices to fall, then "I will use my cash to buy it". Also known as "**Asset Demand of Money**".

The amount of money held in cash form vary inversely with interest rates. If higher interest available in Bonds etc, people would invest money there instead of keeping money in liquid form (cash).

2.2 SUPPLY OF MONEY (मुद्रा की पूर्ति)

Time Liabilities of a Bank (FDRD) समय / मीयादी देयताएँ	Demand Liabilities (CASA) मांग देयताएँ
<ul style="list-style-type: none"> - Fixed deposits, Cumulative/ recurring deposits, Staff security deposit etc. - Bank legally not required to pay customer before maturity but can pay after deducting penalty/ interest. 	<ul style="list-style-type: none"> - Current Account, Savings Account, Demand Draft - Overdue balance in Fixed Deposits - Unclaimed deposits
Public parks more money here, because better returns.	-----
-----	More liquid because easily convertible into cash.

*CU: Coins & Currency with Public

Measure संकुचित, व्यापक	*CU	Commercial Banks		Post Office Savings Bank		Liquidity तरलता	Qty
		Demand Deposits (CASA)	Time Deposits (FDRD)	Demand Deposits (SA)	Time Deposits (!notNSC)		
Narrow Money	M1	✓	✓	X		☆☆☆☆	☆
	M2	✓					
----- Money	M3	✓					
	M4	✓				☆	☆☆☆☆

- Self-Extrapolate e.g. $M_3 = M_1 + \text{Time deposits with commercial banks}$.
- M3 is the most commonly used for measuring money supply, aka "**Aggregate Monetary Resources**" (समस्त मौद्रिक संसाधन).
- In Money supply, we are only counting the "**NET Demand / NET Time deposits**" i.e. only public deposits in bank. The interbank deposits, which a commercial bank holds in other commercial banks, not counted.



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2.3 CREATION OF MONEY (मुद्रा का निर्माण)

M0 / Reserve Money / Government Money / High Powered Money (उच्च शक्ति मुद्रा) is issued under RBI Act, by RBI's ISSUE DEPARTMENT, with condition that ISSUE DEPARTMENT'S assets must match its liabilities.

Assets of Issue Department (परिसंपत्तियाँ)	Liabilities of Issue Department [M0]
<ol style="list-style-type: none"> 1. Rupee coins [RBI circulates it as 'agent of govt'] 2. Gold coins and bullion [Min. 115 crores] 3. Foreign Securities [Earlier Min. 85 crores but Post-1995 no such requirement.] 4. Govt. Securities [through which Govt borrows money from RBI, pays interests to RBI] 	<p>Currency (& coins) in circulation:</p> <ol style="list-style-type: none"> 1. Held by Public 2. Held by other Banks in "Vault cash" (i.e. amount for day to day Ops.) 3. Other Deposits in RBI (of Public, Banks & Governments)

2.3.1 Velocity of Money Circulation (मुद्रा संचालन का वेग)

It is the average number of times money passes from one hand to another, during given time period. e.g. you bought pen worth Rs.10 from shopkeeper, he uses same 10 rupee note to buy tea from another shop, then same currency note performed function of 20 Rupees. This "Velocity of money circulation" is affected by following factors:

- More quantity of money -> less velocity.
- Income distribution. Money in the hands of poor people has higher velocity than the rich.
- Booming period = more raw material purchase & hiring = higher velocity
- Low financial inclusion / low banking penetration = People tend to save more in physical assets or in cash then money doesn't change hands much= low velocity.
- If more people use loans for purchase=> higher velocity. Hence developed countries => higher velocity, because people save less and spend more because of lifestyle and confidence in Government's social-security e.g. USA.
- Higher the GDP, more transactions taking place = Higher velocity.

2.4 MONEY MULTIPLIER (मुद्रा गुणक)

RBI's legal reserve system (CRR-SLR) leads to *Fractional Reserve Banking & Credit Creation* by the commercial banks, which creates money multiplier effect as following:

High Powered money (M0) = 100	Asset Side	Loaning	10% Reserve ('r')
Bank#1	100	90	10
Bank#2	90	81	9
Bank#3	81	72.9	8.1
Bank#..
Total Money (here M3)	1000 =	900 +	100

$$\text{Money Multiplier} = \frac{\text{Stock of Total Money}}{\text{Stock of High Powered money}} = \frac{1000}{100} = 10.$$

- Every "R" reserve generates "1/R" new money. Here, 10% reserve generated 10x times the high-powered money. 4% reserve ratio will generate 25x times (in theory), however in reality the multiplier will be lower due to poor banking penetration, black money etc.
- In functional economy, money multiplier is always greater than 1.
 - o & It directly improves with cut in legal reserve ratios (SLR, CRR)
 - o & It indirectly improves as economy develops, consumption / loan demand increases, banking penetration improves etc. In 60s = less than 2x, 90s = more than 3x, At present = more than 6x.



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2.5 FACTORS AFFECTING MONEY SUPPLY [M1, M3]

M1, M3 Money Supply will increase when:

- When Money multiplier and / or Velocity of money increases.
- When RBI's asset side increases e.g. Government borrowing more from RBI using G-sec or increase in RBI's Forex securities.
- With the increase in banking penetration, financial inclusion, formalization of economy, Boom period, whenever loan demand increases.
- When RBI adopts Cheap / Easy / Dovish / Expansionary monetary policy to combat deflation.

3 MONETARY POLICY (मौद्रिक नीति)

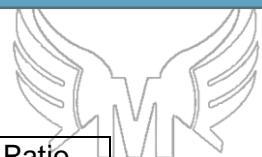
- **[Definition]** Monetary Policy is a macroeconomic policy (समष्टि आर्थिक नीति), designed by the central bank of a country, to manage money supply & interest rates. It helps shaping variables such as inflation, consumption, savings, investment, and capital formation (मुद्रास्फीति, खपत, बचत, निवेश और पूँजी निर्माण).
- **[Significance]** Monetary policy plays an important role in price stability [inflation control], economic growth, job creation and social justice in any economy.
- John Maynard Keynes: When economy is functioning at full employment, aggregate supply matches aggregate demand i.e. Consumption (C) + Investment (I) + Govt Purchase (G) + Net Export (eXport-iMport). If demand higher than supply -> inflationary gap.
- **Philip Curve:** Inflation _ = unemployment _ (and vice versa).
- Therefore, stable & moderate inflation is good for the economy. So, RBI tries to keep inflation with 2-6% CPI (All India) using its bi-monthly monetary policy made by its 6-member statutory monetary policy Committee.

3.1 MONETARY POLICY: QUANTITATIVE TOOLS (परिमाणात्मक साधन)

Also known as (aka) **General or Indirect Tools** as they affect the entire economy, and not just a particular sector.

3.1.1 Statutory Reserve Requirements: CRR, SLR (Fight inflation: _, deflation: _)

CRR: _____ (नकद कोष अनुपात)	SLR: _____ (वैधानिक तरलता अनुपात)
Banks have to keep this much deposits with RBI. RBI doesn't pay interest on it, except in extraordinary circumstances like 1999-2000's Banking slowdown.	Banks have to keep this much deposits in liquid assets such as cash, gold, G-Sec, T-Bills, State Development Loan Bonds and other securities notified by RBI.
Bank earns no profit / interest*	Some profit*
Mandated under RBI Act, 1934 (Section 42)	Banking Regulation Act, 1949 (Section 42)
RBI can fix any amount of CRR, legally there is no minimum floor or maximum ceiling. Presently it's 4% of total DTL	Legally, SLR can't be more than 40%. Presently it's 19.5% of NDTL and will be reduced to 18% in 2019-20 in phased manner.
Counted on Total Demand and Time Liabilities (DTL) of the Bank.	On Net Demand and Time Liabilities (NDTL) (निवल मांग और समय देयताएँ)



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During demonetization, RBI prescribed Incremental CRR of 100% to drain excess liquidity & prevent crashing of loan interest rates. It was a temporary measure, presently, no incremental CRR.	Associated topic: Liquidity Coverage Ratio (LCR) and High Quality Liquid Assets (HQLA): we'll study in BASEL-III lecture.
Scheduled Commercial Banks (SCBs) must maintain CRR	Same
State and Central Cooperative Banks must maintain CRR, but RBI could keep different slabs / norms for them.	Same
RRBs don't have to maintain CRR	RRBs must maintain SLR, but RBI could keep different slabs / norms for them.

- SLR/CRR are counted on fortnightly basis. If not maintained, bank will have to pay penalty interest rate which is linked with Bank Rate.
- CRR/SLR ensure monetary stability of India through **two primary functions**
 - 1) They assist in money multiplier effect
 - 2) They create Buffer-Protection during a Bank Run i.e. an emergency when everybody wants to take money from his bank account at once, mainly due to fake news / rumors.
- While in theory CRR/SLR can be used for inflation control but RBI primarily relies on REPO Rate (=its Policy Rate) to combat inflation, and not CRR/SLR.

Asked in UPSC-CDS-2011-II	Asked in UPSC-Pre-2015				
<p>Q. Find correct statements about Statutory Liquidity Ratio (SLR)</p> <ol style="list-style-type: none"> 1. To meet SLR, Commercial banks can keep cash only. 2. SLR is maintained by the banks with themselves. 3. SLR restricts the banks leverage in pumping more money into the economy. <p>Answer codes:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">(a) 1, 2 and 3</td> <td style="width: 50%;">(b) 1 and 3</td> </tr> <tr> <td>(c) 2 and 3</td> <td>(d) only 2</td> </tr> </table>	(a) 1, 2 and 3	(b) 1 and 3	(c) 2 and 3	(d) only 2	<p>Q. When the Reserve Bank of India reduces the Statutory Liquidity Ratio by 50 basis points which of the following is likely to happen?</p> <ol style="list-style-type: none"> (a) India's GDP growth rate increases drastically (b) Foreign Institutional Investors may bring more capital into our country (c) Scheduled Commercial Banks may cut their lending rates. (d) It may drastically reduce the liquidity to the banking system
(a) 1, 2 and 3	(b) 1 and 3				
(c) 2 and 3	(d) only 2				

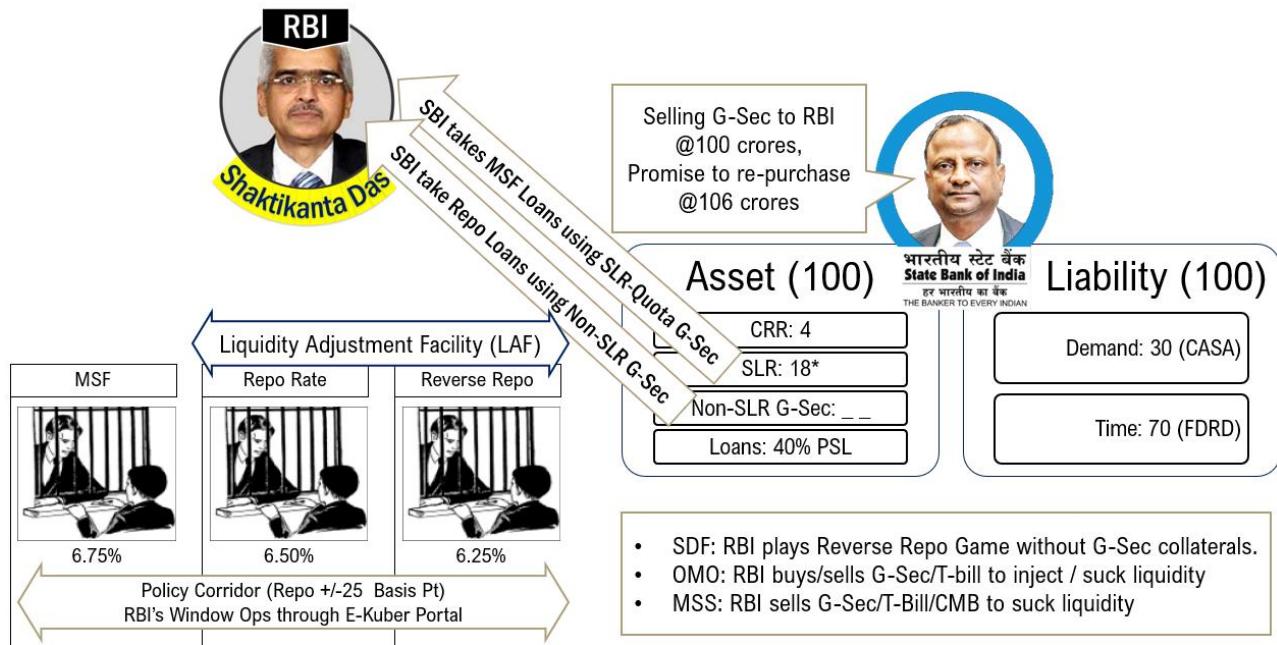
3.1.2 Key Rates (Inflation -> __ Rates, Deflation -> __ Rates)

- **Bank Rate (बैंक दर):** Interest rate at which banks borrow long term loans from RBI without pledging any securities/collaterals. It's not the primary tool of monetary policy, but used in computation of penalty rates.
- **Marginal Standing Facility (MSF, 2011 - सीमांत स्थायी सुविधा):** The Interest rate at which RBI lends short-term loans to Scheduled Commercial Banks (SCB) with their _____ as collaterals. MSF _____ than Repo Rate.



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- **Liquidity Adjustment Facility (LAF, 2000- तरलता समायोजन सुविधा)**: consists of two mechanisms:
 - I. **LAF-Repo Rate (पुनः क्रय-अनुबंध)**: The Interest rate at which RBI lends short-term loans to its clients with their G-Sec as collaterals. Clients enter into an agreement with RBI to repurchase their G-sec at a future date at a (higher) pre-determined price. SCB _____ pledge their SLR-quota-G-Secs. Repo Rate is our Policy Rate to control inflation. MSF & Reverse Repo tied with it.
 - II. **LAF-Reverse Repo Rate (उलट पुनः क्रय-अनुबंध)**: It's the interest rate that clients earn when parking their surplus funds with the RBI for short periods. Mechanism similar to Repo, RBI gives its G-Sec used as a collateral. Reverse Repo is _____ than Repo Rate.



3.1.2.1 Key Rates- associated terms

- **Policy Corridor:** It's the width among MSF-Repo-RR. Presently, 25 basis points (0.25%). Previously it had been 1%, 0.50% but narrowed to 0.25% for better alignment with call money market, thus ensuring better transmission of monetary policy
- **Window Operations:** LAF-MSF “windows” are operated through RBI’s _____ CBS platform.
- **(Uncollateralized) Standing Deposit Facility (SDF, स्थायी जमा सुविधा):** Banks park funds in RBI for short-term to earn interest. No G-sec or collateral, unlike Reverse Repo. This helps RBI absorb excess liquidity for short term in situations like demonetization when RBI may not have enough G-Secs to pledge as collaterals. Urjit Patel Committee on Monetary policy (2013) proposed this, Budget-2018 agreed to amend RBI Act for this.
- **Tri-Party Repo Rate (त्रि-पक्षीय पुनः क्रय-अनुबंध):** In ordinary repo, there are two parties- borrower vs. lender (RBI). In Tri-party Repo, there are 3 parties 1) borrowers 2) lenders 3) Tri-Party Agent (e.g. NSE) who, acts as an intermediary between the



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two parties to facilitate collateral custody, payment and guaranteed settlement. RBI issued guidelines in 2017, NSE started this in 2018. This is not a tool of Monetary Policy. It helps deepening Corporate Bond market.

3.1.3 Market Operations (OMO, MSS): (Inflation -> Sell G-Sec, Deflation -> Buy)

- **Open Market Operations** (खुले बाजार की क्रियाए): RBI buys and sells G-sec, T-Bills to control money supply. RBI buying injects liquidity, RBI selling sucks liquidity.
 - **Market Stabilization Scheme** (बाजार स्थिरीकरण योजना): RBI sells G-sec, T-Bill & Cash Management Bills (CMB) to suck excess liquidity. While the money thus collected is not part of Govt.'s borrowing, but Govt. pays interest on it. This mechanism was enhanced during Demonetization to counter excess liquidity and crashing of lending rates.
 - **Sterilization:** <in Pillar#3: Balance of Payment>

Q. Which of the following measures would result in an increase in the money supply in the economy? (Asked in UPSC-Pre-2012)

1. Purchase of G-Sec from the public by the Central Bank
 2. Deposit of currency in commercial banks by the public
 3. Borrowing by the government from the Central Bank
 4. Sale of government securities to the public by the Central Bank

Select the correct answer using the codes given below:

3.2 MONETARY POLICY: QUALITATIVE TOOLS (गुणात्मक साधन)

While quantitative tools (SLR, CRR, Repo etc.) control the ‘volume’ of loans, these qualitative tools (PSL,LTV etc.) control the “distribution” of loans to a particular sector of economy (e.g. agriculture) or particular segment of society (e.g. farmers, women, SC/ST). Hence, also known as **SELECTIVE** (चयनात्मक) or **DIRECT** Tools.

3.2.1 Moral Suasion (नैतिक दबाव / सलाह)

- “Persuasion” without applying punitive measures. RBI governor tries this tactic via conferences, informal meetings, letters, seminars, convocation, panel discussion, memorial lectures.
 - Example, Governor asking Banks to transmit rate cuts, open new branches in rural areas, spread financial literacy, give loans to farmers beyond PSL quota etc. Similarly, Governor asking CM/FM to control fiscal deficit & subsidy leakage to enhance the impact of RBI’s monetary policy.

3.2.2 Direct Action (सीधी कार्यवाही)

- RBI can punish banks (and even non-banks) for not complying with its directives under RBI Act, Banking Regulation Act, Payment and Settlement Systems Act, Prevention of Money Laundering Act, Foreign Exchange Management Act (FEMA).

3.2.3 Margin Requirements / LTV (सीमा अनिवार्यता)

- RBI can mandate that Loan to Value (LTV) for a gold-loan, home loan, auto loan or business loan can't be more than x% of the value of the collaterals. RBI can change this x% to boost / curb demand.



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3.2.4 Selective Credit Control (चयनात्मक ऋण नियंत्रण)

In a negative / restrictive direction	In a positive direction
<ul style="list-style-type: none"> - In erstwhile-USSR: Credit Rationing System where an individual can't get more than prescribed amount of loans for each category (housing, education, business). - 1960s: Credit Authorization Scheme (CAS) in India: all commercial banks had to obtain prior approval of the RBI before giving Rs. 1 crore/> to a single borrower. - 1970s: RBI imposed quantitative ceiling on non-food loans to boost green revolution, food inflation. <p>But such measures failed due to lax monitoring and loopholes.</p>	<ul style="list-style-type: none"> - Consumer credit control e.g. During deflation / recession, RBI can relax the downpayment / EMI installment norms for durables like Vehicles, TV, Fridge etc. to boost consumption and demand. - Priority Sector Lending <see below>

3.3 PRIORITY SECTOR LENDING (प्राथमिकता क्षेत्र के लिए ऋण मानक)

- 1968: First time RBI used the word “priority sector”: Banks must give 40% of their loans to 3 priority sectors 1) agri 2) small industries 3) exports by 1985.
- 1971: Credit Guarantee Corporation of India Ltd. setup to facilitate bank lending to the priority sectors. [Will study more with MUDRA Bank in NBFC pillar]
- 2015: the PSL norms were updated:

Priority Sector Loans	Quota
Weaker Sections: SC, ST, Women, PH, Minorities, Manual scavengers, Artisans, NRLM/NULM beneficiaries, PMJDY Overdrafts upto Rs.10k.	_ _ %
Agriculture: Non-corporate farmers etc.	10%
Agriculture: *Marginal Farmer (upto 1ht); *Small farmer (>1 upto 2ht)	_ %
Micro Enterprises, Khadi-Village industries	7.50%
Above parties, as well as Small & Medium Enterprises, Affordable housing loans to beneficiaries under Pradhan Mantri Awas Yojana, food processing companies, Vermi compost, biofertilizer, seed production, Exporters, Student-Education loans (upto Rs.10l), Social Infrastructure (schools, health care, drinking water, sanitation facilities); Renewable Energy Projects (wind mills, biomass generators, solar street light, micro-hydel plants etc.)	4.50%
Total PSL for SCB and (Foreign Banks with 20/> branches).	_ _ _

- If foreign bank has less than 20 branches, they'll also have to give 40% PSL-Quota loans WEF 31/3/2020, but no internal loan-quotas for weaker section, small farmers, khadi enterprise etc. for such banks.
- If Regional Rural Bank (RRB) or Small Finance Bank, then above 40% quota + extra 35% quota (in any PSL-sectors) = _ _ PSL loan-quota.
- Loans given to Microfinance Agencies for above categories, are also counted in quota.
- Bank + NBFC's joint lending / co-origination loans to PSL categories are also eligible, with conditions.



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3.3.1 Priority Sector Lending Certificates (PSLC) from 2016 onwards

- In this arrangement, the overachieving Banks can sell their excess PSL in form of 'certificates' to underachieving banks without transferring the loan assets or its risk.
- Four kinds of PSLCs traded through RBI's _____ Portal, viz., Agriculture (PSLC-A); Small and Marginal Farmers (PSLC-SM); Micro Enterprises (PSLC-ME); and General (PSLC-G).
- If an underachiever bank can't fulfil its PSL-quota through PSL-certificates purchase then ultimately, it'll have to deposit PSL-shortfall money to NABARD's Rural Infrastructure Development Fund (RIDF), SIDBI's Small Enterprises Development Fund (SEDF) or NHB or MUDRA Ltd. as per the norms. Under-achiever bank will earn interest from such deposited money, but it'll be linked with Bank-Rate.

Q. Priority Sector Lending by banks in India constitutes _____ (Asked in UPSC-Pre-2013)

- a) Agriculture
- b) Micro and Small Enterprises
- c) Weaker Sections
- d) All of the above

3.4 MONETARY POLICY TOOLS: A READY RECKONER TABLE

Tools & Strategy?		<2%CPI= Fight deflation (अपस्फीति)	>6%CPI= Fight Inflation (मुद्रास्फीति)
- Deflation: ↑ money supply, inject liquidity=> make loans cheaper, ↑ consumption	- Inflation: Do reverse	Easy, Cheap, Dovish, Expansionary policy. आसान-सस्ता व्याजदरे, विस्तारवादी	Tight, <u>Dear</u> , Hawkish, Contractionary तंग- मँहगी व्याजदरे, संकुचनवादी
Qualitative	Reserves: CRR, SLR		↑
	Key Rates (Repo, MSF, Bank Rate)	↓	
	Market Ops (OMO, MSS)	OMO: RBI _____ G-Sec from market MSS: N/A	OMO: RBI _____ G-Sec MSS: same as OMO
Qualitative	Moral Suasion / Direct Action	Nudge / Force the banks to enforce Dovish Policy	To enforce the Hawkish policy
	Margin Req. / LTV	Increase e.g. Gold-LTV: 60%->90%	
	Selective Credit Control / PSL	<think!>	<ul style="list-style-type: none"> - ↓the loan-flow to sectors where speculative investment is leading to demand-side inflation e.g. real-estate & housing. - ↑loan-flow to sectors where loans can ↑supply e.g. onion farmers.



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<p><i>Asked in UPSC-Pre-1995</i></p> <p>Q. Which of the following is not an instrument of Selective Credit Control?</p> <ul style="list-style-type: none"> a) Regulation of consumer credit b) Rationing of credit c) Margin requirements d) Cash reserve ratio 	<p><i>Asked in UPSC-Pre-2013</i></p> <p>Q. An increase in the Bank Rate generally indicates that ___</p> <ul style="list-style-type: none"> A. Market rate of interest is likely to fall. B. Central Bank is no longer making loans to commercial banks. C. Central Bank is following an easy money policy. D. Central Bank is following a tight money policy. 				
<p><i>Asked in UPSC-Pre-2015</i></p> <p>Q. Consider the following:</p> <p>1) Bank rate 2) Open market operations 3) Public debt 4) Public Revenue</p> <p>Which of them is/are part of Monetary Policy?</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">(a) 1 only</td> <td style="width: 50%;">(b) 2, 3 and 4</td> </tr> <tr> <td>(c) 1 and 2</td> <td>(d) 1, 3 and 4</td> </tr> </table>	(a) 1 only	(b) 2, 3 and 4	(c) 1 and 2	(d) 1, 3 and 4	
(a) 1 only	(b) 2, 3 and 4				
(c) 1 and 2	(d) 1, 3 and 4				

4 MONETARY POLICY IN PRESENT-DAY INDIA

There are 3 major ways of making monetary policy

1. **Exchange rate stability:** Singapore & other export-oriented economies use this.
 2. **Multiple Indicators:** Central Bank tries to focus on Growth, Employment, Inflation Control and Exchange rate stabilization. India's RBI had this before 2016.
 3. **Inflation targeting:** Central Bank only aims to keep inflation controlled, and other indicators (growth, employment, exchange rate) will automatically fall in line. This strategy successful in Western nations, adopted in India WEF 2016-Oct, based on Urjit Patel Committee Report (2013-14), by amending RBI Act Section 45 with following provisions:

4.1 MONETARY POLICY MAKING UNDER RBI ACT SINCE 2016

Monetary Policy to be made by a statutory Monetary Policy Committee with following composition:

RBI side	Govt. Side
<ol style="list-style-type: none"> 1. RBI Governor, as the Ex-officio Chairman. 2. Dy.Governor responsible for Monetary Policy: Viral Acharya 3. One person nominated by RBI Central Board: Michael Patra (Executive Director, RBI) 	<ol style="list-style-type: none"> 1. Dr. Chetan Ghate, Indian Statistical Institute 2. Dr. Pami Dua, Delhi School of Economics 3. Dr. Ravindra H. Dholakia, IIM-A
Their tenure tied with their ex-officio job tenure E.g. Shaktikanta's <i>shakti</i> (powers) will be gone after 3-year tenure as RBI-Governor expires, unless reappointed.	Tenure: 4 years, no re-appointment. They're selected by a Committee headed by cabinet Secretary (IAS)

- Meeting quorum 4 members- incl. Governor. Minimum four meetings a year. In practice, they meet every two months to decide bi-monthly monetary policy updates.
 - Repo rate (=Policy rate) decided by Majority vote. If tie, then Governor has _____ vote.

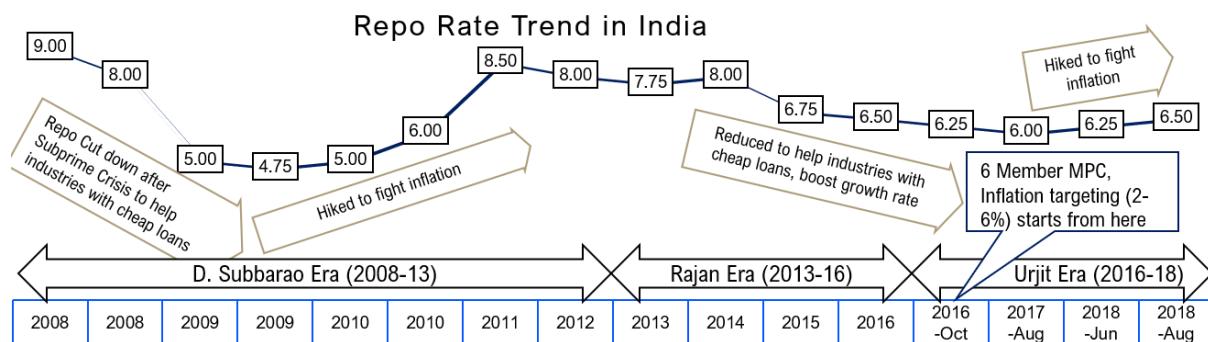


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- To ensure transparency / accountability: Govt can send message only in writing. Committee must publish its minutes of the meeting on ___ day, and “Monetary policy report” at every 6 months.
- Inflation target decided by Union Government in consultation with RBI.
 - o **Present target:** Keep CPI (All India) within 2-6% for _____ (ending at 31/03/2021). [alt. way of saying: 4% +/- spread of 2%]
 - o **Target fail:** if inflation not kept in this 2-6% zone for 3 consecutive quarters (=9 months) then Committee must send report to Govt with reasons and remedies.

Asked in UPSC-Pre-2015	Asked in UPSC-Pre-2017				
<p>Q. With reference to inflation in India, find correct statement:</p> <ul style="list-style-type: none"> a) Controlling the inflation in India is the responsibility of the Government of India only b) The Reserve Bank of India has no role in controlling the inflation c) Decreased money circulation helps in controlling the inflation d) Increased money circulation helps in controlling the inflation 	<p>Q. Consider following statements about Monetary Policy Committee:</p> <ol style="list-style-type: none"> 1. It decides the RBI's benchmark interest rates. 2. It is a 12-member body including the Governor of RBI and is reconstituted every year. 3. It functions under the chairmanship of the Union Finance Minister. <p>Find Correct Statements:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">(a) 1 only</td> <td style="width: 50%;">(b) 1 and 2 only</td> </tr> <tr> <td>(c) 3 only</td> <td>(d) 2 and 3 only</td> </tr> </table>	(a) 1 only	(b) 1 and 2 only	(c) 3 only	(d) 2 and 3 only
(a) 1 only	(b) 1 and 2 only				
(c) 3 only	(d) 2 and 3 only				

4.2 REVIEW OF LAST 1 YEAR'S MONETARY POLICIES



	Policy Decisions & Regulatory Announcements [we will study in appropriate pillars/sections]
Feb-2018	<ul style="list-style-type: none"> - No change in Repo@6%; Neutral Stance - Share market volatility, Advanced Economies recovery= foreign investors' outflow-> weakening of rupee + OPEC-Russia OIL production CUT = crude oil led inflation. - PSL loan caps removed for MSME. Base rates-MCLR Reforms. - ATM-Cash recycler machine subsidy removed - Ombudsman for NBFCs
April-2018	<ul style="list-style-type: none"> - No change in Repo @6%; Neutral Stance - Wait and Watch mode because Budget's pro-farmer-MSP, pro-rural approach; 7th Pay Commission's HRA hikes could generate demand-side inflation.



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	<ul style="list-style-type: none"> - IndAS accounting norms for Indian Banks deferred till 1/4/2019 - BASEL-III CCCB not necessary for this FY. - Payment System data must be stored in India within next 6 months. - Reiterated that cryptocurrencies / VC are dangerous WRT consumer protection, market integrity and money laundering. No entity regulated by RBI shall deal with VC companies, else be ready to "Face Direct Action". - RBI's inter-departmental group to check desirability and feasibility to introduce a central bank digital currency. - RBI data science lab for big-data analytics will be setup by 2018-Dec. - Regulatory norms for Cash-in-Transit (CIT) companies and Cash Replenishment Agencies (CRAs) - Financial literacy: new booklets for five target groups: Farmers, Small entrepreneurs, School children, Self Help Groups and Senior Citizens. Will review Lead-Bank Scheme.
June-2018	<ul style="list-style-type: none"> - Repo hike 25 bps= @6.25%; Neutral Stance - There has been a 12% increase in the crude oil price since the April policy. Crude Oil price rise are 'passed through' because Governments not reducing custom / excise /state VAT. So, had to fight inflation by raising Repo. - Will implement Deosthalee Committee's Public Credit Registry report. - Will allow Voluntary Transition of Urban Cooperative Banks into Small Finance Banks. - PSL home-loan guidelines revised to sync with Pradhan Mantri Awas Yojana. - Will develop a suitable rechargeable device or offline-software/app mechanism for visually challenged to identify Indian banknotes.
Aug-2018	<ul style="list-style-type: none"> - Rate hike 25 bps= @6.50%; Neutral Stance (meaning next time, either hold, hike or cut). - Rupee weakening against dollar, Government's MSP-hike = more inflation likely. Had to fight inflation by raising Repo. - Norms for Co-origination of loans for Bank-NBFC. - Banks' Internal Ombudsman trial successful. Now applicable to all SCB. - Extension of MSF-LAF facilities to certain cooperative banks.
Oct-2018	<ul style="list-style-type: none"> - No change in Repo but Stance changed to: Calibrated Tightening (meaning next time either rate hold or rate hike but no chance of ratecut) - RBI still apprehensive of oil prices, rupee strength and inflation, but did not increase Repo, just wait and watch for now.
Dec-2018	<ul style="list-style-type: none"> - No change in Repo; Stance: Calibrated Tightening - While Crude oil prices have declined by ~30% since October, so higher inflation is unlikely. But RBI wants to keep inflation @4 per cent on a durable basis. So, "calibrated tightening" stance continued. - Loan rate external benchmarks WEF 1/1/2019. - RBI to reduce SLR, from 19.5% to 18% at the rate of 25 basis points in each quarter for BASEL-LCR-HQLA compliance. (will learn in Pill#1:BASEL) - India and Japan have agreed to enter into a bilateral swap arrangement of \$75 billion (will learn in Pill#3) - Urban Cooperative Banks to have board of management under RBI. - Told Banks to keep special facilities for the senior citizen customers since 2017, if not done then be ready for "DIRECT ACTION" via Banking Ombudsman.



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- RBI's own Ombudsman for digital transactions- he'll look into not just banks but all payment service providers.
- Framework for Limiting Customer Liability in Unauthorized E-Transactions in Prepaid Payment Instruments.
- RBI to setup Ex-SEBI Chairman U K Sinha's Committee on long-term solutions for the economic and financial sustainability of MSME.

Feb-
2019 <stay tuned>

4.3 LIMITATIONS OF MONETARY POLICY IN INDIA

Even though the monetary policy is updated every 2 months, its efficacy in controlling inflation or boosting growth is restricted by following factors:

- Repo is not major source of funds for banks, unlike the Advanced Economies, where households don't save that much in Banks.
- Indian Banks don't immediately pass on the rate cuts to customers, citing NPA problems.
- Supply side issues: El-Nino/Poor monsoon hurting crop production, geopolitical issues increasing global crude oil & raw material prices.
- Government side issues: Fiscal repression, Fiscal slippage, Fiscal deficit, Subsidy leakage, Populist Loan-waivers etc.
- Structural Issues in Economy: lack of electricity-road infrastructure, Ease of Doing Biz, Presence of Informal moneylenders in rural areas who circulate black money at exorbitant interest rates. Poor penetration of banking sector and financial inclusion etc.

Because of these reasons, RBI can't greatly reduce the Repo/CRR/SLR, and then its criticised for not making cheap loans available to industries.

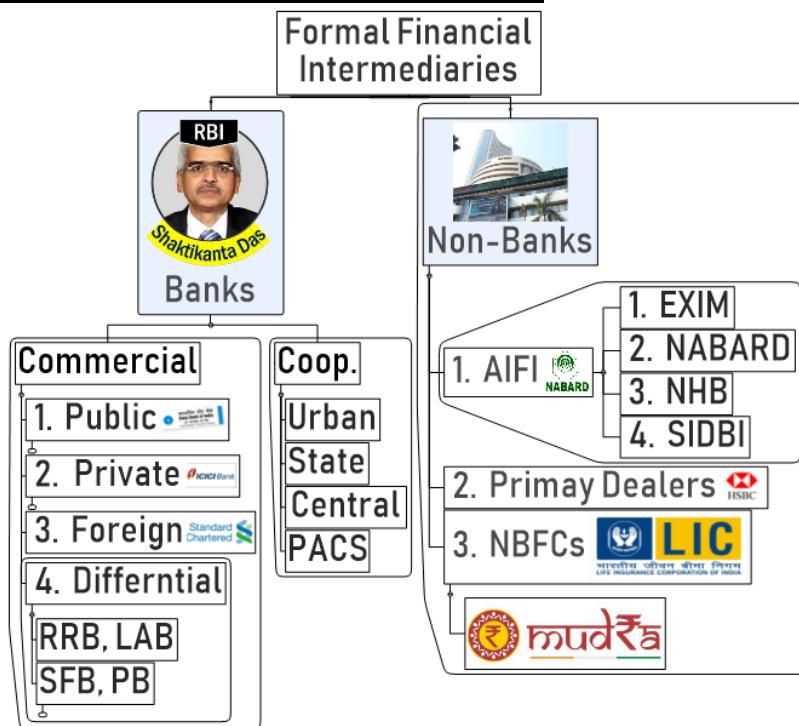
4.3.1 Mock Questions for UPSC Mains/GSM3 (150-250 words)

1. "Monetary policy is both a catalyst and an impediment to India's growth story." Examine critically. "भारत की विकास-गाथा में मौद्रिक नीति एक उद्दीपक भी है और एक अवरोधक भी है।" गंभीररूप से विश्लेषण करे.
2. "Monetary policy is a useful medicine, but NOT panacea for economic growth". Comment in context of India. "आर्थिक विकास के लिए, मौद्रिक नीति एक उपयोगी दवा है, लेकिन रामबाण नहीं". टिप्पणी करे.
3. Discuss the significance of Monetary policy in India's economic growth and human development. भारत की आर्थिक वृद्धि और मानव विकास में मौद्रिक नीति के महत्व पर चर्चा करें.



Banks & NBFCs Classification

- A Financial Intermediary (FI: वित्तीय मध्यस्थ) is an entity that acts as the middleman between two parties in a financial transaction between lenders vs. borrowers, investors vs. entrepreneurs, households vs business firms.
- Such FI can be subdivided into (1) Formal (2) Informal.



5 FORMAL FI \Rightarrow BANKS

5.1 RESERVE BANK OF INDIA (RBI): भारतीय रिजर्व बैंक

1913	Commercial banks were required to register under the Companies Act, but monitoring was lax. No CRR, SLR, BASEL Norms.
1926	Royal Commission on Indian Currency (_____ Commission) recommends setting up a central bank named 'Reserve Bank of India'.
1929	Great Depression in USA leads to collapse of 450+ banks in India. So British Government becomes serious about setting up RBI.
1934	Reserve Bank of India Act was enacted.
1935, April	RBI becomes operational from 1 st April, with 1 st Governor Sir _____ Government ownership was ~4.4% only.
1935, July	Commercial Banks fulfilling certain conditions were listed in the 2 nd Schedule of RBI Act, & such " Scheduled Banks " were required to keep CRR with RBI.
1943-49	_____ becomes the first INDIAN Governor of RBI. He had also participated in the Bretton Woods Conference, USA (1944).
1948-49	All private investors' shares transferred to Govt under the RBI transfer of ownership act 1948. Therefore, RBI governor answerable to Parliament, has to pay dividend to Government from its profits.
19____	Banking Regulation Act (बैंकिंग विनियमन अधिनियम) empowered the RBI to <ul style="list-style-type: none"> ⇒ Give license to companies to open banks, give permission banks to open new branches. ⇒ Prescribe auditing and liquidity norms for Banks such as SLR. ⇒ Protect interest of depositors. Force elimination / merger of weak banks.



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MCQ. In context of independent India's economy, which one of the following was the earlier event to take place? (Asked in UPSC Prelims-2009)

- A) Nationalization of insurance companies
- B) Nationalization of state bank of India
- C) Enactment of Banking regulation Act
- D) Introduction of first Five year plan

Table 1: RBI Central Board Composition

(Non-Official Directors)	(Official Directors)
<ul style="list-style-type: none"> - 2 Government officials - 10 directors nominated by Government. - 4 directors from RBI's local boards @West, East, North, South 	<ul style="list-style-type: none"> - RBI Governor - 4 Dy. Governors

5.1.1 RBI Governor & Dy Governor

- 25th Governor: Shaktikanta Das (Retd. IAS, Former finance secretary, G20 Sherpa, Member of 15th Finance Commission). He replaced Urjit Patel (2018-Dec).
- RBI Act (Section 8) provides for “NOT MORE than 4” Dy. Governors viz.
 1. B.P. Kanungo: from RBI officer cadre.
 2. N. S. Vishwanathan: from RBI officer cadre.
 3. Mahesh Kumar Jain: Appointed by appointment committee
 4. Dr. Viral V. Acharya: Appointed by appointment committee. also, Ex-officio Member of Monetary Policy Committee.

Their tenure usually 3 years. Re-appointment Possible. They're selected by Financial sector regulatory appointment search committee (FSRASC) headed by the Cabinet Secretary (IAS).

Related Topic: *RBI Autonomy, Dividend Controversy, Section 7, PCA/BASEL : all with next NPA Handout.*

5.1.2 RBI Offices & Departments

- RBI 4 regions: Northern: Delhi, Eastern: Kolkata, Southern: Chennai, Western: Mumbai
- RBI has various departments looking after Banks, NBFCs, Payment Systems, Foreign Exchange Management etc.
- Previously individual departments directly acted against violators. WEF 1/4/2017: A New **Enforcement Dept** was setup in RBI for centralized action against violators.
- This is different from FinMin's **Enforcement Directorate** (प्रवर्तन निदेशालय) that looks after Foreign Exchange Management Act, 1999 (FEMA) and Prevention of Money Laundering Act, 2002 (PMLA)- विदेशी मुद्रा प्रबंधन अधिनियम, और धनशोधन निवारण अधिनियम.

5.1.3 RBI: Functions of

- 1) **Controller** of Money Supply: Issues M0 under RBI Act, Makes Monetary Policy.
- 2) **Controller** of Foreign Exchange: through FEMA Act. (more in Pillar#3)
- 3) **Banker** to Governments & Public Debt Manager.
- 4) **Banker's _____**: Lender of Last resort, Advises in monetary matters.
- 5) **Regulator** of all “BANKS”: through BR Act'49, Payment Systems'07
- 6) **Regulator** of AIFI, NBFC-D & others.
- 7) **Promotional Roles**: Customer protection through Ombudsman, Financial Inclusion through PSL norms, 25% rural branch requirements.
- 8) Data Publication & International Coop. @BASEL, IMF, G20's Financial Stability Board etc.

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**MCQ. The Reserve Bank of India (RBI) acts as a bankers' bank. What does it mean?
(Asked in UPSC-Pre-2012)**

- 1) Other banks retain their deposits with the RBI.
- 2) The RBI lends funds to the commercial banks in times of need.
- 3) The RBI advises the commercial banks on monetary matters.

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

**MCQ. The Reserve Bank of India regulates the commercial banks in matters of
(Asked in UPSC-Pre-2013)**

- 1) Liquidity of assets
- 2) Branch expansion
- 3) Merger of banks
- 4) Winding-up of banks

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

5.2 SCHEDULED BANKS (अनुसूचित बैंक)

When RBI is satisfied that a bank has (Paid Up Capital + Reserves) = Min __ Lakhs & it is not conducting business in a manner harmful to its depositors, then such bank is listed in the ___ Schedule of RBI Act, and known as a Scheduled Bank.

Scheduled Bank	Non-Scheduled Bank
Required to deposit CRR money to RBI	Can maintain the CRR money with themselves.
Eligible to borrow / deposit funds in RBI's window operations.	Depends on RBI's discretion.
are required to protect the interests of depositors and abide to RBI norms.	Ofcourse, they also have to do it, else RBI can shut them down under BR Act.
Can be subdivided into two parts 1) Scheduled Commercial Banks (SCB) e.g. _____ 2) Schedule Cooperative Banks like Haryana Rajya Sahakari Bank, Tamil Nadu State Apex Cooperative Bank	Hundreds of cooperative banks are non-Schedule. But we need not see their list at Rbi.org.in/CommonPerson/English/scripts/banksinindia.aspx

5.3 FI⇒ COMMERCIAL BANKS⇒ PRE-INDEPENDENCE

Table 2: Before Independence (Exact Years Not-IMP.)

1707	Bank of Hindustan, Calcutta (Europeans owned)
1806-42	- Three Presidency Banks at Bengal then Bombay then Madras. - 1861: all three were given the right to issue currency. - 1921: They were combined into Imperial Bank of India⇒ SBI (1955)
1865	Allahabad Bank (Europeans owned)
1894	PNB: Indian owned, Lala Lajpat Rai helped in foundation.
1908	Bank of Baroda by Maharaja Sayajirao Gaekwad III
1913-30s	State Bank of Travancore, State Bank of Patiala, the rise and collapse of Banking industry, then Birth of RBI (1935)
1940s	State bank of Bikaner, Jaipur, Hyderabad, Travancore by the respective princely states / Nawabs. Post-Independence: became 'Associated Banks of SBI', and ultimately, merged in SBI (2017).



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5.3.1 Nationalization of Banks After Independence: Reasons

- ⇒ **NEXUS between Banks and Industrialists:** From 1950s to 1960, only 188 elite people controlled the economy by being in board of top 20 banks, 1452 companies, and numerous insurances, finance companies. This led to reckless lending to directors and their firms. So, Banks failed frequently, RBI had to close unviable banks.
- ⇒ Private Banks unwilling to open in rural areas- this did not help in **financial inclusion** of poor, farmers, MSME or achievement of FYP targets or reducing regional imbalance.

Table 3: Nationalization & Merger of Banks after Independence

1948	RBI Transfer of Ownership Act.
1955	Imperial Bank nationalized and became SBI.
1955-56	LIC Act took over private life insurance cos.
1963	State Bank of Jaipur and Bikaner merged together.
1969	'Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969: 14 Private banks with 50 cr/> deposits were nationalized e.g. Bank of Baroda, PNB, Dena, Canara etc. - Catholic Syrian Bank (1920, Kerala), Ratnakar Bank, Dhanlaxmi Bank etc., did not have such large deposits, so they were left out & called " Private Banks ".
1972-73	GIC Act- took over private Non-Life (=General) insurance cos. Later GIC was re-organized with 4 subsidiaries: National Insurance, New India Assurance, Oriental Insurance and United India Insurance.
1980	6 banks with 200 cr/> deposits were nationalized e.g. Corporation Bank, Vijaya Bank, Oriental bank of Commerce etc.
2008-10	State Bank of Saurashtra and State Bank of Indore merged into SBI.
2013	- _____ was setup as PSB, HQ Delhi, 100% ownership by Union Government. - BMB's Board of Directors: _____. Staff & Deposit Holders: both men and women, Loans given predominantly to women- and that too without collaterals upto Rs.1 crore.
2017, 1st April	BMB & 5 Associated Banks of SBI viz. State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Mysore (SBM), State Bank of Patiala (SBP) and State Bank of Travancore (SBT), merged with SBI from 1 st April by swapping of shares.
2017, Nov	- Alternative Mechanism Panel setup under the FM Jaitley's chairmanship (other members: Piyush Goyal, Nirmala Sitharaman). - They examine the proposals for merger/consolidation of the Public Sector Banks (PSBs) and forward to Cabinet for approval. - Department of Financial Services coordinates the filework.
2019, 1st April	_____ to be merged into Bank of Baroda, by swapping of shares. Then BoB will become India's 3 rd largest bank after #1 SBI and #2 HDFC.



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5.4 PRIVATIZATION OF PSBs (सार्वजनिक क्षेत्र के बैंकों का निजीकरण)

- **Pro-Arguments:** Economies of Scale, Geographical & Technological Synergies, Easier compliance with BASEL-III norms, reduced cost of business-> better lending & deposit rates.
- **Anti-Arguments:** Employees worried seniority, promotion, increments; financial burden of Voluntary Retirement Scheme (VRS). Banks may lose regional identities & customer intelligence with transfer of employees. Big customers may shift to other banks for faster service and personalized privileges.

5.4.1 UTI Bank -> Transformed to Axis Bank (2007)

- ⇒ Setup in 60s as a *Sarkari* Mutual Fund Company through Unit Trust of India Act 1963
- ⇒ 1993: Obtained License to open UTI Bank.
- ⇒ 2001: Ketan Parekh Sharemarket Scam, Govt has to bailout UTI -> further restructuring 2007-> Became Axis Bank: 77% private shareholding + 23% by Public sector bodies like LIC, New India Assurance, SUUTI etc. (as of 2019, Jan).

5.4.2 IDBI Bank -> Purchased by LIC (2018)

- ⇒ Setup in 60s as a Development Financial Institution (DFI) through the Industrial Development Bank of India Act, (1964).
- ⇒ 2004: Transformed into a Public Sector Bank, after Narasimham-II suggested DFI abolition.
- ⇒ IDBI Bank shareholding: 81% Government + ~11% LIC + remaining by other investors
- ⇒ 2014: RBI's P.J. Nayak Committee that suggest Govt should exit shareholding in smaller PSBs, to enhance their efficiency.
- ⇒ Budget 2016: Govt agreed to reduce shareholding to <50% in IDBI Bank.
- ⇒ 2018: IDBI has the highest NPA (28%) among PSB, so no mentally-fit investor willing to buy Govt's shares. Govt. forces LIC to buy its 40% for ~9k crores. Thus, LIC will own 51% in IDBI. Deal was approved by the respective financial regulators (RBI and IRDAI) by 2018-July.
- ⇒ **Positive:** Govt. no longer worry about BASEL-recapitalization of IDBI. LIC can market its insurance policies to IDBI consumers (*bancassurance*).
- ⇒ **Negative:** LIC policy holders' money is going into a loss-making Bank. They'll be deprived of optimal returns (opposite to had LIC invested in a profitable company) = this amounts to "Financial Repression of Households" (वित्तीय दमन).

5.5 COMMERCIAL BANKS ⇒ PRIVATE SECTOR BANKS (PvB) निजी-क्षेत्र के बैंक

While the nationalization of banks was done with the lofty objectives, but politicization in Public Sector Banks (PSBs) created new set of problems:

- Government administered loan interest rates for populism= Low profitability for PSBs.
- Low recovery from NPA due to political interference, and legal loopholes.
- Employees unions hampering any innovation or customer responsiveness.
- **1991:** the Balance of Payment crisis finally forced Govt. to set up a committee for Banking Sector Reforms under The **former RBI Governor** _____ . He said:
 - o Government should ↓ its shareholding in Public Sector Banks.
 - o RBI should ↓ CRR and SLR, Govt should not dictate interest rates to Banks, Liberalise the branch expansion policy
 - o Allow entry of New Private Banks and New Foreign Banks.



Table 4: Three rounds of private bank licensing in India

Round-1 (1993-95)	Round-2 (2001-04)	Round 3 (2013-16)
1) ICICI 2) HDFC 3) Indus 4) DCB 5) UTI-> later Axis bank 6) IDBI->now owned by LIC 7) Global Trust Bank-> Merged with Oriental Bank #8-9-10: Bank of Punjab, Centurian Bank, Times Bank were merged into HDFC	1) Kotak Mahindra 2) _____ (Founder Rana Kapoor)	Rajan invited applications, Bimal Jalan Committee made selections: 1. _____ (A Microfinance company based in W.Bengal) 2. _____ (An infra finance NBFC based in Maharashtra). Later on, another NBFC "Capital First" merged so renamed into IDFC-First

5.5.1 On-Tap License to open Private Sector Banks

A private entity can open Bank only after getting license from RBI under Banking Regulation Act, 1949. Previously, one had to wait till RBI invited applications. But in the On-Tap system (WEF 2016), one can apply to RBI whenever he wishes, provided that:

1. It's a Resident Indian individual, NBFC, or private company with min. 5 years of experience in Banking-Finance Sector, and Min. 500 crore capital, and total assets not more than Rs. 5000 crores. [Amount / B.com/CA-interpretations not imp. for UPSC]
2. Proposed Bank will be controlled by Indians & willing to open 25% branches in unbanked rural areas.

5.6 COMMERCIAL BANKS ⇒ FOREIGN BANKS (विदेशी बैंक)

In Nehruvian Socialist Economy there was disdain & apprehensions about Foreign Banks. Only a handful of them were allowed to open branches. But, Post-Narasimham-Reform: foreign banks approval policy was liberalized.

Foreign Bank in India	<ul style="list-style-type: none"> - They're Incorporated abroad (i.e. registered under the Companies Act of a foreign nation) & opening branch / subsidiary in India e.g. Citibank, Bank of America, HSBC. - While CRR, SLR & other norms applicable, but PSL norms vary depending on number of branches. [Ref: Prev. Handout: PSL]
Indian Public Sector Bank	<ul style="list-style-type: none"> - Foreigners can invest max. 20% in its shareholding. E.g. BoB (15%), SBI (14%), PNB (13%) - Although Government thinking of raising it to 49% to help capital mobilization for BASEL-III norms. [More in Next NPA handout]
India Private Sector Bank	<ul style="list-style-type: none"> - Upto 49% (automatic) and upto 74% by approval of Government. - e.g. HDFC (73%), ICICI (59%) Axis Bank (52%). - Although Government thinking of raising it to 100% to help capital mobilization for BASEL-III norms



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5.7 COMMERCIAL BANKS ⇒ DIFFERENTIAL BANKS

Difference	Universal Bank (सार्वत्रिक)	Differential Bank (भेदकर)
Branches	Anywhere: example SBI, ICICI [*After opening 25% of branches in unbanked rural areas]	Geographical Restrictions on branch opening for Local Area Bank (LAB), Regional Rural Banks (RRB)
Accept	Both Time & Demand Deposits of any amount.	Payment Bank – Accept Max. _____ only.
Give Loans to	Anyone [After 40% PSL]	- SFB, RRB: _____ to PSL - Payment Bank can't give loans;

Chronology of differential banks: RRB(1976) → local area bank (1996) → Small Finance Bank & Payments bank(2015) → Wholesale banks (proposed)

5.7.1 Commercial Banks-> Differential Banks-> RRBs & LAB

Parameters	(Universal) Commercial Banks सार्वत्रिक वाणिज्यिक बैंक	Regional Rural Banks क्षेत्रीय ग्रामीण बैंक	Local Area Bank स्थानीय क्षेत्र बैंक
Examples	_____	Uttar Bihar Gramin Bank (Sponsor bank- Central Bank of India)	*Given @bottom of table
Banking Reg. Act	Applicable	Applicable + RRB act 1976 & its amendment in 2015 to facilitate merger	Only Banking Reg. Act
CRR, SLR, MSF,	Applicable	Applicable but RBI could prescribe separate norms.	They're Non-Sch. Banks so every norm with caveats
PSL	Applicable (40%)	Applicable & higher: 75%	Same as Commercial Bank
Lending Rates	Free to decide within RBI's methodology for Marginal Cost of Funds Based Lending Rate (MCLR). [More under NPA]	Can't be more than prevailing lending rates of Cooperative Banks in the area	
Geographical Presence	Anywhere (India and even overseas branches)	Restricted to few districts. E.g. Baroda Gramin Bank branches confined to Gujarat's southern districts.	Max. 3 geographically contiguous districts. only 1 urban centre per district.
Vote power	Depends on Shareholding.	(Union + State + Sponsor bank) = 51%	Same as UCB
Father	N/A	M.Narasimham's Committee on Financial Inclusion in 70s	Accidental FM budget 1996
Regulator	Only RBI	RBI + _____	Only RBI

* **Local Area Banks:** Initially 4: (1) Coastal Bank Andhra Pradesh (first to setup in 99), (2) Subhadra Local Area Bank, Kolhapur; (3) Krishna Bhima Samruddhi (Andhra & Karnataka) and (4) Capital Local Area Bank: Punjab (Largest). But later Capital LAB converted into Small Finance Bank (2016), so now only 3 left.



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5.7.2 Commercial Banks⇒ Differential Banks ⇒ SFB & PB

On **Nachiket Mor** Committee's recommendations (2013-14), Rajan approved these new types of banks for (1) financial inclusion (2) competition & innovation among players.

Parameters	Small Finance Banks लघु वित बँक	Payment banks भुगतान बँक
Examples	Capital Small Finance Bank (Punjab), Ujjivan (Karnataka), Utkarsh (UP): Total 10 list at rbi.org.in/scripts/banklinks.aspx	7 at present: Airtel, India Post, FINO, Paytm, Aditya Birla Idea, Jio, NSDL. (<i>Total 11 were selected</i>)
Eligibility	<i>Min. 100cr. capital-walla</i> Resident Indian, Local Area Bank, NBFC, Micro-finance, with 10 years exp. in banking / finance	<i>Min. 100cr. capital-walla</i> resident Indians, NBFCs, PPI-wallets (pre-paid payment instrument), mobile telephone companies, super-market chains, cooperatives & companies controlled by resident Indians
Area	RBI Committee gave selection preference North East & Central India clusters where Universal Banks' penetration is poor	Anywhere
Selected by?	Usha Throat (Former RBI Dy.Gov)	Nachiket Mor(Ex-RBI Board Member)
CRR, SLR, Repo, FDI?	Same as Indian private banks	Same as Indian Private Banks, but caveats in SLR.
Rural Penetration	Must have 25% branches in unbanked rural areas	No need but 25% access points must be in rural areas like Business correspondence (BC), Kirana Stores
Target Consumers	Unserved, Underserved Farmers, Micro, Small industries	Promoting Small savings Remittance of migrant labors, low income households, unorganized sector, small business.
Accept Deposits	Yes, without any restrictions	<ul style="list-style-type: none"> - No NRI deposits - Can accept Time & Demand Deposits but max. balance Rs. _____ per year per customer.
Debit cards	YES (but EMV-Chip-walla)	YES (EMV-Chip-walla)
Credit cards	YES (but EMV-Chip-walla)	No (because can't "loan")
Loans	<ul style="list-style-type: none"> - Yes, but _____ in PSL, - 50% of loan portfolio of Rs. 25 lakhs/< loans. 	<ul style="list-style-type: none"> - Can't loan, So no PSL. - Min.75% of Demand deposits in Gsec, T-Bill; - Max.25% of all deposits in other SCBs
Evolve?	Yes, after 5 years can become Universal Commercial Bank.	Not mentioned.

- BASEL-III norms applicable on both of them, and they are tighter than a (universal) commercial scheduled bank.
- Both can sell Mutual Fund (MF), Pension, Insurance policies with approvals of respective regulators.
- **Payment Bank Challenges?** Low profitability due to lending restrictions. 2018: RBI barred Vijay Shekhar Sharma's PayTM Payment Bank from opening new accounts as it could not keep Min.100 crore capital, but the ban lifted in 2018-Dec.



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Asked in UPSC-Pre-2016

Q. Find correct Statement(s) about Payment Banks?

- 1) Mobile telephone companies and supermarket chains that are owned and controlled by residents are eligible to be promoters of Payment Banks.
- 2) Payment Banks can issue both credit cards and debit cards.
- 3) Payment Banks cannot undertake lending activities.

Codes:

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

Asked in UPSC-Pre-2017

Q. What is the purpose of setting up of Small Finance Banks (SFBs) in India?

1. To supply credit to small business units
2. To supply credit to small and marginal farmers
3. To encourage young entrepreneurs to set up business particularly in rural areas.

Codes:

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

5.7.3 India Post Payment Bank (IPPB)

- Registered as a Public Limited Company under Companies Act, 100% owned by Department of Posts (Ministry of Communication and Information Technology.) -> Obtained RBI's License under Banking Regulation Act to start working as a Payment Bank.
- Airtel Payments Bank was first to launch operations in 2017- Jan. Later, IPPB launched pilot branches at Raipur (Chhattisgarh) and Ranchi (Jharkhand). Then IPPB launched full-fledged operations in 2018. In between, Paytm, Fino, Birla Idea and Jio launched their Ops. *In short IPPB not the first to launch full fledged Ops.*
- **Motto:** _____ . Largest customer reach with 1.55 lakh Post offices across India. Doorstep banking through Postmen (but fees applicable).
- IntraBank transfer: no fees. IMPS/NEFT/RGST: fees applicable.
- Bank Account Types: **Safal, Sugam, Saral** (~~internal differences about ATM withdrawal limits etc. not important for UPSC~~).
- Account can be opened with zero balance, no minimum balance requirement. Max. Balance _____ per person per year. Customer Age: 10 years / >
- Also partnered with Bajaj Alliance Life Insurance (BALIC) to sell insurance policies.

MCQ. Which of the following statements about the India Post Payments Bank (IPPB) is/are correct? [Asked in UPSC-CDS-2018-1]

- 1) It has been incorporated as a Public Limited Company.
 - 2) It started its operation by establishing two pilot branches at Hyderabad and Varanasi.
- Answer codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

5.7.4 Wholesale & Long Term Finance Banks (WLTB)

2017: RBI proposed. Entry capital 1000 crores, can't accept deposits less than 10 crores, can give loans only to large corporates & infrastructure projects. Other banks may use it for PSLC-certificate trading.



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5.8 FI⇒ BANKS⇒ COOPERATIVE BANKS (सहकारी बैंक)

Type	Commercial Banks	Cooperative Banks
Banking Reg. Act	since 1949	Applicable since 1966.
Regulator	RBI	_____, State Registrar of Cooperative Societies
CRR, SLR, BASEL-III	Yes	Yes, but, RBI could keep different slabs/ norms.
Repo, MSF borrow	Eligible	Yes, but only selected category of Cooperative Banks
PSL Lending	Yes 40-75%	---
Who can borrow	Anyone	Only Members
Vote power	Shareholding	1 person 1 vote, irrespective of capital contributed
Profit Motive	Yes	No Profit No Loss motive.
Presence	All India & overseas	Mainly in Guj, MH, Andhra, TN

Table 5: Classification of Cooperative Banks

Urban Cooperative Banks (शहरी)	Rural Cooperative Banks (ग्रामीण)
<p>Further subcategories depending on</p> <ul style="list-style-type: none"> - Scheduled / Non-Scheduled; - Single State / Multi State. <p>From 2018, RBI allowed them to voluntarily upgrade to Small Finance Banks, with certain conditions.</p>	<p>1) Long term: Land Banks, Cooperative Agriculture & Rural Development Banks</p> <p>2) Short term: State Cooperative Bank -> District Central Cooperative Bank (_____) -> Primary Agriculture Cooperative Society (_____)</p>

- **Challenges:** Politicization due to 1 person 1 vote, casteism, poor recovery of loans, scams, money laundering.
- They were prevented from exchanging banned 500-1000 notes due to malpractices.
- **Budget-2017:** provided funds to NABARD for implementing Core Banking Solution (CBS) within PACS & DCCB- this will help in targeted delivery of farm loans and subsidies.

Related topics: Jan Dhan Yojana, Lead Bank Scheme etc. later in Pillar#1: Financial Inclusion

6 FORMAL FI⇒ NON-BANK FINANCIAL INSTITUTIONS

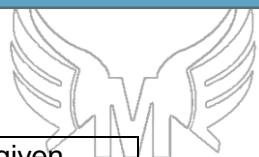
गैर-बैंक वित्तीय संस्थान

6.1 (EXTINCT) DEVELOPMENT FINANCE INSTITUTIONS (DFI)

विकास वित्त संस्थान were meant for Medium to long term loans to industries, including also support services like arranging foreign currency, underwriting, technical / management consultancy, Bank guarantee etc. They did not accept DEPOSITS from ordinary people.

1948	Industrial finance corporation of India Ltd. (IFCI) Act. Later became a Non-Deposit-Taking-Systematically-Important (NBFC-ND-SI).
1951	State Finance Corporation (SFI) Act, because IFCI alone couldn't cater industrial loan demand.
1955	National Small Industries Corporation (NSIC) by Government of India (GoI)
1955	ICICI: Industrial credit and Investment Corporation of India Ltd was setup by GoI, World Bank, and other FI. Later became a Private Sector Bank.

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1964	- Industrial development bank of India (IDBI) Act. For a while, it was also given regulatory powers over Industrial finance but then overtaken by SIDBI, EXIM Banks. 2004: Transformed into a Public Sector Bank. 2018: Government sold its majority shareholding to LIC.
-------------	---

Narasimham-II ('98) recommend there should be only two categories: Bank or non-bank. DFI should join either one.

6.2 NON BANK \Rightarrow ALL INDIA FINANCIAL INSTITUTIONS (AIFI): अखिल भारतीय वित्तीय संस्थान

All four are setup by respective acts of Parliament.

EXIM (Jan 1982)	NABARD (Jul 1982)	NHB (1988)	SIDBI (1990)
Export-Import Bank of India	-----	National Housing Bank	-----
Boss: Government of India (100%)	Previously RBI had minority-stakes in NABARD but as of 2018: 100% Govt owned.	Boss: RBI (100%). But, Finance Act 2018 amended NHB Act, for transferring RBI's stakes to Govt.	BOSS: SBI, LIC, IDBI other public sector banks, insurance companies etc.
Promotes cross border trade and investment, helps importers- exports with loans and foreign currency.	<ul style="list-style-type: none"> - Regulatory authority: Coop + RRB - + Indirect refinance to farmers, artisans - Operates Rural Infra. Development fund (_____) from PSL shortfalls from SCBs. 	<ul style="list-style-type: none"> - Finance to banks and NBFCs for housing projects. - Regulator of Housing Finance Cos (NBFC) - _____ index to monitor residential real estate prices. 	<ul style="list-style-type: none"> - Operates Small Enterprises Development Fund (SEDF), which receives funding from PSL shortfalls of Foreign Banks with <20 branches. - Operates _____ for loans to small entrepreneurs & SME via schemes like Mudra, Stand-up-India.

— 5th AIFI = Industrial Investment Bank of India (IIBI) closed in 2012.

- NABARD Amendment Act 2017: 1) increased capital 2) facilitated transfer of RBI shares to Govt 3) MSME definitions updated.
- AIFIs are not 'banks' because can't accept direct deposits from people at large.
- RBI is the regulator over AIFI, BASEL norms applicable but RBI can prescribe different / slabs norms / deadlines.

Asked in UPSC-Pre-2013	Asked in UPSC-Prelims-2004
<p>Q. Which of the following grants/grant direct credit assistance to rural households?</p> <ol style="list-style-type: none"> 1) Regional Rural Banks 2) National Bank for Agriculture and Rural Development 3) Land Development Banks <p>Answer Codes:</p> <p>(a) 1 and 2 only (d) 1 and 3 only (c) 1 and 3 only (d) 1, 2 and 3</p>	<p>Find Correct Statement(s)</p> <ol style="list-style-type: none"> A. NHB, the apex institution of housing finance in India, was setup as a wholly owned subsidiary of RBI B. Small industries development bank of India was established as a wholly owned subsidiary of the Industrial development bank of India C. Both A and B D. Neither A nor B



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6.3 FI \Rightarrow NON-BANK \Rightarrow PRIMARY DEALERS (PD)- (प्राथमिक विक्रेता)

- They deal in "primary" market. directly buy G-sec from RBI's E-Kuber platform and sell it in the secondary market.
- Total 21 PD licensed by RBI: 14 of them are Banks. E.g. Standard Chartered Bank, HSBC (HongKong), SBI, Kotak etc.

6.4 FI \Rightarrow NBFCs (गेर-बैंकिंग वित्तीय कंपनिया)

Parameter	Commercial Banks	Non-Banking Financial Companies (NBFCs)
Registration	Banking Regulation Act	Companies Act
Supervision	RBI	Varies: Mutual funds-SEBI, Insurance Company: IRDA etc.
Entry Capital	500 Cr.	5cr for MicroFin, 2 cr for others; 200 cr. For reinsurer etc. [figures not imp]
Numbers	22 Public Sector (incl. Post Payment Bank), 56 RRBs, 37 private sectors (including SFC, PB), 44 Foreign Banks.	Total 10,190 out of them 108 deposit Taking, remaining are non-deposit-taking (ND).
Deposits	<ul style="list-style-type: none"> - Can accept Time & Demand [chequable deposit] - Their deposits are insured under DICGCI Act. 	<ul style="list-style-type: none"> - Only NBFC-Deposit-Taking (NBFC-D) & even they can accept only Time Deposits. - Can't issue their own chequebook, debit/credit card. - Deposits are not insured.
Prudential Norms	CRR, SLR, applicable	NBFC-D: SLR required but RBI can prescribe different slabs / norms. CRR not applicable on any NBFC.
BASEL	Applicable	<ul style="list-style-type: none"> - Applicable on 108 NBFC-D and - Applicable on 276 NBFCs – ND – SI (non-deposit taking Systematically Important with assets over Rs. 500 crores) e.g. L&T Finance, Cholamandalam etc. <p>But RBI can prescribe different slabs / norms /deadlines.</p>
Investment	They can keep depositor's money in RBI approved securities. But can't invest in share market per se.	Can invest clients' money in share market. E.g. Mutual Funds
Loan Rate	Decided as per RBI's MCLR methodology.	Varies & depends on nature of biz.
Recovery	Loan recovery powers under SARFAESI Act.	<ul style="list-style-type: none"> - Only Housing Finance Companies have SARFAESI powers. - Gold Loan company can auction gold. - Mutual Fund Company may have to wait till liquidation of bankrupt company.
Consumer Complaints	RBI's Ombudsman, Bank's Internal Ombudsman	RBI's separate Ombudsman for NBFCs starting the NBFC-D since 2018.



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MCQ: Find correct Statement(s) about NBFCs in India [Asked in UPSC-Prelims-2010]

- A. They cannot engage in the acquisition of securities issued by government.
- B. They cannot accept demand deposits like savings account.
- C. Both A and B
- D. Neither A nor B

MCQ: The main functioning of the banking system is to [Asked in UPSC-CDS-2013-II]

- | | |
|--|--|
| (a) accept deposits and provide credit | (b) accept deposits and subsidies |
| (c) provide credit and subsidies | (d) accept deposits, give credit and subsidies |

6.4.1 NBFCs Regulated by RBI

Asset Finance Company (AFC)	Loans for economically productive assets like truck, bulldozer, tractor, pumpset, E.g. SREI Equipment Finance
Infrastructure Finance Company (IFC)	Gives loan for infra. projects. E.g. Rural Electrification Company Ltd. (REC): PSU under Power Ministry
Infrastructure Debt Fund (IDF)	Long term loans to highway / port developers etc. e.g. L&T IDF, Kotak IDF, IDFC IDF ("IDFC First" has separate license for Bank).
Core Investment Company (CIC)	<ul style="list-style-type: none"> - They do long term investment in Companies. E.g. Tata / Birla / Reliance Capital & Infrastructure Leasing & Financial Services Limited (IL&FS) - IL&FS is owned by SBI, LIC and Corporates from Japan and Abu Dhabi. 2018: In controversy because couldn't repay interest to lenders. <i>More in next NPA handout.</i>
Asset Reconstruction Companies (ARC)	They borrow bad loans / NPA from Banks & other NBFCs, and try to salvage value from the underlying assets. E.g Anil Ambani's Reliance ARC.
Factoring Companies	They lend short term money to client against his invoices / accounts receivable. E.g. IFCI Factors, Siemens Factoring.
Gold Loan Companies	e.g. Muthoot gold loan, Mannapuram Gold. RBI decides their Loan to Value ratios.
Micro Finance Institutions (MFI)	RBI + Dept Corporate Affairs (<i>given on next page</i>)
Fintech cos: P2P Lenders	Similar to Olx-Quickr connecting sellers of second hand goods with buyers, the P2P lending websites connect borrowers and lenders. E.g. Faircent.com, Cashkumar.com
Fintech cos: Account Aggregators (AA)	<ul style="list-style-type: none"> - They manage information of a customer's financial assets & display it to him or to third party (like loan giver, credit rating company, App like Google pay etc.) - 2018-Nov: RBI said it'll give license to 5 companies. List awaited.
----- (अवशिष्ट)	Any NBFC that is not regulated by any other regulator- falls under RBI's purview.



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6.4.2 NBFCs Regulated by SEBI

Stock Broker	They help clients buy-sell shares/bonds (=debentures) depending on his instructions E.g. Motilal Oswal, Indiabulls, Sher Khan etc.
Mutual Funds (MF)	<ul style="list-style-type: none"> - They pool clients' money and MF-manager invests it in shares/bonds using his own discretion & expertise. - E.g. SBI's Shariah Equity Mutual Fund: clients' money invested in Sharia compliant Cos. That don't deal with alcohol, pork, debt, tobacco or weapons.
Investment Banks: (US term) & Merchant Banking Companies: (UK term)	Underwriting, Merger & Acquisition, Wealth Management of rich people: E.g. Kotak Mahindra, Citigroup, Bank of America. DSP Merrill Lynch, Morgan Stanley, Canara Bank, SBI capital (separate license)
Venture Capital Fund VCF	Help startup companies via equity finance e.g. IFCI, IDG.

6.4.3 NBFCs Regulated by Others

Regulator	Example NBFC Companies
-----	<ul style="list-style-type: none"> - Life Insurance companies e.g. LIC, HDFC Standard Life Insurance - Non-Life (=General) insurance companies e.g. IFFCO-Tokio General Insurance
-----	All Pension Funds, except EPFO
-----	Housing Finance Companies such as DHFL, Muthoot Housing finance etc. (have SARFAESI Powers)
Dept of Company Affairs	<ol style="list-style-type: none"> 1. NIDHI Companies: Mutual benefit club, only members can borrow. e.g. South Madras Benefit Fund Ltd, Maben Nidhi Ltd (of Mannapuram group) 2. Microfinance Companies: They give loan to poor without collateral, flexible EMI, But no loans above 50k. e.g. Bandhan (WB- got PvB license), Disha (A'Bad: got SFB license), SKS (Andhra), Cashpor (UP), Ujjivan (Karnataka).
State Registrar of Chit Funds	Chit fund is a type of collective investment scheme with monthly contributions & borrowing by contributing members e.g. Shriram Chits. (<i>More in Pillar#1: Financial Inclusion</i>)



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6.4.4 NBFC⇒ Mudra (2015, 100% SIDBI subsidiary)

- Micro Units Development & Refinance Agency. (सूक्ष्म इकाई विकास एवं पूनः वित्तपोषण एजेंसी)
- **Objective?** provides indirect lending via SCB, RRB, Cooperatives, MFI & other NBFCs through refinancing.
- **Ownership?** It's wholly owned by _____, and also receives the funding from PSL-shortfalls via RBI and budgetary support via Department of Financial Services.
- **Beneficiary?** Non-Farm-Non-Corporate type Micro Enterprises.

Table 6: Definitions in Micro, Small and Medium Enterprises Development Act / Bill

Category	Micro, Small and Medium Enterprises Devlp Act, 2006		Bill 2018: Only annual turnover
	Msg: Investment in Plant and Machinery	Services: Investment in Equipment	
	Upto 25 lakh	Upto 10 lakh	Upto 5cr
	>25 lakh upto 5 crore	>10 lakh upto 2 crore	>5cr upto 75 cr
	>5cr upto 10 crore	>2cr upto 5 crore	>75cr to 250cr

Table 7: Mudra-Products:

Pradhan Mantri MUDRA Yojana (PMMY)	MUDRA Rupay Card
1) Shishu : loans upto _____ 2) Kishor : >50,000/- upto 5 lakh 3) Tarun : > 5 lakh and upto _____	<ul style="list-style-type: none"> - ATM cum Debit Card issued against MUDRA loan account. - For working capital component. - Can be accessed in all modes like a routine debit card (ATM, MicroATM, PoS, Online)

- Mudra loans are collateral-free. If borrower defaults on loan, then lender's losses are covered through Credit Guarantee Fund for Micro Units [CGFMU] operated by National Credit Guarantee Trustee Company Ltd. [NCGTC]- a private ltd company by Dept of Financial Services (setup in 2016).
- **MUDRA Challenges?** (1) Loan Interests are high (2) Rising NPA/Bad loans.

MCQ. Pradhan Mantri MUDRA Yojana is aimed at (Asked in UPSC-Pre-2016)

- a) bringing the small entrepreneurs into formal financial system
- b) providing loans to poor farmers for cultivating particular crops.
- c) providing pensions to old and destitute persons.
- d) funding the voluntary organizations involved in the promotion of skill development and employment generation.

6.4.5 Stand Up India Scheme, 2016 (उत्थित भारत)

- **Boss?** FinMin's Dept of Financial Services (वित्तीय सेवा विभाग)
- **Objective?** Each SCB bank branch to give Greenfield Loans between 10 lakh and 1 Crore to at least 1 _____ and atleast 1 _____ entrepreneur with tenure upto 7 years.
- **Collateral?** Bank can ask collaterals. If loan without collaterals, then Credit Guarantee Fund for Standup India (CGFSI) operated by **NCGTC**.



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6.5 NBFC: ISLAMIC BANKING

- Interest (*Riba*) is prohibited (*Haram*) in Islam. So, Islamic Banking operates through *Ijara*, *Murabaha*, *Musharaka* mechanisms- in which depositors' money is invested in borrower's property / business and returns are shared in form of rent / profit but not in the form of _
- - - - -
- While previous committees said give permission to Islamic Banks in India, but ___ is opposed (2017).
- **Pro-Arguments?** Financial inclusion of Muslims. Mobilization of deposits from Islamic countries for Indian Economy.
- **Anti-Arguments?** Specialized Manpower Required. PM-Jan-Dhan Yojana, Post Office Payment bank efforts will dissipate. USA authorities say it's used for terror finance & money laundering.

7 INFORMAL FINANCIAL INTERMEDIARIES (अनौपचारिक वित्तीय मध्यस्थ)

- They provide loans without KYC, PAN or Aadhar card but require property/vehicle/home/goods/crop/gold etc. as collaterals/pawn. They charge very high compound interest rates & use muscle power for recovery, hence their NPA is minimal.
- They don't fall under RBI/SEBI purview, but State Governments have individual laws against them e.g. Bombay Moneylenders Act 1947, Kerala (1958), Gujarat (2011). These laws require such informal lenders to register, impose ceiling on the interest rate & prohibit strong-arm tactics.

Types	Indigenous Banker	Moneylender / Brokers
Medieval time known as	Shroff, Shikarpuri, Chettiar, Marwari, Aiyar, Rastogi	Kabuli Pathan, Quistwala, Arhatia, Village Bania, Soni, Mahajan & Seth, Pawnbrokers, Financial Brokers
Money mobilization	They used to mobilize money from Public via: 1) Hundi: bill of exchange; 2) Commercial bills	They use their own money (or some villain's blackmoney)

Mains Q: “Discuss the evolution / structure / function / objective of particular FI”- will be a rather too simplistic Mains Question for UPSC. These institutions have to be seen in the context of GDP/Economic Growth, Investment/NPA & Inclusive Growth/Financial Inclusion. So, we'll try some Mock Mains Qs once we've completed those topics.



Burning Issues of Banking Sector

8 BURNING ISSUES OF BANKING ⇒ LOANS & NPA

RBI's 6-member statutory MPC decides policy rate (=repo rate) to keep inflation within 2-6% CPI (All India) but who decides lending rates of individual banks, & how? Ans.⇒

8.1 BANKS' LENDING RATES

1969	Government began nationalization of private banks, and 'administered interest rates' on them.
1991	M.Narsimham suggested deregulation: Govt should not dictate / administer individual banks' interest rates & RBI should only give methodology to banks.
2003	RBI introduced _____ (BPLR).
2010	RBI introduced BASE Rate + Spread system; update frequency on individual banks' discretion .
2016	<ul style="list-style-type: none"> - RBI introduced _____ (MCLR) + Spread system. Banks to calculate on monthly basis. It consists of CRR Cost, Operating Cost, Marginal cost of funds (Repo Rate, Deposit Interest) etc. - Benefits? Better transmission of Monetary Policy; transparency & accountability to borrowers. Although RBI's Janak Raj internal study group (2017) showed MCLR did not yield all benefits so new method...⇒
2019, 1st April	<ul style="list-style-type: none"> - NEW loans (not existing loans) to be linked with " _____ Benchmark + Spread" system. 1 Category of Loans = 1 External Benchmark. - Individual bank free to pick any one External Benchmark such as RBI repo rate (6.50%) or 91-day T-bill yield (6.56%) or 182-day T-bill yield (6.73%) or any other benchmarks by Financial Benchmarks India Pvt. Ltd. - Benefits? Same benefits which MCLR couldn't fully deliver.

Table 1: Type of Loans based on Lending Rates

Fixed Interest Loan (निश्चित ब्याज ऋण)	Interest Loan (चलायमान)
e.g. Short-term crop loans upto Rs.3 lakh rupees for farmers at fixed Interest 7%. This interest rate will not be changed throughout the loan tenure.	e.g. (External Benchmark) + Spread = 12% But benchmark is regularly updated. So resultant interest rate may increase or decrease throughout the tenure of loan.
	Teaser Loan: A sub-type of _____ interest rate loan, wherein initial years have low interest, but afterwards- higher interest rate. While RBI has not banned Teaser loans but has put stricter regulations on it from 2011.



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Table 2: Type of Borrowers

Prime Borrower	has capacity to repay loans.
Subprime Borrower	doesn't have the capacity to repay loan. Giving teaser rate home loans to sub-prime borrowers was among the reasons for Sub-prime Crisis in USA (2007-08), which ultimately led to Global Financial Crisis (GFC).
Overleveraged Borrower	has borrowed too much money than his ability to pay it back. An Overleveraged company has high ratio of Debt (Bonds/loans) to Equity (Shares).
Zombie Lending	When a weak bank keeps giving new loans to a subprime / overleveraged borrower.

MCQ. Why is the offering of "teaser loans" by commercial banks a cause of economic concern? (Asked in UPSC-Pre-2011)

1. The teaser loans are considered to be an aspect of sub-prime lending and banks may be exposed to the risk of defaulters in future.
2. In India, the teaser loans are mostly given to inexperienced entrepreneurs to set up manufacturing or export units.

Answer Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 or 2

MCQ. What is/are the purpose/purposes of the 'Marginal Cost of Funds based Lending Rate (MCLR)' announced by RBI? (Asked in UPSC-Pre-2016)

1. These guidelines help improve the transparency in the methodology followed by banks for determining the interest rates on advances.
2. These guidelines help ensure availability of bank credit at interest rates which are fair to the borrowers as well as the banks.

Answer Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

8.2 NPA: अनर्जक परिसंपत्तियां

8.2.1 NPA / TBS Problem: Three Stages of

1. **Till mid-2000s:** Boom period in global economy. Indian Corporates were taking large amount of loans & became overleveraged.
2. **From 2007-08:** Subprime & Global Financial Crisis (GFC): Indian goods-services exports declined. UPA government's policy paralysis & judicial activism, environment activism⇒ projects got delayed. Companies began facing difficulties finishing projects & repaying loans.
3. **By 2013:** ~1/3rd of the bank loans were owned by “... companies” i.e. companies with interest coverage ratio less than 1 = not generating enough revenue even to repay the loan interest.

Thus, balance-sheets of (1) some _____ & (2) Public Sector Banks (PSB) became weak. It is called “Twin balance sheet syndrome (TBS)” [दोहरे तुलनपत्र की समस्या] by Economic Survey 2015-16.

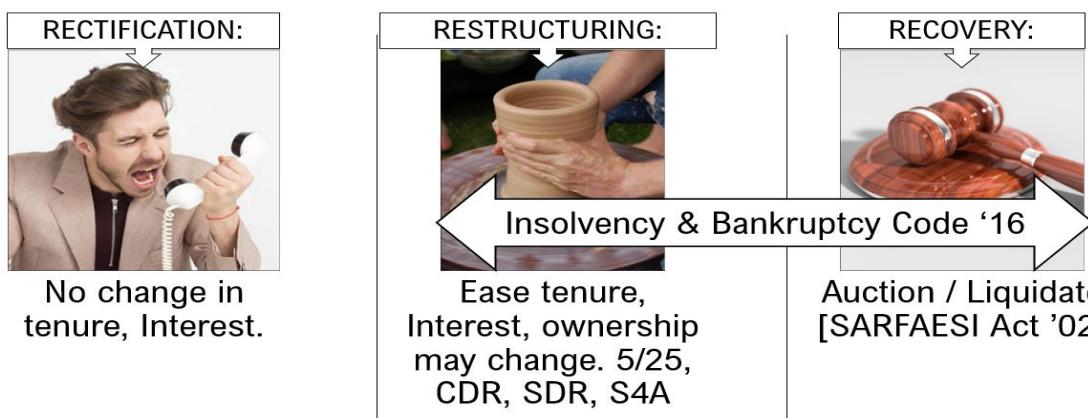


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8.2.2 NPA related definitions in Banking Sector

Std. Assets	Loan account where borrower is repaying the principal and interest in timely fashion.
SMA-0	If loan principal / interest unpaid for 1-30 days from its due date, then such loan account is classified as Special Mention Account-0.
SMA-1	31-60 days
SMA-2	61-90 days
NPA	<ul style="list-style-type: none"> ⇒ If loan principal or interest is not paid for more than _____ from its due date, then such loan account is classified as Non-Performing Asset (NPA). For the farm loans, NPA is not counted on number of days but on number of cropping seasons. ⇒ Indian Commercial Banks' NPA is over ₹10 lakh crores (absolute figures); and over 10% of total lending. [As of 31/3/2018]. ⇒ NPA Size: PSB > PvB > Foreign Banks. ⇒ Provisioning: As per RBI norms, banks must set aside funds to cover losses against their NPA. Such 'provisioning of funds' decreases the profitability of the Bank. Gross NPA MINUS Provisioning = NET NPA.
Substandard asset	When loan account remains in the NPA classification for 12 months/>>
Doubtful asset	When loan account remains in substandard classification for 12 months/>>
Loss Asset	When a bank, its auditor or RBI declares that given doubtful asset has little / no salvageable value.
Loan write-off	When loan is written off from the 'asset-side' of the bank balance sheet, to save corporation tax. Loan write-off doesn't waive bank's right to recover that bad loan, it's merely an accounting exercise for tax-benefits.
Restructured loan	When principal / interest rate / tenure of the loan is modified. Banks may do it when borrower facing difficulty in repaying loans.
Stressed Asset	NPA + Loans Written-Off + Restructured Loans = Stressed Assets
OTS with Haircut	If bank allows the client to pay 60% of dues and forgoes 40% as loss, then we say bank has offered "Onetime Settlement (OTS) with 40% haircut"
Evergreening	<ul style="list-style-type: none"> - Banking: When a borrower taking a new loan to pay off his old loan. - Patents: When drug patent expires after 20 years, pharma-company makes minor modifications in the old drug's molecule to register new patent, thus keeping its monopoly rights on the production.

8.3 RBI "3R" FRAMEWORK FOR REVITALIZING STRESSED ASSETS





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8.3.1 Rectification (सुधार)

- 2015: RBI ordered the Banks to conduct Asset Quality Review (AQR) and begin rectification of bad loans i.e. Bank doesn't change in loan interest, tenure or terms, but asks client to rectify his irregularity in loan-repayment.
- In genuine case, additional loan may be given. Bank may also try to find a new partner / investor for reviving the project.

8.3.2 Restructuring (पुनर्गठन)

- ⇒ **Restructuring** = Changing the Loan interest (%) or tenure or ownership.
- ⇒ **— for Infrastructure loans:** RBI allowed banks to extend infra-loan tenure upto 25 years, and even reduce loan interest rate. But such Interest rate will be reviewed each 5 years.
- ⇒ **CDR: Corporate Debt Restructuring:** loan can be restructured if 75% of the lenders approve.
- ⇒ **— : Strategic Debt Restructuring (रणनीतिक ऋण पुनर्गठन):** Bank's Debt (Loan) is converted to Equity (Shares with Voting Rights) & bank sells it to highest bidder ⇒ company's ownership may change. Scheme unsuccessful as it required the approval of existing shareholders.
- ⇒ **— - Scheme for Sustainable Structuring of Stressed Assets (तंगहाली आस्तियो की संधारणीय संरचना):** Only unsustainable portion of Debt (Loan) converted to equity (Preferential Shares without voting rights) & sold off to investors, in such manner that company's ownership is not changed.
- ⇒ **JLF- Joint lenders forum (ऋणदाताओं का संयुक्त मंच):** Consortium of the lenders, who will work out aforementioned restructuring methods. But, proved unsuccessful because PSB Officials would not vote positively due to the fear of Media & 4C [Courts, CBI, CAG and CVC]. RBI stopped above schemes from 31 March 2018. Now banks can restructure loans only under the provisions of Insolvency and Bankruptcy Code (IBC) 2016.

8.3.3 Recovery (वसूली)

Bank liquidates loan-defaulter's assets under either of the following acts:

- ⇒ SARFAESI Act 2002 (सरफेसी अधिनियम) OR
- ⇒ Insolvency and Bankruptcy Code 2016 (शोधन-अक्षमता एवं दिवालियापन संहिता 2016): If 75% of the lenders don't agree for restructuring / resolution plan, then assets will be liquidated.

(UPSC-Prelim-2017) 'Scheme for Sustainable Structuring of Stressed Assets (S4A)' is related to:

- procedure for ecological costs of developmental schemes.
- scheme of RBI for reworking the financial structure of big corporates with genuine difficulties.
- disinvestment plan for Central Public Sector Undertakings.
- Provision in 'The Insolvency and Bankruptcy Code'.

8.4 SARFAESI ACT 2002: ORIGIN, OBJECTIVE & LIMITATIONS

- ⇒ **1991: Narsimhan-I** Committee on banking sector reforms observed that borrowers obtain stay orders from ordinary courts = banks have difficulty recovering NPA. So, — —



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----- (DRT: ऋण वसूली न्यायाधिकरण) were set up (1993)- ordinary courts can't interfere in the loan recovery process.

- ⇒ **1998: Narsimhan-II** Committee observed that DRTs need to be strengthened with a law, so, Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act enacted (2002). [प्रतिभूतीकरण और वित्तीय आस्तियों का पुनर्गठन और प्रतिभूति हित को प्रभावी करने का अधिनियम 2002]
- ⇒ Under SARFAESI act, Banks and Housing Finance Companies (NBFCs) can attach the mortgaged assets when loan is not repaid. They can change board of directors in such companies, can auction such assets, can also sell such assets to **Asset Reconstruction Companies (ARC, NBFC)**. SARFAESI not applicable on farm loans.
- ⇒ If loan-defaulter wants to obtain a stay order, he cannot go to ordinary courts. He will have to approach for DRT. If DRT doesn't help then ⇒ higher appeal to Debt Recovery Appellate Tribunal (DRAT), but DRAT will require him to deposit minimum 50% of the loan dues (to discourage frivolous appeals). ⇒ higher appeal to high court.

Limitations of SARFAESI Act

- ⇒ The DRTs & DRATs are **understaffed**. 1 lakh+ **cases pending** (2016), so, case will go on for years and the debtor will remain in possession of asset. This leads to erosion of asset-value (machinery, vehicles) even when DRT allows auction.
- ⇒ In some businesses, auction or liquidation may not yield the best return for the banks (e.g. hotel resort in remote area, where no other hoteliers are keen to invest). In such cases, if the loans were restructured, banks could salvage more value. But, SARFAESI act **doesn't facilitate arbitration** (मध्यस्थता) So, Govt. came up with a new law IBC ⇒

8.5 INSOLVENCY AND BANKRUPTCY (I&B) CODE 2016: शोधन-अक्षमता एवं दिवालियापन संहिता 2016



- ⇒ Individual, Partnership firm or Company defaults on a **business loan** of ₹ 1 lakh or more, then, lenders approach National Company Law Tribunal (NCLT: राष्ट्रीय कंपनी कानून अधिकरण), to initiate proceedings under the I&B Code.



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- ⇒ NCLT will grant moratorium (पाबंदी) of 180-270 days so no other lender can unilaterally attach assets under SARFAESI Act.
- ⇒ Within that period, an _____ (IP: शोधन-अक्षमता संबंधी पेशेवर) will make a resolution plan e.g. reduce loan interest, extend loan tenure, or IP could even find another investor to finance the pending project etc.
- ⇒ If 75% of the Lenders (ऋणदाता) agree with such _____ plan, then it will be set in motion, otherwise, IP will _____ (परिसमापन) the assets to recover the dues.

⇒ **Appeal Structure?**

- A. If borrower is individual / partnership firm: Appeal @DRT of SAFAESI Act. OR
- B. If Borrower is a Company: Appeal @NCLT of the Companies Act.

⇒ **I&B Code is not applicable to following defaulters:**

- A. _____ **Defaulter** (जान-बूझकर बकाएदार): A borrower who has the capacity to repay, but he's not repaying the loan. E.g. Vijay Mallya was declared willful defaulter by SBI (2017). OR
- B. _____ **Defaulter** (असमर्थ बकाएदार): A borrower whose loan account is in NPA for more than a year, and he has no capacity to repay even partial loan amount.

Above two categories of borrowers are not eligible for I&B resolution process. Their assets will be directly liquidated under SARFAESI Act.

8.5.1 Insolvency and Bankruptcy Board of India (IBBI)

- ⇒ भारतीय शोधन-अक्षमता एवं दिवालियापन बोर्ड is the _____ body that monitors and implements I&B Code 2016.
- ⇒ IBBI composition: One Chairman (M.S.Sahoo), 1 nominated member from RBI, other members from Government's side. Total 1 chairman + 9 member = 10 people.
- ⇒ IBBI's administrative control rests with the Ministry of Corporate Affairs (MCA).
- ⇒ Chairman has **5 years / 65 age tenure**, whichever earlier. Also **eligible for reappointment**.
- ⇒ IBBI selects Insolvency Professionals Agencies (IPAs). These IPAs enroll and supervise the members practicing as Insolvency Professionals (IPs). Presently, 3 organizations given "IPA" status viz. 1) ICAI (Chartered Accountants) 2) ICSI (Company Secretaries) and 3) Institute of Cost Accountants.
- ⇒ IBBI also selects **Information Utility (IU)** organization to maintain **database of borrowers**. In 2017, **NeSL**: National E-Governance Services Ltd (owned by consortium of SBI, LIC etc.) was the first to get the IU status. It is compulsory for the lenders to share data with IU. IU helps lenders in two ways:
 - 1) by looking @borrowers' credit history, lenders can make informed decisions about whether to give loan or not, and how much interest to charge?
 - 2) This database helps establishing documentary proofs during NCLT / DRT / judicial / liquidation proceedings.

8.5.2 Banking Regulation (Amendment) Act 2017: बैंकिंग विनियमन (संशोधन) अधिनियम

- ⇒ I&B Code resolution process can start only AFTER a bank / NBFC files a motion at NCLT. But, Public Sector Bank (PSB) officials fear Media, CBI, CVC, CAG & Courts - hence were reluctant to even file motion @NCLT.



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⇒ I&B Resolution plan can work only if 75% of lenders approved. But even in such voting, PSB-executives will shy away from voting positively. To solve these problems, Government first issued an ordinance and then passed a bill for amending Banking Regulation Act. This amendment increased RBI's powers to force the banks to begin process under I&B Act.

8.6 BORROWERS' DATABASE & TRACKING

8.6.1 Public Credit Registry (ऋण की सार्वजनिक रजिस्ट्री)

Presently, multiple organizations keep borrowers' database / credit history viz.

- 1) Under the I&B code, Insolvency and bankruptcy board of India (IBBI) has authorized the National e-governance services Ltd (NeSL) to act as an Information Utility (IU).
- 2) Under the Credit Information Companies Regulation Act (CICRA 2005), RBI has given license to CRISIL (oldest CIC-1987), CARE, FITCH India, ICRA, Brickwork Ratings , SMERA etc. as Credit Rating Agencies [ऋण पात्रता-मूल्यांकन एजेंसी].
- 3) RBI has its own "Central Repository of Information on Large Credits (CRILC)" for Loans above Rs 5 cr. Banks & NBFCs have to submit weekly updates in this portal.

But, not all of these databases are under the direct control of RBI. Each has their own methodology for data collection & tabulation. Not all of these databases are covering all individual and corporate borrowers of India. So, **RBI's Committee** (2017-18) recommended setting up a Digital Public credit registry (PCR) with following features:

- 1) PCR will be setup under RBI, using data from SEBI, Corporate Affairs Ministry, GST authorities, IBBI, Banks, NBFCs etc.
- 2) PCR will help lenders to get complete 360-degree profile of borrower on real time basis.
- 3) PCR will help RBI in early detection of systematic stress, checking the efficacy of monetary policy & other big data analytics.

2018: RBI issued tender to select a company for developing PCR portal. _____ Company won the tender/contract. [Update when IT-Company is finalized]

<i>[Asked in UPSC-CDS-2016-II]</i>	<i>[Asked in UPSC-CDS-2018-1]</i>
Which one of the following is/are credit rating agency/ agencies in India? (a) CRISIL (b) CARE (c) ICRA (d) All of the above	The Reserve Bank of India has recently constituted a highlevel task force on Public Credit Registry (PCR), headed by (a) Sekar Karnam (b) Vishakha Mulye (c) Sriram Kalyanaraman (d) Y. M. Deosthalee

8.6.2 Legal Entity Identifier (LEI) Number: (कानूनी इकाई पहचान नंबर)

⇒ Even if a company is blacklisted by Indian banks, it could apply for loans overseas, and those overseas bankers may not be aware of company's history. So, there should be a global "Aadhar card" number for companies, and they must be forced to quote that number during every financial transaction.



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- ⇒ After Sub-Prime Crisis and Global Financial Crisis (GFC), the _____ and its Financial Stability Board (FSB) came up this LEI concept- a 20-digit alphanumeric code.
- ⇒ LEI's Global Boss: Global Legal Entity Identifier Foundation (GLEIF), Frankfurt, Germany.
LEI's Indian agent: Clearing Corporation of India.
- ⇒ RBI had ordered the large borrowers (who have taken loans above Rs.1,000 crore from Indian banks) to obtain LEI number by 31/8/2018, then gradually smaller companies must obtain LEI-number in a phased manner.
- ⇒ Companies must quote this LEI-number in their financial transaction. RBI has power to issue such directives under: Payment and Settlement Systems Act, 2007 & Banking Regulation Act 1949.

Even if a borrower has obtained LEI, his name is in PCR, yet one day he runs away from India, then what to do? Ans. ⇒

8.7 FUGITIVE ECONOMIC OFFENDERS ACT, 2018 (भगोड़ा आर्थिक अपराधी अधिनियम)

- ⇒ This act targets economic offenders accused of cheque dishonor, loan / investment / chit-fund scam, money laundering etc. worth ₹ _____ crores /> & left India to avoid facing prosecution / arrest.
- ⇒ Special courts under the PMLA (Prevention of Money-laundering Act, 2002) will order the villain to appear within 6 weeks, if not then he's declared "Fugitive Economic Offender" ⇒ his Indian & _____ & Benami properties will be attached (जब्ती).
- ⇒ Once property attached- the _____ will oversee its administration / liquidation(परिसमापन).
- ⇒ No ordinary civil court / tribunal can give stay order. Villain can make appeal only in High Court and Supreme Court. (उच्च न्यायालय और सर्वोच्च न्यायालय).

If Borrowers don't repay, SARFAESI auctions give little recovery, CRR-SLR insufficient to repay deposits then bank collapse imminent. Then, how to protect the depositors? Ans. ⇒

8.8 DICGCI ACT: OBJECTIVE & LIMITATIONS

- 1961: Deposit Insurance and Credit Guarantee Corporation Act (निक्षेप बीमा और प्रत्यय गारंटी निगम)- mandates that all types of banks must buy insurance on their deposit accounts from DICGCI- 100% owned by _____. One of RBI Dy. Governor acts as chairman of DICGCI. HQ: Mumbai.
- When a bank shuts down, DICGCI will pay upto ₹ _____ insurance to every deposit holder for his principal and interest.
- Further, DICGCI also provides guarantee cover to bank loans granted to Priority Sector Borrowers, except home loans. ~~With setting up of SIDBI (1990) & National Credit Guarantee Trustee Company Ltd. [NCGTC, 2016]~~ this credit guarantee work is fragmented among many institutes, but we need not PHD over it.

Limitation of DICGCI

- ⇒ If a customer had deposited more than ₹1 lakh rupees in a single commercial / cooperative bank, then he gets only ₹1 lakh from DICGCI. And for remaining amount he must wait till RBI / Cooperative Registrar liquidates the bank.



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- ⇒ DICGCI doesn't cover NBFCs. 2002: UTI (a Government owned mutual fund company) made big losses. DICGCI not liable to protect UTI-clients. So, Government had to pay ₹14,561 crores bailout package.
- ⇒ Therefore, Financial Sector Legislative Reform Commission (FSLRC) under Justice B.N. **Srikrishna** (2011-13) recommended a new organization called **Resolution Corporation** (RC) via FRDI Bill.

8.9 FRDI BILL 2017: OBJECTIVE & WITHDRAWAL

- ⇒ Financial Resolution and Deposit Insurance (FRDI) Bill (वित्तीय समाधान और निक्षेप बीमा) aimed to transform the DICGCI into a Resolution Corporation (RC). All financial intermediaries (Banks and NBFCs) will have to buy insurance from RC, to protect their depositors.
- ⇒ RC will monitor these Banks and NBFCs, if they come in 'imminent financial risk', RC will draft a resolution plan e.g. merging it with another entity, or finding new investors for infusing additional capital etc.
- ⇒ However, incase of weak bank, if such investor couldn't be found & merger with another bank was not possible, then RC could even use the weak-bank's depositors' money to infuse equity (share) capital into the Weak-Bank. This was called "**Bail-In**" provision - highly criticized by media and Opposition parties. 2018-Aug: Government withdrew the bill. ~~So, we need not do further PHD over FRDI or its Bail-in provisions.~~

8.10 A BAD BANK CALLED "PARA"

- ⇒ Former Chief Economic Advisor (CEA) Arvind Subramanian's Economic Survey 2016-17 had proposed a bad bank named "**Public Sector Asset Rehabilitation Agency**" (**PARA**: सार्वजनिक क्षेत्रीय परिसंपदा पुनःप्रतिष्ठापन एजेंसी).
- ⇒ PARA will buy bad loans from PSBs, try to salvage the maximum value from loan-restructuring / liquidation-auction and absorb the losses.
- ⇒ Arvind S. also suggested RBI to give additional dividend to Govt. to start this bad bank & finance its losses. Ofcourse, this idea was not implemented. But, media attention landed on Urjit Patel- *why he's unable to solve NPA problem & could Bad Bank solve this problem!!?* So, Urjit responded by tightening Prompt Corrective Action (PCA) framework.

8.11 PROMPT CORRECTIVE ACTION (PCA) FRAMEWORK

- ⇒ 2002: RBI Governor Bimal Jalan designed it. (त्वरित सुधारात्मक कार्रवाई रूपरेखा)
- ⇒ 2017: Urjit Patel toughened PCA norms further.
- ⇒ 2018: _____ announced separate 'Prompt Corrective Action (PCA) Framework' framework for Regional Rural Banks (RRBs).
- ⇒ In PCA framework, **all Commercial Banks** are monitored for Asset Quality (NPA), Capital Sufficiency (BASEL-III), Profitability (Return on Assets: RoA)- and are classified into **Risk threshold #1, #2, #3**. Higher the number, higher the risk. Then, accordingly, RBI will take corrective actions such as:
 1. RBI giving strict warning, conducting deeper audit & supervision.
 2. Restricting bank's directors' salaries and dividend distribution to its investors.
 3. Restricting bank's branch expansion & lending operations.
 4. Forcing merger / shutdown of a weak bank (under Banking regulation Act 1949).

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- ⇒ If a PCA-listed bank wants to get 'whitelisted', it'll have to reduce its _____, obtain additional _____, improve its _____.
- ⇒ As of Dec-2018: 11 out of 21 Public Sector Banks in PCA list. So, Govt. wanted RBI to lift/ease PCA-restrictions. But Urjit did not oblige.

8.12 BASEL-III NORMS (बेसल-3 मानदंड)

- ⇒ Bank for International Settlements (BIS) is an international institution made up of 60 countries' Central Banks. HQ @ BASEL, Switzerland. Its committee on banking supervision set norms in 1988 (I), 2004 (II), 2011(III) to ensure global financial stability.

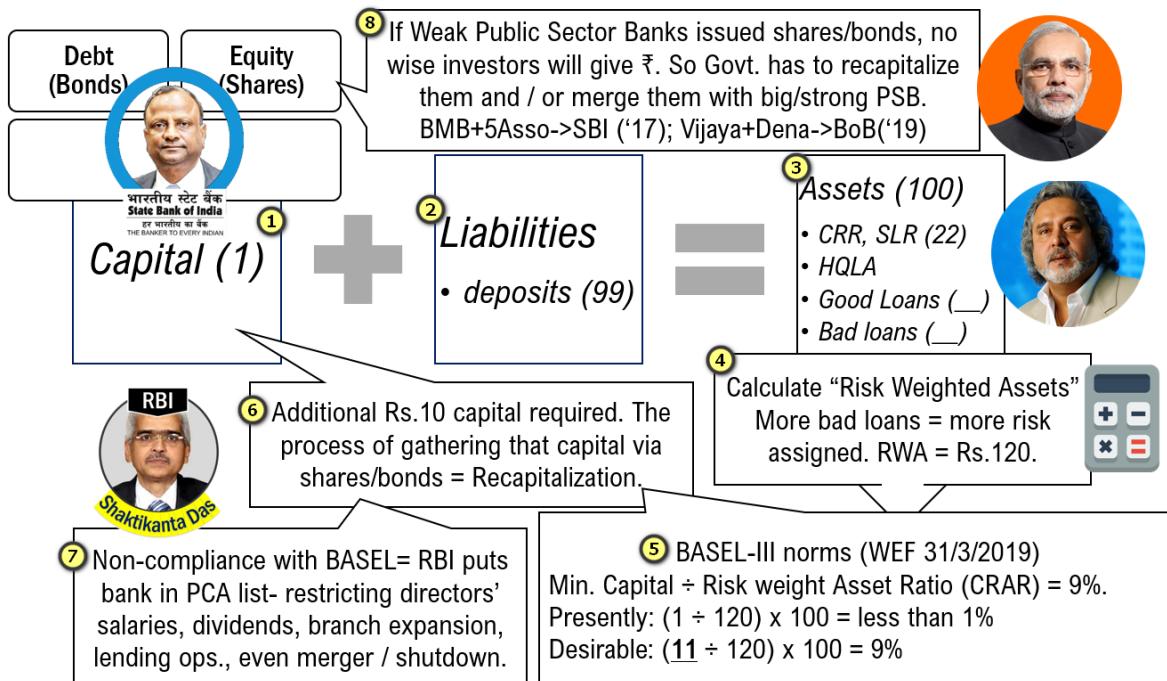


Figure 1: we need not bother with Tier-1 Tier-2 Capital etc.

- ⇒ From 1/4/2013, RBI began phased implementation of BASEL-III norms in India:
- ⇒ First, a bank needs to calculate its _____ (RWA: जोखिमपूर्ण संपत्ति).
- ⇒ Against these RWA, (Universal) Scheduled Commercial Banks (SCB) must keep:
 - ⊖ **“Minimum Capital to Risk Weighted Assets Ratio”** (_____) at 9% or higher from **31/3/2019**.
 - ⊖ Capital Conservation Buffer (**CCB**) from 31/3/2020.
 - ⊖ Counter Cyclic Capital Buffer (**CCCB**): whenever RBI notifies.
- ⇒ Each member country's Central Bank can prescribe different ratios depending on their country's situation.
- ⇒ As NPA ↑ = bank's asset quality degrades = its Risk-weighted assets (RWA) will ↑; then bank must arrange more capital to comply with these ratios, norms and buffers.
- ⇒ If a bank can't comply with BASEL norms, then RBI puts it in ____ list. In worst case, bank will have to merge/ sell off its business to another bank or shut down.
- ⇒ BASEL Norms also apply on Differential Commercial Banks (_____), Cooperative Banks, AIFI (_____) and certain category of NBFCs, but RBI can prescribe separate norms / limits / deadlines for them.



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MCQ. (UPSC-Prelim-2016) Objective of BASEL-III norms?

- a) Develop national strategies for biological diversity.
- b) reduce the GHG emissions but places a heavier burden on developed countries.
- c) transfer technology from developed Countries to poor countries to replace chlorofluorocarbons in refrigeration.
- d) improve banking sector's ability to deal with financial and economic stress and improve risk management.

8.12.1 Recapitalization of PSBs [सार्वजनिक क्षेत्र के बैंकों का पुनःपूँजीकरण]

- If a bank doesn't have enough capital to comply with BASEL-III norms it can issue debt (bonds) and equities (shares) to gather new capital.
- **2015:** Projected that Public Sector Banks (PSBs) will require ₹ 1.8 lakh crore additional capital by 31/3/19 to comply with BASEL-III norms.
- So, Finance Ministry's _____ came up with _____ PLAN for phased-recapitalization of PSBs with ₹ 70,000 crores from 2015 to 2018. Individual PSB will get funding based on outcomes / performance.
- **2017:** It became clear ₹70,000 crores was insufficient for BASEL-III compliance. So, Modi Govt. announced ₹ 2.11 lakh crore recapitalization package.

Component	Amt in ₹ Cr.
PSBs to mobilize equity (share) capital from private investors. However, investors shy away from smaller banks with weak balancesheets, so BMB & 5 Associated Banks merged with SBI (2017). Vijaya & Dena to be merged with BoB (2019, 1 st April)	58,000
Government's budget support to PSBs	18,000
Government to issuing Bank Recapitalization Bonds (RCB) in the market with following features: <ul style="list-style-type: none"> - These bonds will have interest rate of ~7%, mature @ 2028-2033. - Non-transferable to third party, Non-convertible into shares. 	1,35,000**
Total	2,11,000*

2018-Dec: Even this ₹2.11 lakh crore package was found insufficient, so, Govt. sought supplementary grants from Parliament to infuse additional ₹41,000 crores in PSBs. Thus, **total ~₹ _____ lakh crores mobilized** help PSBs in BASEL-III compliance.

******Critiques argue that PSBs themselves are forced to buy these Bonds using public deposits, and thus Bank Recapitalization Bonds are merely a 'creative accounting' practice to comply with BASEL-III norms, but we need not bother with such "B.Com / Controversy in News" for UPSC.

MCQ. With reference to the governance of public sector banking in India, Find Correct Statement(s):(Asked in UPSC-Pre-2018)

1. Capital infusion into public sector banks by the Government of India has steadily increased in the last decade.
2. To put the public sector banks in order, the merger of associate banks with the parent State Bank of India has been affected.

Answer Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2.



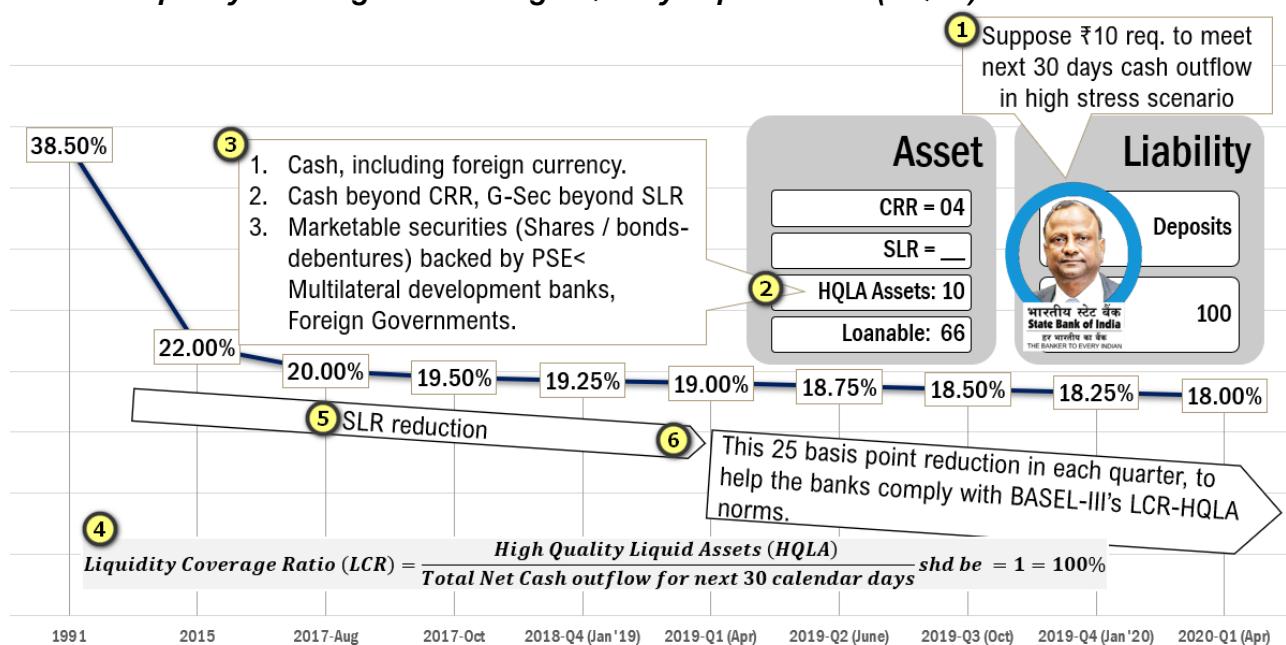
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8.12.2 BASEL-III related Misc. Terms

8.12.2.1 Counter-cyclical Capital Buffer Norms (CCCB)

- ⇒ Part of BASEL-III norms. It requires banks to create capital buffer during the boom period in economy, so that such buffer can be used during the bust/slowdown.
- ⇒ RBI must announce this norm 4 quarters (=1 year) in advance. So far RBI has not required Indian Banks to keep CCCB.

8.12.2.2 Liquidity Coverage Ratio & High-Quality Liquid Assets (HQLA)



- ⇒ BASEL-III norms require the banks to keep enough in High Quality Liquid Assets (HQLA) so that bank can survive a 30 days high stress scenario of cash outflow / bank run. If a Bank has enough HQLA assets to survive this test, we say this Bank has Liquidity Coverage Ratio (LCR) of 1 (or 100%).
- ⇒ RBI implemented deadline came gradually Jan 2015: 60%, ..+ 10% each year.... Jan'19: 100% or more.

8.12.2.3 D-SIB: Domestic Systematic Important Banks

- ⇒ In 2010, G-20's brainchild Financial Stability board (HQ: BASEL) asked countries to identify Systematically Important Financial institutions and put framework to reduce risk in them. [Side note: Same parents responsible for birth of _____]
- ⇒ Each year in August, RBI identifies banks that 'too big to fail' (=if they fail, it'll severely hurt the economy) and labels them as Domestic Systematic Important Banks (D-SIB), & orders them keep additional equity capital against their Risk Weight Assets (RWA).
- ⇒ Presently, 3 D-SIBs in India: _____ (Latest Entry).

8.13 BANKING SECTOR: GOVERNANCE / ADMINISTRATIVE REFORMS

8.13.1 Gyan-Sangam-I, 2015, Pune

FinMin's Dept of _____ (वित्तीय सेवा विभाग) organized a workshop of financial regulators, Public Sector Bank, Insurance Companies etc. It resulted in 3 outcomes:

- 1) PSBs' CMD post bifurcated into 1) separate chairman and 2) separate MD&CEO so that banks can function in more professional and accountable manner.



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- 2) **Indradhanush** plan for bank recapitalization (Rs.70,000 crores) tied with governance reforms in PSBs.

- 3) Finance Ministry setting up an autonomous body- Bank Board Bureau (BBB).

8.13.2 Bank Board Bureau (BBB), 2016

- BBB selects top officials (MD, CEO, Chairman and full-time Directors) for PSBs, LIC and other public sector financial institutions. Actual appointment done by FinMin's Department of Financial Services. (*Just like UPSC selects candidates suitable for IAS but DoPT notifies appointment.*)
- BBB also helps the banks in governance reforms, raising capital for BASEL-III etc.
- BBB has 1 Part-Time Chairman, 3 Part-Time Members and 3 Ex-officio Members (from Govt & RBI side)
- 2018, April: **Bhanu Pratap Sharma** (retd.IAS) replaced Vinod Rai (retd.IAS, CAG) as the new chairman of BBB.

8.13.3 Enhanced Access and Service Excellence (EASE: बढ़ी पहुंच और सेवा उत्कृष्टता)

Agenda 2018

- **2017, October:** Government announced ₹2.11 lakh crore package for recapitalization of PSB. But critiques argued such relief measures will just make the PSBs lazy & undisciplined (moral hazard). So,
- **2017, November:** First Public Sector Bank (PSB)-Manthan organized by Dept of Financial Services (DFS) at Gurugram. Based on the participants' inputs...
- **2018, January:** FinMin's Dept of _____ released EASE framework with 6 pillars to make PSBs Responsive and Responsible viz.
 1. Customer Responsiveness.
 2. Responsible Banking: Reduce NPA, prevent frauds.
 3. Credit Off Take: Try to reach out to potential borrowers for home, auto, education, loans.
 4. Help MSME entrepreneurs via SIDBI's Udyamimitra.com portal. Approve/reject loans in not more than 15 days.
 5. Deepening Financial Inclusion & Digitalization.
 6. Employees' Human Resource Management (HRM): improve with training, performance linked promotion-salaries-posting-transfers etc.

Implementation? Each whole-time director of a PSB will be entrusted with one pillar of the framework. Their performance will be checked by the PSB's board of directors. An independent agency will be tasked to check public perception.

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Table 3: Points for assembling Mains Answers Rapidly



Eco.Survey-2015: "4R" framework	Eco.Survey-2014: "4D" framework
Recognition: of bad loans via asset quality review (AQR)	Disinter "Digup graves, recover money": using
Resolution: via ALPHABETICAL soup: ----- ... [although scrapped post-I&B code]	Differentiate among PSB: Profit Maker PSB: Capitalize for BASEL-III whereas Loss Maker PSB: Merge or Privatize ⇒
Recapitalization: for BASEL-III norms ⇒ Indradhanush, Bank Recap Bonds & other measures: Total ₹ _____ lakh crore mobilized.	Diversify: Allow more number and variety of Banks. ⇒ _____ allowed. Wholesale Bank proposed.
Reforms: Governance & Administration of PSB ⇒ _____	Deregulate: Lower SLR, Promote Corporate Bond market so they borrow less from Banks e.g. Tri-Party Repo mechanism.

8.14 MISC. BANK CONTROVERSIES / ISSUES

8.14.1 PNB, LoU, SWIFT, Nostro & Nirav Modi

PNB (Mumbai Branch): *Give foreign currency loan to our client for purchase of goods (diamonds, airplanes, whatever), if he doesn't pay, we'll pay.*

- If such bank guarantee given to another bank in a foreign country, it's called **Letter of Undertaking/ Letter of Credit**: internal difference not important.
- if such bank guarantee given to same bank (PNB)'s overseas branch, it's called **Letter of Comfort**.
- Bank earns commission / fees from client for issuing such letters / guarantees.
- The foreign currency thus loaned, goes into PNB's Nostro (Latin:Ours) account, & Nirav uses the dollars to buy diamonds in HongKong.
- **PNB Scam:** PNB-Mumbai's corrupt manager kept issuing LoUs to diamond merchants Nirav Modi & Mehul Chowkasi without due-diligence or collaterals for 7 years, worth ~₹12,000 crores. And 2018-January duo left India.
- PNB officials couldn't detect scam because LoUs were generated through **SWIFT** platform, which was not integrated with their Core Banking Solution (CBS) server.

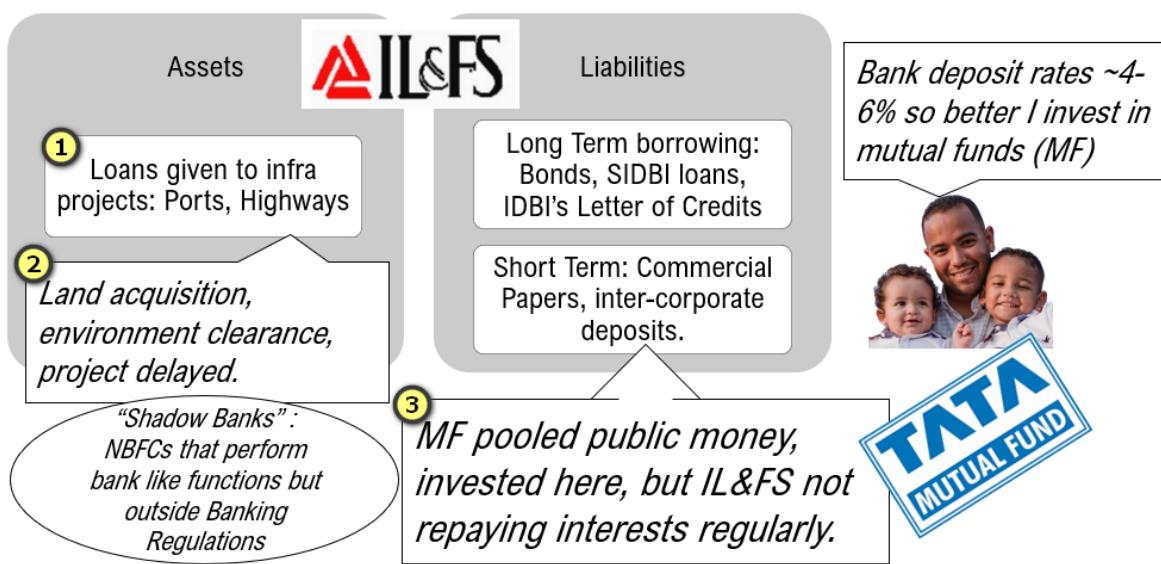
8.14.2 Financial Messaging Systems

Within India	Globally
Structured Financial Messaging System (SFMS) designed by Tata Consultancy Services (TCS) for IDRBT (=Research arm of RBI) to serve the messaging function in NEFT, RTGS, and other inter-bank, intra-bank e-transactions platforms <u>within India</u> .	Society for Worldwide Interbank financial telecommunication (SWIFT) By a Cooperative organization in _____ La Hulpe city (1973). To serve the messaging function for Banks, NBFCs & brokers who may / may not have direct bank relations / settlement systems with each other due to international borders.



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8.14.3 IL&FS, Shadow Banking, NBFC Liquidity Crisis



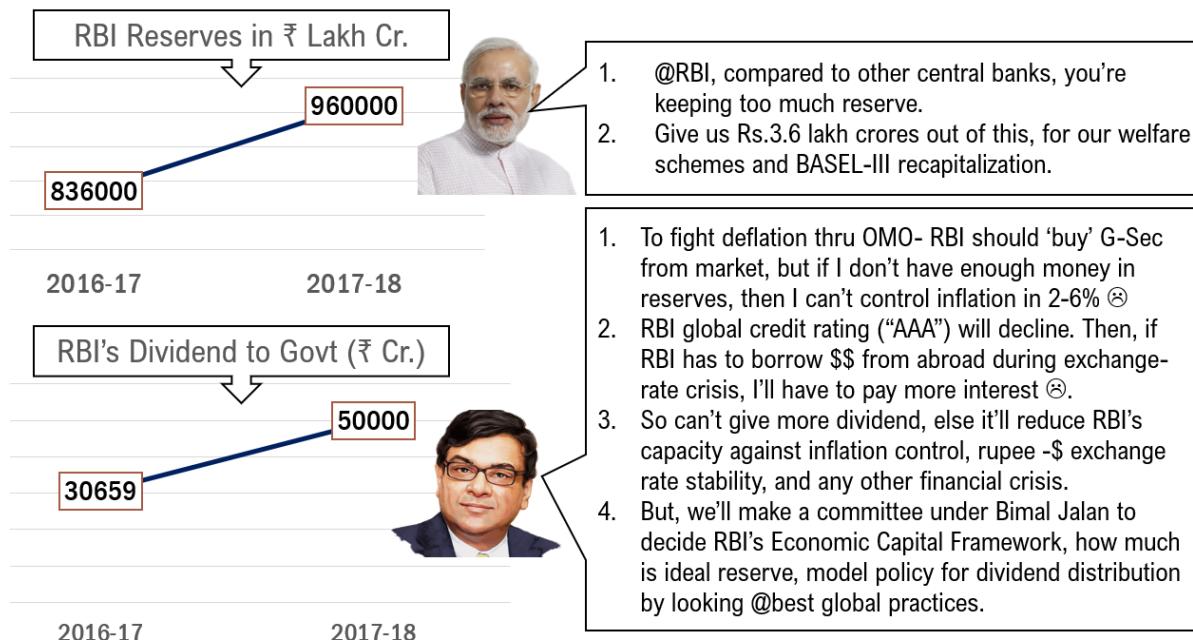
- Infrastructure Leasing & Financial Services (IL&FS) is a Systemically Important Non Deposit Taking Non - Banking Finance Company (**NBFC - ND - SI**) Setup in 1987 HQ@Mumbai.
- **Shareholders:** LIC > Japan's Orix group > Abu Dhabi's group > Central Bank of India > SBI.
- **Challenge?** 1-2-3 of above diagram.

Remedies undertaken?

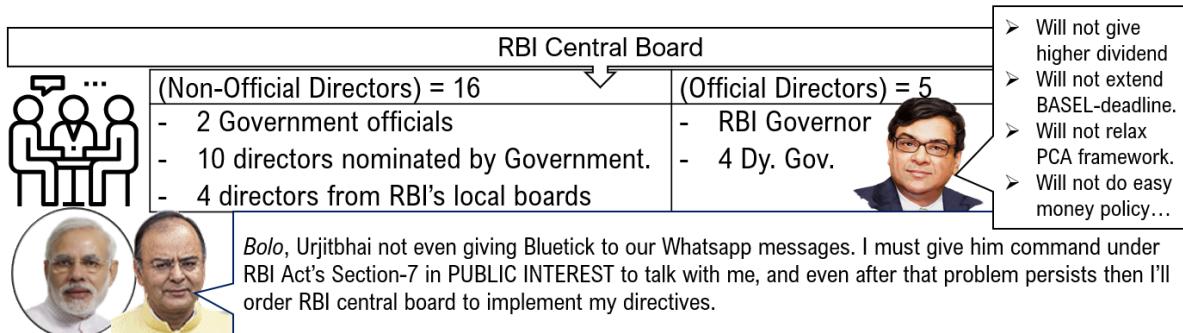
- Under Companies Act: Ministry of Corporate Affairs replaced the IL&FS's Board members. Uday Kotak made new Chairman.
- PSBs unable to lend more to IL&FS due to PCA framework. But, RBI relaxed securitization norms for NBFCs so they can use existing loan papers to issue new securities to borrow money from market, thus increasing liquidity /money supply for NBFCs' biz operations.
- LIC says we'll not allow IL&FS to collapse (=we may use Policy holders' money to rescue it just like IDFC) = "Financial Repression of households".

8.14.4 RBI Dividend, Reserves, Economic Capital Framework

RBI's income sources include:↓	From its income, RBI allocates funds for↓
<ol style="list-style-type: none"> Interest on G-Sec that are not sold in Open Market Ops. Interest on Foreign G-Sec / Sovereign Bonds. Interest on Loans given to its other Banks / NBFCs. Revaluation of foreign currency and gold in RBI reserves. Seigniorage: profits from printing money- because face value < intrinsic value. Penalties imposed on errant Banks. 	<ol style="list-style-type: none"> Staff retirement fund, provisions for bad loans, depreciation in assets... Reserves for contingency (emergency): ~₹ 2.5 Lcr. Reserves for Exchange Rate Stability (Technically called "Currency & Gold Revaluation Reserve: ~₹ 7 lakh cr) <p>After making these allocations, profit is shared with Union Govt. in form of 'Dividend' (RBI Act Section 47).</p>



8.14.5 Section-7 Directive & Urjit Patel's Resignation



This topic is not very important because UPSC usually avoids “Controversy in News”. Urjit Patel was unhappy with Government interfering / criticizing his work. Such as:

- ⇒ **Higher Dividend:** Govt. demanded higher dividend from RBI to finance the recapitalization of PSBs for BASEL-III, and to finance its own fiscal deficit & populist welfare programs. Urjit Patel felt RBI's higher reserves are necessary to check any financial crisis. Excessive dividend could increase inflation. He did not oblige.
- ⇒ **BASEL-III-relaxation:** These norms will become fully effective on 31/3/2019 but PSBs don't have enough capital to comply so they requested Finance Minister (FM) to tell Urjit Patel to extend the deadline, Urjit Patel did not oblige.
- ⇒ **PCA-relaxation:** Urjit Patel vigorously implemented Prompt Corrective Action framework, so Public Sector Banks' branch expansion, lending operations were restricted, they came running to FM. FM asked Urjit to relax PCA. He did not oblige.
- ⇒ **Tight Money Policy:** CEA Arvind Subramanian & BJP-Ministers were criticizing RBI's “Tight” Monetary Policy depriving MSMEs of cheap loans and thus harming India's growth rate. Whereas Urjit Patel deemed tight policy necessary to keep inflation @2-6%CPI (All India) on durable basis so he did not oblige.
- ⇒ **PNB Scam:** Jaitley expressed displeasure that RBI couldn't detect PNB-Nirav Modi fraud, whereas Urjit Patel defended that he lacks effective powers under Banking Regulation Act to take punitive actions against Public Sector Banks.

All these forced Govt. to issue Section -7 Directive to RBI.



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8.14.5.1 Section-7 of RBI

- ⇒ Section 7(1) of the RBI Act empowers the Government to consult with RBI Governor in _____.
- ⇒ In, 2018-October, for the first time in the history of Independent India, Govt began a Section-7(1) consultation with RBI Governor Urjit Patel, for issues of PCA norms, BASEL-III deadline, higher dividend to Govt., Cheap Monetary Policy etc.
- ⇒ If RBI Governor doesn't positively respond in such Section-7(1) consultation, then Section 7(2): Government can issue binding direction / orders to RBI _____ to implement its wishes.
- ⇒ Although, fearing backlash from Media & Opposition Parties, Govt did not issue any specific directions to the RBI Board. But, 2018-Dec: Urjit Patel resigned before completing 3-year term. He is not the first RBI governor to resign & we need not prepare KBC-GK-names of all the RBI governors who resigned before their term.

8.15 MOCK QUESTION FOR MAINS GSM3 (250 WORDS EACH)

1. "While Insolvency & Bankruptcy Code doesn't fully cure the Twin Balance sheet Syndrome, it certainly helps alleviating the pain." Elaborate. "हालांकि शोधन-अक्षमता एवं दिवानियापन संहिता भारत के दोहरे तुलनपत्र की समस्या को पूरी तरह से ठीक नहीं करता है, लेकिन यह निश्चित रूप से दर्द को कम करने में मदद करता है।" विस्तृत कीजिए.
2. Explain the significance of governance reforms in Public Sector Banks (PSBs) for India's economic growth. भारत के आर्थिक विकास के संबंध में सार्वजनिक क्षेत्र के बैंकों में शासन सुधारों के महत्व को समझाइए.
3. What is "Twin Balancesheet Syndrome"? Enumerate the steps taken by RBI to resolve it. "दोहरे तुलनपत्र की समस्या" क्या है? इसे हल करने के लिए भारतीय रिजर्व बैंक द्वारा उठाए गए कदमों की सूचि दीजिए.
4. With respect to India's financial stability, explain the significance of (i) PCR framework (ii) BASEL-III Norms (iii) Public Credit Registry (iv) Shadow Banks. भारत की वित्तीय स्थिरता के संबंध में इन्हे समझाइए: (i) पीसीआर ढांचा (ii) बेसल-III मानदंड (iii) ऋण की सार्वजनिक रजिस्ट्री (iv) प्रतिष्ठाया बैंक्स.



9 SEBI, SHARE MARKET (PILLAR#1-C)

MCQs from SEBI/ Sharemarket /Financial Market / Companies Act Topic in UPSC Prelims- 2014 (1 MCQ), 2015 (0 MCQ), 2016 (2 MCQs), 2017 (0 MCQ), 2018 (1 MCQ).

A player should keep in mind the cost:benefit accordingly.

9.1 SECURITIES (प्रतिभूति)

A ‘Security’ means a certificate document indicating that its holder is eligible to receive a certain amount of money at a particular time. This could be a

Equity: Share certificate	Debt (ऋण): Bond / Debenture
Holder gets dividend from the profits of the company. If no profit, then no dividend.	Holder gets interest & principal irrespective of whether company makes profit or not.
called owners, proprietors of the company.	Creditors of the company.
Have _____ claim during liquidation	_____ claim.

9.2 FINANCIAL / SECURITIES MARKET: MEANING AND TYPES

It is the place where buying and selling of securities takes place.

Classification	Market Subtypes
Tenure: (अवधि)	<ol style="list-style-type: none"> 1. _____ Market (<1 year) मुद्रा बाजार 2. _____ Market (1 year/>) पूँजी बाजार
Freshness प्राथमिक एवं द्वितीयक बाजार	<ol style="list-style-type: none"> 1. _____ Market (where new securities are issued for the first time). Helps a company /government to connect with the investor. It has no separate physical existence but classified for economic analysis. 2. _____ Market (where the old securities are resold). It has physical existence such as Bombay Stock Exchange at Dalal Street, Mumbai. Provides liquidity and confidence to investors to buy new securities in Primary Market. (compared to a scenario if there was no market to resale used cars- तो कम लोग नई कार खरीदने जाएंगे.)
Settlement	<ol style="list-style-type: none"> 1. Future Market: Where parties write contract today to buy/sell something at specific price on a future date 2. Spot Market: if instantly bought & sold.
Asset	<ul style="list-style-type: none"> - Depending on what asset is traded, market can be divided into Bond (Debt) market, Share (Equity) market, Gilt-Edged Securities Market, Foreign Currency Market, Commodity Market etc. - Presently, they have their individual exchanges where buying and selling occurs. But if there was a supermall where all these products were available in one place it will be called “_____ Exchange”. SEBI permitted BSE & NSE to launch such thing (2018).



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9.3 DEBT INSTRUMENTS (ऋण उपकरण)

Creditors to company. First claim during liquidation. Assured interest irrespective of profit of company. These debt instruments can be classified into short-term vs long term.

9.3.1 Short term debt instruments (लघु अवधि ऋण उपकरण)

- Tenure = less than 1 year. Usually 'unsecured' because not backed by any Asset.
- Usually sold at discount and re-purchased at _____. The difference between these two prices is the interest earned by investor.
- They're traded at **Money Market** and are (usually) 'negotiable & transferable' in nature i.e. lender can sell to third party, and third party can demand money from borrower.
- **Near Money** = Asset that is highly liquid = can be readily converted into cash.

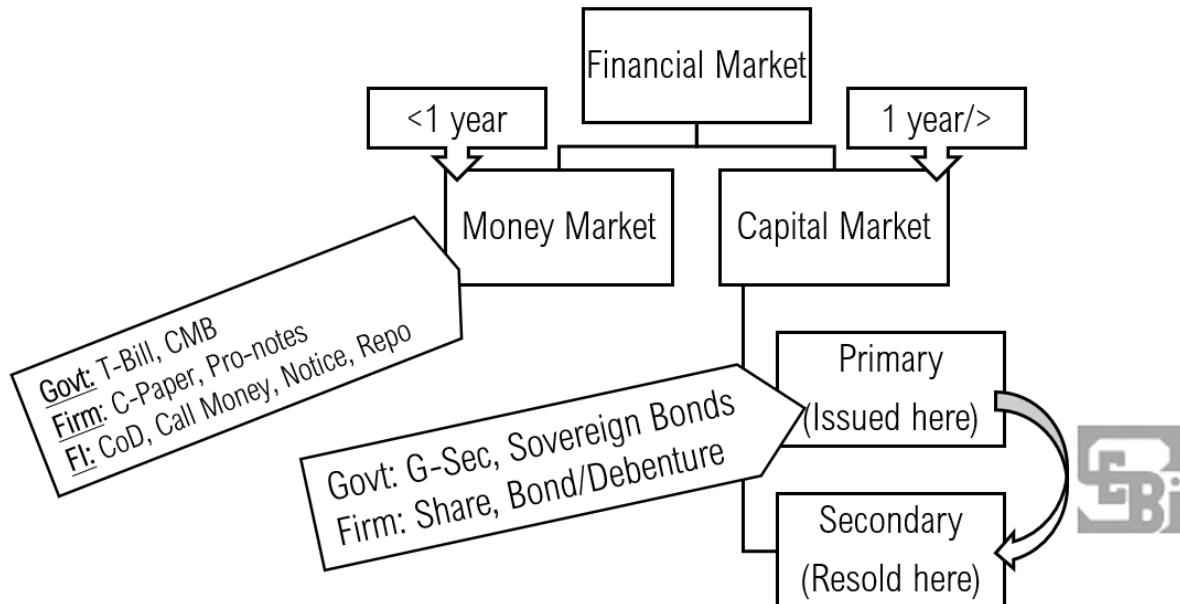


Table 1: Further sub-division based on who is the Borrower?

Borrower	Short term debt instrument
Govt.	<ol style="list-style-type: none"> 1. State govt's treasury bills (14 days). But stopped since 2001. 2. Union govt's treasury bills (91, 182 and 364 days) & Cash Management bills (CMB: upto 90 days, started in 2009). 3. WMA (ways and means advances): it's the mechanism through which ___ lends money to Govt, for temporary short term needs when there is mismatch in receipt and expenditure of Govt. This WMA is not counted in Fiscal Deficit formula (<i>More in Pillar#2: Budget</i>).
Company	<ul style="list-style-type: none"> - Bill of Exchange, Hundi, Commercial Papers, Promissory Notes. - Side note: Currency Note is a 'Promissory Note' issued by RBI Governor however, he's not bound to pay any interest. Just promises to exchange it with other currency notes and coins of equal face value.
Merchant to bank	<ul style="list-style-type: none"> - Commercial Bill.
Banks / NBFC	Certificate of Deposits (जमा प्रमाण पत्र). RRBs and LAB can't issue.



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Call Money	It's the interest rate when Financial Intermediaries (Banks/NonBanks) borrow for ONE DAY among themselves.
Notice Money	Same as above but for 2 to 14 days .
Repo	Repo and Reverse Repo- already covered with Monetary Policy

MCQ. Find Correct statements:(Asked in UPSC-Pre-2018)

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.

Ans Codes: (a) 1 and 2 only (b) 3 only (c) 2 and 3 only (d) 1, 2 and 3

MCQ. Which of the following is /are example (s) of 'Near Money'? [UPSC-CDS-2016-I]

1. Treasury Bill
2. Credit Card
3. Saving accounts
4. Money Market Instruments

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

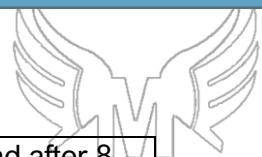
9.3.2 Long Term Debt Instruments (दीर्घ-अवधि ऋण उपकरण)

Tenure = 1 year/>. Further sub-division based on who is the Borrower?

Issuer	Objective? उद्देश्य?
Modern day Government to borrow money	<ul style="list-style-type: none"> - Government securities, Dated securities, Sovereign bonds (संप्रभु स्वर्ण बांड), Kisan Vikas Patra etc. (more in "Financial inclusion lecture") - Also called Gilt Edged securities (उच्च / अग्रिम टर्ज की प्रतिभूतिया) because repayment is assured by Government. (Although, give lower interest rate because of low risk to investor). - Global Credit Rating Agencies gives 'rating' to sovereign bonds. " ___ " is best and highest given to US Treasury Bonds. India's rating is ~"BAA" = moderate risk of default. - World's top three credit rating agencies- Fitch, Moody's and Standard & Poor have pro-US/EU allegiance. Critics argue these 3 agencies do not give adequate upgradation to India, China, Russia despite the economic growth. So, India has proposed the ___ group to set up its own independent credit rating agency.
Modern day Govt. to curb Gold Consumption	<p>Real Interest Rate (वास्तविक ब्याज दर) = Nominal (नामित) Interest minus Inflation. When Real Interest is negative, purchasing power ___ despite increase in money quantity in bank account. Then people prefer to park money in gold/real estate- which is not very beneficial to economy. So..</p> <p>Inflation Indexed Bonds (IIB-मुद्रास्फीति सूचकांकित बांड)</p> <ul style="list-style-type: none"> - Launched in 1997, 2013, 2018 to provide positive ___ interest rate to household, thereby reducing the Gold consumption & Current account deficit (CAD) & weakening of rupee against dollar (else expensive crude->petrol, diesel inflation). - e.g. Inflation Indexed National Savings Securities-Cumulative (IINSS-C) with Interest Rate = CPI + 1.5% [and Principal also protected against inflation.] <p>Sovereign Gold Bond (2015: संप्रभु स्वर्ण बांड)</p>

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	<ul style="list-style-type: none"> - They're denominated in gold grams. Annual interest 2.75%, and after 8 years you get the amount equivalent to prevailing gold prices at that time. Benefit / challenges? = Pillar#3, along with Gold Monetization Scheme.
Colonial era Govt.	<ol style="list-style-type: none"> 1. Coupon Bonds: Contain detachable coupons- presented to the issuer to claim the interest. 2. Zero Coupon Bonds: Are sold on discount and repurchased at face value, do not have any coupons. 3. Bearer Bonds: Not linked to a PAN card, Aadhar card or passport, voter card or social security number. Anyone who presents it to the issuer, will get interest and principal. Usually issued during the war time.
ULB	Urban Local Bodies issue Municipal bonds to borrow money from public.
Companies	<ul style="list-style-type: none"> - Bonds (British Term), Debentures (American Term): Internal difference not important. - If the company has high risk of default on repayment, the Credit Rating Company will mark it as ____ Bonds ("BB to D" Grade) e.g. IL&FS. Such company will have to offer a very high interest rate next time. - Redeemable Bonds (मोच्च): will repay regular interest and will return principal on maturity. Irredeemable Bonds (अमोच्च): will pay only interest but no principal returned. - Hybrid instruments: Issued as "Bond" but can be converted into share. E.g. Optionally Fully Convertible Debentures (OFCD: वैकल्पिक रूप से पूर्णतः परिवर्तनीय ऋण पत्र).
BRICS Bank	<ul style="list-style-type: none"> - 2014- BRICS Nations had setup the New Development Bank (NDB, HQ: Shanghai, China). Later it launched BRICS Bonds to mobilize money for its infrastructure loans. Denomination: USD



IFC	<ul style="list-style-type: none"> - Masala Bonds: These _____ denominated bonds issued outside India, to borrow money for Indian companies. World Bank's sister agency International Financial Corporation (IFC) launched & named them 'Masala Bonds' to arrange loans for Indian private sector companies. - 2015: RBI allowed Indian entities to launch such Masala Bonds. 2017: NHAI also issued Masala Bonds in London stock Exchange to mobilize money for Indian Highway projects. - Maharaja Bonds: IFC-bonds are issued within India in ₹ denomination
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World Bank	<ul style="list-style-type: none"> - 2018: launched world's first Blockchain Offered New Debt Instrument called Bond-i. - Sold in Australia using _____ blockchain technology. - Local Manager: Commonwealth Bank of Australia (CBA) [Reserve Bank of Australia is separate]. - Tenure: 2 years @~2% interest. Denomination: _____ Dollars, hence also called "Kangaroo Bond".
Non-Chinese in China	PANDA Bonds is a bond issued by a non-Chinese entity (e.g. Pakistan or IFC or ADB) inside the Chinese Market to borrow money. Denomination : _____ -Renminbi
Green bonds (हरित बांड)	<p>For renewable energy, pollution control, environment friendly Projects.</p> <ul style="list-style-type: none"> - World's first Green Bond launched by World Bank (2007) - India's first Green Bond launched by Yes Bank (2015) - BRICS Bank (New Development Bank) issued Yuan-denominated green Bonds (2016) - Indian Renewable Energy Development Agency (IREDA) launched India's first Masala Green Bond at London Stock Exchange (2018).
Blue Bond (नील बांड)	A sub-type of green bond, where money borrowed for Climate resilient water / marine / fisheries projects. E.g. 2018- _____ issued world's first 'Blue Bond,' to expand its marine protected areas and fisheries sector.

MCQ: With reference to 'IFC Masala Bonds', sometimes seen in the news, which of the statements given below is/are correct? (Asked in UPSC-Pre-2016)

1. The International Finance Corporation, which issues them, is an arm of the World Bank.
2. They are the rupee-denominated bonds and are a source of debt financing for the public and private sector.

Answer Code: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

MCQ. Which one of the following is a viable alternative to term-loans for raising debt finance by large publicly traded firms? (UPSC-IEnggS-2018)

- (a) Shares (b) Debentures (c) Asset loans (d) Gold loans

9.3.3 Electoral bonds (चुनावी बांड)

- ⇒ Announce Budget 2017. Only _____ can issue at present, and in multiples of Rs.1,000, Rs.10,000, Rs.1,00,000, Rs.10,00,000 and Rs.1,00,00,000. [Notified by Dept. of Economic Affairs, Finance Ministry.]
- ⇒ **When?** For ten days at the start of each quarter. (January, April, July and October). However, in Lok Sabha election year, can sell for another 30 days.
- ⇒ **Who can buy?** Only an Indian _____ or Company registered in India -> deposit money in a bank account-> use that money to buy Electoral Bond, after giving certain KYC-documents. So, electoral Bond can't be bought **anonymously** or directly with **cash**.
- ⇒ Electoral Bonds can be donated only to a political party registered under Representation of the People Act (RPA), 1951 and which has secured _____ votes polled in last Lok Sabha or Vidhan Sabha elections.
- ⇒ **Validity?** Only _____ days from the date of purchase. Within that time, buyer must donate, and political party must deposit in its SBI (current) bank account. No interest payable.
- ⇒ **Characteristics?** Paper / Physical format (not DEMAT / electronic format). Bearer instrument (Donor or Recipient's name not mentioned), Promissory Note (promises to



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transfer money in bank account) and an interest free banking instrument (zero interest payable to anyone). Can't sell it to third party, can't pledge it for loans.

⇒ **Benefits?** Transparency in political funding, Reducing influence of cash and black money in election, Confidentiality to donor.

~~Ignored for poor cost:benefit- Bond Yield, Yield To Maturity, bond yield's linkages with monetary policy, exchange rate, gold & crude prices.~~

9.4 EQUITY INSTRUMENTS (इक्विटी)

They're owners / proprietors of the company. If profit, they get dividend. Last claim during liquidation.

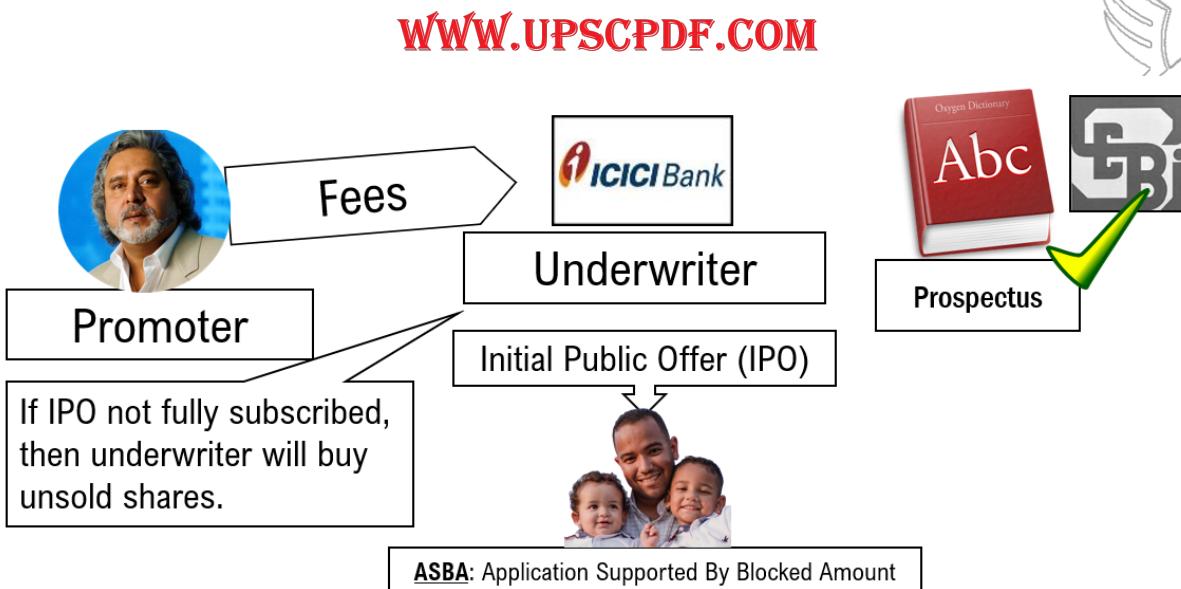
Keywords	Features
Ordinary shares	Have voting power in the meetings of shareholders. Last claim during liquidation.
Preferential shares	अधिमान्य शेयर्स. During liquidation, these investors will be given money before the ordinary shareholders. Further subtypes: with or without voting powers.
Sweet Equity	Shares given @discount to directors & employees for their value addition to company [Amount is regulated under Companies Act]
Penny stocks	Shares whose market price remain excessively low compared to its face value, for a long period. Usually associated with some hidden game for money laundering through shell companies. PHDNotREQ
Venture capital funds (VCF)	Professional firms helping startup companies with seed capital. (could be debt / equity / hybrid)
Angel Investors एंजल निवेशक	Rich person helping startup companies out of his hobby, passion, profit motive or time pass. e.g Ratan Tata in Urban Ladder app. (could be debt / equity / hybrid)
RGEES Started in 2012	Rajiv Gandhi Equity Savings Scheme= Govt gives income tax benefit to people who invest in the share market for the first time. Discontinued by Budget-2017 (instead of renaming after DeenDayal).

MCQ. What does 'Venture Capital' mean? (Asked in UPSC-Pre-2014)

- (a) A short-term capital provided to industries
- (b) A long-term start-up capital provided to new entrepreneurs
- (c) Funds provided to industries at times of incurring losses
- (d) Funds provided for replacement and renovation of industries

9.5 METHODS OF ISSUING SHARES

Shares have printed price on the certificate called **Face Value or Par Value** (सममूल्य). If they're sold at higher price than face value, it's called "**Premium Value**".



Initial public offer (IPO) प्रारंभिक लोग निर्गम	⇒ Company hires an underwriter (usually, a merchant bank, investment bank). ⇒ Underwriter drafts Red Herring Prospectus for SEBI approval. ⇒ Then, Underwriter invites application from public & sells them shares at face value or higher. (unlike T-bill, the shares not sold at discount on issuance). If less subscription, then underwriter will buy the unsold securities by himself.
Follow on public offer (FPO) अनुसरण...	⇒ If company had already issued shares previously, and now again issuing more shares then it is called up FPO. ⇒ Rights issue (अधिकार निर्गम): Company issues more shares but gives first right to existing shareholders to buy them, if they refuse then offered to outsiders.
Other methods / terms	Offer for sale / Private placement / Issuing bonus shares / share splitting / share swap / share buyback / PE Ratio etc. = NOT IMP. However, to satiate your curiosity you may self-study them from Investopedia.

9.5.1 ADR/GDR: Indian shares in Videshi locker

- An Indian (or any non-American) company wants to mobilize money from American share market but does not want to go through the process of registration with the American regulator.
- Then Indian Company gives the Indian shares to an American Bank, and based on those Indian shares, the American Bank will create and sell American depositary receipts (ADR: अमेरीकी निपेक्षागार रसीद) to American investors. **Denomination:** USD.
- **Global depositary receipt (GDR):** Same as above, but when single bank issues receipts for investors in multiple countries. **Denomination:** USD or Euro.
- **Bharat / Indian depositary receipt (IDR):** Similar concept- American (or any foreign) company wanting to mobilize money from Indian investors. Permitted since 2009-10. **Denomination:** INR (Rs.)

9.6 STOCK EXCHANGES / SECONDARY MARKET

Shares are issued through IPO@Primary market. Then, they can be resold at Secondary market, commonly known as *Share market* or *Stock Exchange*.



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- ⇒ World's Oldest: Amsterdam Stock exchange (1602) Netherlands.
- ⇒ Asia's Oldest: Bombay Stock Exchange (1875)
- ⇒ India's stock exchanges chronology: BSE->A'bad->Kolkata->NSE
- ⇒ Just like Banks have Core Banking Solutions for e-banking, Stock exchanges also have their electronic platforms for trading. E.g. **BOLT** (BSE's On-line Trading System) and **NEAT** (National Exchange for Automated Trading). They run using internet facility from **VSAT** (Very Small Aperture Terminal) Satellite.

9.6.1 DEMAT Account



- ⇒ If shares and bonds are traded in paper-form, then transactions are slow & prone to the risk of theft, forgery and fire.
- ⇒ Depository is an organization that stores the physical securities in its vault and allows investors to trade them in electronic (=DEMATERIALIZED) form.
- ⇒ Customer has to open Demat account in a depository-partner (DP) which can be a bank or an NBFC.
- ⇒ SEBI regulates them under the Depositories Act 1996. Notable examples are Central Depository services Limited (**CDSL**) and National securities depository Limited (**NSDL**: started by SBI, IDBI, UTI, NSE et al). NSDL also has RBI license to operate_ _

9.6.2 Types of Investors: Depending on Buying Capacity

1. **Qualified Institutional Buyers (QIB)**: Are those investors with expertise and financial muscle to make large investments in capital markets. E.g. Mutual Funds, Insurance Company, Foreign Venture Capital Funds etc. SEBI has separate registration norms for them.
2. **Anchor investors**: They're QIBs who are offered shares before IPO-launch. This gives confidence to other investors to subscribe IPO.
3. **Retail investor**: An individual investor who is not a QIB.

Underwriter will keep quota for each category of investors, as per SEBI norms.

9.6.3 Types of Investors: Depending on Buying Behavior

1. **Jobbers (आढ़ती)**: Full time engaged in buying / selling securities using money from their own pockets. (Whereas brokers / commission agents buy/sell using money/shares of their clients).
2. **STAG (Male Deer)**: He buys newly issued securities **from primary market** & sells them in secondary market for quick profit.
3. **Bull (तेज़दिया)**: Optimistic speculator who hopes share prices will rise, so purchases (to sell them later at much higher price). Just like a bull tends to throw his victim up in the air, the bull speculator stimulates the price to rise.
4. **Bear (मंददिया)** – A pessimistic speculator who fears prices will fall so, he sells. A bear usually presses its victim down to ground. Similarly, the bear speculator tends to force down the prices of securities.



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Further subtypes with various animal / bird names can be found on Investopedia but with poor cost : benefit in exam.

9.6.4 Notable Indexes

- **SENSEX?**: Sensitive Index/ संवेदी सूचकांक. It's the weighted average of Free Float Market Capitalization (FFMC) of 50 companies, selected by BSE's "Index Cell".
- **NIFTY?** NSE index of 50 companies. **Nikkei?** Tokyo Stock Exchange index of 225 companies.

SENSEX – when does it go up	Goes down
RBI's soft /easy monetary policy -> cheap loan & credit cards -> consumers to spend more -> more profit to company-> more dividend –investor thinks “ <i>better I buy more shares to get more dividend</i> ”: Bullish	Tight monetary policy
Peace, Economic boom / prosperity, Political Stability	War, recession, political instability-> Bearish market.
When govt. hikes foreign investment limits	Inverse.
Merger-Acquisition, new product launches, Environmental permissions for new factory	CEO/MD arrest/FIR, Courts slapping fine, media exposing scandal...

MCQ. In the parlance of financial investment, ‘Bear’ denotes [UPSC-CDS-2012]

- an investor, who feels that the price of a particular security is going to fall.
- an investor, who expects the price of a particular share to rise.
- a shareholder, who has an interest in a company, financially or otherwise.
- any lender, whether by making a loan or buying a bond.

MCQ. Which of the following statements is/ are correct? [UPSC-CDS-2012-II]

1. NIFTY is based upon 50 firms in India.
2. NIFTY is governed and regulated by the Reserve Bank of India.
3. NIFTY does not trade in mutual funds.

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

9.7 ----- (SEBI)

- ⇒ भारतीय प्रतिभूति और विनियम बोर्ड, HQ- Mumbai
- ⇒ (1988) Formed by executive order -> (1992) Became Statutory Body -> powers increased through amendments in 1999 & 2014. Now it can order search and seizure, attachment of properties, arrest and detention.
- ⇒ **SEBI Board Composition:** Chairman + 1 officer from RBI + 2 officers from Union Government + 5 members appointed by Union Government.
- ⇒ **Chairman:** upto 5 years / 65 age. Reappointment possible. _____(IAS) initially given 3 years term in 2017, could be extended in future.
- ⇒ Regulates **Process** of issuing securities (Bonds, Shares, IPO, EPF, ReIT, INVITs, etc.) using the Securities Contracts Regulation Act, 1956 [SCRA: प्रतिभूति संविदा विनियमन]
- ⇒ Regulates **Places** (Depositories, Stock exchanges, Commodity Exchanges etc.)
- ⇒ Regulates **Persons** (individual investors, Brokers, Fund Managers, Public Limited companies etc.)
- ⇒ Regulates any Collective Investment Scheme (**CIS**) of ₹_____ cr/> [In the aftermath of SAHARA scam, Chit Fund scams.]



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- ⇒ **Further appeal:** _____ (SAT)->Supreme Court. Same SAT also hears appeals against the orders passed by Insurance Regulatory Development Authority of India (IRDAI) and Pension Fund Regulatory and Development Authority (PFRDA).
- ⇒ “SCORES” online portal for complaint. Financial literacy of investors.

SEBI has to protect the investors & increase their participation because:

- ⇒ Share market scams erode publics’ hard-earned savings -> alcoholism, depression, suicide and other social ills.
- ⇒ Duped investors will shy away from share market & they may invest in gold / real estate = not very beneficial to economy.
- ⇒ If households don’t participate in capital market- then corporate companies will have to approach the banks to get more loans. But banks’ lending capacity is limited by CRR, SLR, PSL, NPA, PCA= bottleneck in factory expansion, job creation, and economic growth.

9.7.1 SEBI Reforms

- ⇒ Harshad Mehta (1992), Ketan Parekh (2001) arranged money from banks, used it for rigging the share prices & make windfall gains during bull-runs by other investors. Once the prices crashed, small investors suffered. To prevent such scams, SEBI introduced _____ System, wherein if fluctuation in the share prices is more than “x%” then stock exchange will have to stop trading for “y minutes / hrs”.
- ⇒ **Badla System/Carry forward system:** It’s buying of shares using borrowed money and making promises & carrying forward the settlement for upto 72 days. This helped scamsters so SEBI discontinued it (2001) & introduced **(T+2) rolling settlement system** i.e. after trade is conducted, the parties must settle it within two working days (= buyer pays money, seller gives shares/bonds/securities).
- ⇒ Rupal Panchal (2005) opened multiple fake DEMAT accounts to increase the chances of getting share allocations in IPO. Then she’d sell such shares in stock-exchange for higher prices. Subsequently, SEBI made PAN Card (issued by Income Tax Dept) compulsory for opening DEMAT Accounts. SEBI also introduced **ASBA** (_____-) - it allows the underwriter to block the amount in IPO-investor-applicant’s bank account, but only IF shares allotted to the applicant, his bank money will be deducted. ASBA-Benefits:
 - (1) only serious investors with sufficient bank balance can apply.
 - (2) investor continues to earn bank interest on his blocked amount until the process of IPO-share allotment is over.
- ⇒ **Dabba Trading / Bucketing / Box Trading:** While share trade occurs at stock exchange linked with DEMAT accounts, the Dabba Trades occur in the unofficial books/ledgers of a broker. He may or may not execute those orders in actual DEMAT account. Investor prone to scam, govt deprived of taxes hence SEBI declared it illegal.
- ⇒ **Insider Trading:** Whenever company launches new products, wins unique patents, or undergoes merger and acquisition- its share prices will increase. If a person associated with company uses such confidential information for buying/selling shares to make windfall gains. Such insider trading is illegal.
- ⇒ **Trading (भेदिया लेनदेन):** Some large brokers / companies use algorithmic trading computer programmes to automatically buy / sell securities at a speed and frequency that is impossible for a human trader. This can be misused for manipulating the share prices. Therefore, SEBI issued technical measures e.g. a single broker / investor can’t place more than 100 online orders per second.



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9.7.2 Commodity Market, FMC, SEBI merger

- ⇒ A commodity market / exchange (वस्तु बाजार) is a place where buyers and sellers trade goods in bulk such as food grains, precious metals or energy resources (oil / gas)
- ⇒ “**Commodity Futures**”: Type of contract for future delivery and settlement of commodity e.g. “on 1/1/2019, I shall deliver you 500 quintals of wheat at X price”.
- ⇒ Commodity exchanges were under a statutory regulator _____ (FMC) under the ministry of Consumer Affairs and Public Distribution. But Jignesh Shah generated fake receipts without any commodities in the warehouses & traded at NSEL-commodity exchange. FMC failed to prevent scam-it was transferred to Finance Ministry and ultimately merged with SEBI (2015).

9.7.3 Misc Bodies

FSDC (2010)	<ul style="list-style-type: none"> - Financial Stability & Development Council (वित्तीय स्थिरता और विकास परिषद.) Chairman – Finance Minister. Other members – 1. RBI Governor 2. SEBI chief 3. IRDAI chief 4. PFRDA chief. - Functions? Supervision of the economy, large financial conglomerates, coordination among the financial regulators, financial literacy and financial inclusion. - Secretariat assistance by: Dept. of _____
FSB (2009) HQ: BASEL	<ul style="list-style-type: none"> - Financial Stability Board (वित्तीय स्थिरता बोर्ड) is a brainchild of G20. - Function? Financial monitoring at global level., Coordination between national financial regulators bodies. - India has 3 seats in FSB: 1) Secretary of Department of Economic Affairs (IAS) 2) Dy. Governor of RBI 3) SEBI chairman
FATF (1989) HQ: _____	<ul style="list-style-type: none"> - Financial Action Task Force (वित्तीय कार्रवाई कार्यदल) is a brainchild of G7, with HQ@_____. India became member in 2010. - Function? Combating Money laundering and terror finance.

MCQ. With reference to 'Financial Stability and Development Council', find correct statement(s): (Asked in UPSC-Pre-2016)

1. It is an organ of NITI Aayog.
2. It is headed by the Union Finance Minister
3. It monitors macro-prudential supervision of the economy.

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

9.8 INVESTMENT FUNDS

9.8.1 Mutual fund (MF: म्यूच्यूअल फण्ड) for aam-aadmi

- ⇒ is an Asset Management Companies (AMC-NBFC) that pools savings of (retail) investors and gives them “Units”. MF Manager then parks the money in securities & builds his ‘portfolio’.
- ⇒ Whatever dividend/ interest is generated from the portfolio, is distribute among investors in the proportion of their units.
- ⇒ Investor has to pay Entry Load = fees for joining, Exit Load = Fees while quitting. SEBI regulates these fees.
- ⇒ Due to the low deposit rates in banks, people invested money in mutual funds however post-IL&FS crisis, charm declining because Mutual Funds are subject to such market risks.



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9.8.2 Hedge Fund (हेज फण्ड) for rich-aadmi

- ⇒ Special type of Mutual Fund meant for HNI (High Net Worth Individual) who want high risk high return. SEBI norms: Minimum investment per person is ₹1 crore.
- ⇒ Hedge Fund manager will invest their money in Junk Bonds, Risky assets; he'll do risky trading activities such as Arbitrage, Leverage, Short Selling etc. to generate maximum return. (how is that done in real life = UPSC-CSE not for recruitment of HF managers.)

9.8.3 REITs / InvITs: for rich-aadmi

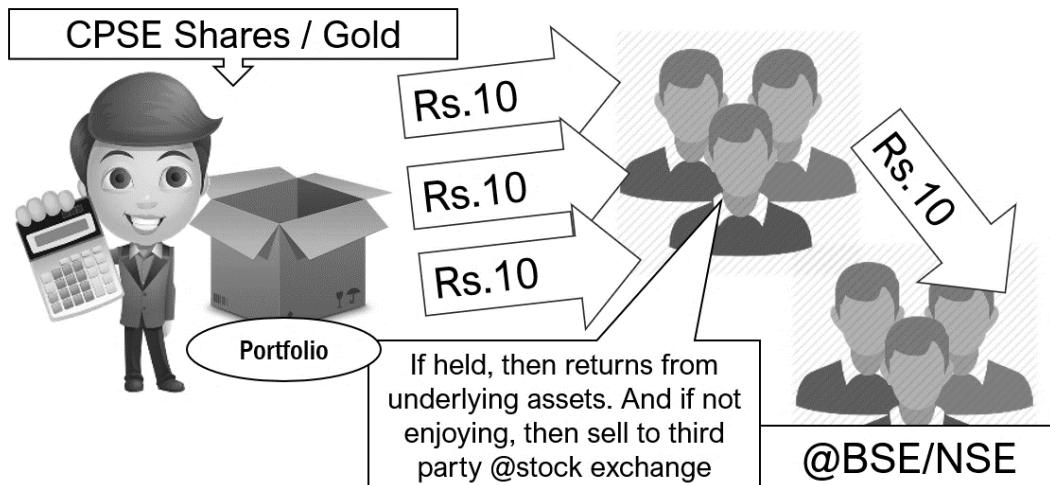
	REITs: (Real estate investment trusts)- (भू-भवन संपत्ति निवेश न्यास)	InvITs: infrastructure investment trusts-(अधिसंरचना निवेश न्यास)
Who can invest?	HNI / institutions: Min. ₹2 lakh investment per application	₹10 lakh.
Manager parks the money in?	in real estate projects that are about to complete. He'll earn income from rent / sale.	In airport, highway, thermal plants, gas grid etc. He'll earn from toll collection at highways, services fees at airports etc.
Example	Blackstone-Embassy group	IRB, india-grid

Benefits of REITs and InvITs-

- Stressed developer gets new finance to finish the project while HNI gets new opportunity to invest his money, and he may also sell the units to third party via stock exchange.
- SEBI permitted these instruments in 2014. Later SEBI relaxed technical norms related to capital, leverage, issue size but they are not important for us.

9.8.4 CPSE-ETF: Exchange Traded Funds

- **Disinvestment (विनिवेश):** government sells its shares from Central Public Sector Enterprises (CPSE: केंद्रीय सार्वजनिक क्षेत्र के उद्यम) but does not reduce its shareholding below 51%. If Govt's shareholding reduced below 51%, then it is called **Privatization (निजीकरण).**
- 2014: Government wanted to disinvest 10 CPSE. If govt tried to sell the shares individual company-wise, it would be more time consuming, and govt may not get good prices for each company.





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- So, the CPSE-shares were given to fund manager Goldman Sachs - who created new securities out of it, called “Exchange Traded Funds”, and made a “New Fund Offer (NFO)” to the public to subscribe to these securities at Rs.10 per unit.
- If an investor holds the ETF- he will get returns from the dividend generated by those CPSE-companies in the backend. If he can also sell these ETF to a third party via stock exchange, hence are called Exchange Traded Funds.
- **BHARAT-22:** Same ETF funda, Govt wanted to disinvest shares from 22 companies including CPSE, PSBs and UTI using ICICI Prudential as fund manager (2017-18). However, PSB-NPA problem = poor dividends = BHARAT-22 not giving good returns, so, investors response was lukewarm.
- **Gold-ETF:** Investors give money-> manager buys gold for safekeeping and trades it depending on price movements-> returns are divided among the unit-holders. In between, the investor may sell his Gold-ETF to third party via Stock Exchange therefore they're also Exchange Traded Fund.

9.8.5 Alternative investment funds (AIF)

It's a technical classification under SEBI norms:

- **AIF Category I:** They generate _____ spillover effects on the economy. Example: Venture Capital Funds, Angel investors fund, SME Funds, social venture fund, Infrastructure funds. SEBI norms are easy on them.
- **AIF Category II:** Neither in Cat-1 nor in Cat-2 E.g. Private Equity or debt fund.
- **AIF Category III:** They undertake excessive risk to generate high returns in short period of time. E.g. ____ Funds. SEBI norms are stricter on them, else they may destabilize the capital market.

9.9 FORWARD / FUTURE CONTRACTS & CALL / PUT OPTION

- A Forward / Future contract is a customized contract between two parties where settlement takes on a future date at a price/quantity agreed upon today. E.g. *on 1/1/2019 I shall sell you 100 nos. of Infosys shares at ₹1000 each.*
- In such contracts, there is risk of other party not honoring commitment if he's getting better deal elsewhere in the future. So, to protecting (=hedging) themselves, they may buy “Option” from a third party by paying fees.
- Option is a type of insurance for executing the forward/future contract in a manner beneficial to them e.g. *I'll sell you for ₹1000 on X date, & you must buy, but if I'm getting another buyer who is willing to pay ₹1500 then I may not sell you & you can't compel me.* Such ‘insurance options’ are further subdivided into **Call Option and Put Option**, their internal difference not imp. for UPSC.

MCQ. Which one of the following terms is used in Economics to denote a technique for avoiding a risk by making a counteracting transaction? [UPSC-CDS-2016-I]

- (a) dumping (b) Hedging (c) Discounting (d) Deflating

9.10 DERIVATIVES & SWAPS

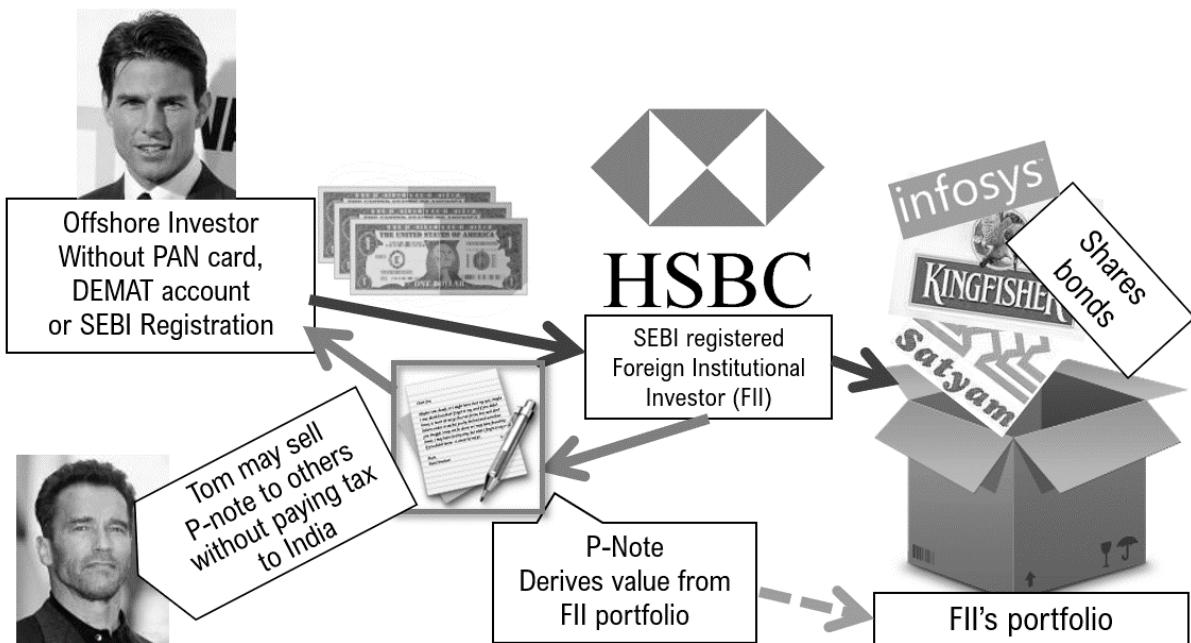
- ⇒ A **derivative** is a contract whose value is derived from the value of another underlying asset which could be a share, bond, commodity or currency. They're usually generated by the process of ‘securitization’. E.g. NHB taking loan papers from banks, using them to generate new Mortgage Backed Securities.



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- ⇒ **SWAP:** is derivative instrument to swap one financial asset with another financial asset (usually) to reduce the risk e.g. Currency Swap Agreement between two countries to protect themselves against dollar volatility (more in Pillar#3).
- ⇒ **Similarly, there are Credit Default Swap agreement** against the risk of default, **Interest swap agreement** to protect against volatility in interest rates. But their mechanisms NOT IMP.

9.10.1 Participatory notes (P-Notes: पार्टिसिपेटरी नोट्स)



- A foreigner wishes to invest in India but does not want to go through the hassles of registering with SEBI, getting PAN card number, opening a DEMAT account etc. So, he will approach a SEBI registered foreign institutional investor (FII) such as Morgan Stanley, Citigroup or Goldman Sachs. He'll pay them & instruct them to purchase particular shares and bonds and store them in their Demat account. Then FII will give him P-Notes, and he'll receive interest and dividend accordingly. He may also sell those P-notes to a third party.
- P-Notes are _____ that derive the value from the underlying Indian shares and bonds.

P-Notes considered harmful to Indian economy because:

- P-note investors are not directly registered with SEBI, the identity of the actual investor and source of funds remain disguised= chances of _____
- If P-Note owner sells his P-Notes to another foreign investor, Government of India will be **deprived of taxes**. (Compared to a scenario where Indian share owner is selling his shares to another Indian investor, then government gets securities transaction tax and capital gains tax on his profit, & he can't dodge it because DEMAT accounts linked with _____ card. More on PAN card@Pillar#2->BlackMoney)
- Therefore, SEBI is tightening the control P-Notes e.g. "X" category of FIIs can't issue P-Notes. "Y" category of FII can issue P-Notes but every time they issue P-notes-they'll have to deposit \$1,000 to SEBI etc.



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9.11 COMPANY TYPES

9.11.1 Company types based on incorporation

Chartered Companies	Setup by a charter given by a king / queen. E.g. East India Company in _____. चार्टर्ड कंपनिया
Statutory Companies	Setup by Special Acts of Parliament or Vidhan Sabha. E.g. RBI, LIC, SBI. वैधानिक कंपनिया
Registered Companies	Registered under The Companies Act, 1956 (and later 2013) e.g. Tata Motors, Infosys. पंजीकृत कंपनिया

9.11.2 Company types based on Ownership

Holding Company / नियंत्रक कंपनी	Subsidiary Company / नियंत्रित कंपनी
A company that owns majority shares in another company. E.g. Tata Sons Ltd. holds majority shares of Tata Consultancy Services (TCS), Tata Steel, Tata Sky etc	A company that is controlled by a parent Holding Company. E.g TCS, Tata Steel, Tata Sky are subsidiary companies of Tata Sons.
Government / Public Sector / सार्वजनिक	Private Sector / निजी क्षेत्र की
When Government owns 51% > shares. Examples: Steel Authority of India (SAIL), India Post Payment Bank (IPPB)	When private parties own 51% >. E.g. Reliance, Adani, Tata

9.11.3 Company types based on number of members

	Private Ltd.	Public Limited Company (Companies Act 2013)
Members	Min. 2 to Max. 200	Min. 7 to Max. unlimited number (depending on how many people buy shares)
	Can't	<ul style="list-style-type: none"> ⇒ A public Ltd. company can invite public to subscribe to its shares and bonds. ⇒ If their shares are listed on a stock exchange (BSE, NSE etc), it's a 'Listed Public Limited Company' (e.g. Reliance), else it's an 'Unlisted Public Limited Company' (e.g. _____ : IPPB)
Min. authorized capital	₹1 lakh	₹5 lakhs (अधिकृत पूँजी). It's the amount of shares the company can issue.
Min. Paid up Capital	₹0	₹0 (देय पूँजी). The amount of money a company has actually received from the selling of shares.
Directors (Min-Max)	2-15	<ul style="list-style-type: none"> - Min 3 to Max 15. out of them one must be Indian Resident, 1 must be Woman and 1/3rd of the directors must be independent directors. - Independent directors are persons without any pecuniary interest in company, they protect minority shareholders' interests.
Term limit	N/A	Their directors have age limit, term limit.
Corporate Governance Norms	Norms either not applicable or relaxed.	<p>Companies Act requires them</p> <ul style="list-style-type: none"> ⇒ to hold specific number of annual meetings of board of directors, norms for quorum, mechanism for e-voting, ⇒ have to appoint Company Secretary,

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	Private Ltd.	Public Limited Company (Companies Act 2013)
	UPSC-CSE≠CA	⇒ Implement mechanism for protecting whistleblowers And so on...

9.11.4 Company Types: Misc.

Under Companies Act	<ul style="list-style-type: none"> ⇒ One Person Company: special type of private ltd company having only one member. ⇒ Not for Profit Company: e.g. GSTN, NPCI etc. their profit is reinvested in business expansion. They get certain tax benefits. ⇒ Dormant Companies: A) setup to start business in future B) setup to store intellectual property C) not filled annual returns for two consecutive years.
Under LLP Act 2008 सीमित देयता भागीदारी अधिनियम	<ul style="list-style-type: none"> ⇒ Limited Liability Partnership (LLP) Company is formed by minimum 2 or more partners. ⇒ Individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct. E.g. Vajiram and Ravi IAS Study Centre LLP ⇒ LLP's registration fees, auditing/reporting norms, tax liabilities, winding up process etc. are more flexible than a (public or pvt) ltd. company registered under Companies Act.
Under Indian Partnership Act 1932	<ul style="list-style-type: none"> ⇒ A Partnership firm is formed by minimum 2 or more partners. ⇒ Each partner is liable jointly with all the other partners for losses, wrongful biz. decisions and misconduct.

9.12 STATUTORY BODIES UNDER MINISTRY OF CORPORATE AFFAIRS (MCA)

9.12.1 Competition Commission of India (भारतीय प्रतिस्पर्धा आयोग)

- ⇒ Competition among companies= consumer gets goods and services at the most competitive / affordable prices.
- ⇒ Therefore, government must prevent cartelization (price fixing or production fixing by Companies), prevent monopoly (single company commanding the production / supply), protect consumers' interests and ensure freedom of trade.
- ⇒ 1970: Monopolies and Restrictive Trade Practices (**MRTP**) Act. Later replaced with Competition Act, 2002- which has a statutory regulator Competition Commission of India (CCI: 1 Chairman + 6 Members)

9.12.2 Insolvency and Bankruptcy Board of India (IBBI)

This too is a statutory body under the Ministry of Corporate Affairs (MCA). Read previous handout for more on I&B Code.

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Table 2: Statutory Bodies under Companies Act 2013



Features	National Company Law Tribunal (NCLT)	National Financial Reporting Authority (NFRA)	Investor and Education Protection Fund	SFIO (Serious Fraud Investigation Office)
	राष्ट्रीय कम्पनी विधि अधिकरण	राष्ट्रीय वित्तीय प्रतिवेदन प्राधिकरण	निवेशक एवं शिक्षा रक्षण कोष	गंभीर धोखाधड़ी अन्वेषण कार्यालय
Members	Judicial + technical	Chairman + 3 full time + 9 part time. 3 yr/65, 1-time reappointment. selected by Cabinet Secy. (IAS) committee.	Boss: Corp. Affairs Secretary (IAS). Plus, members from RBI, SEBI, financial experts	Civil servants & financial experts
Appeal	NCLAT (Appellate tribunal)	NFRAA (Appellate Authority)	Not applicable	Regular Courts
Cases	Hear the cases related to Companies Act, Board room battles, Merger-Acquisition, Corporate Insolvency & Bankruptcy (I&B)	Sets standards for Auditors & Chartered Accounts (CA), in listed companies and large unlisted companies. If malpractices-> investigate and Debarr them, Powers of civil court.	They use unclaimed money from shares/bonds for financial literacy and awareness	Investigate white-collar (financial) frauds. Powers to search, seize, arrest. Once SFIO gets case, other agencies (like CBI) can't proceed.

9.12.3 MCA also associated with:

Chartered Accountants Act 1949	Regulates the CA profession through a Statutory body: Institute of Chartered Accountants of India (ICAI). ICAI also has IPA status under I&B Code.
Company Secretaries Act, 1980	Statutory Body: Institute of Company Secretaries of India (ICSI). Also has IPA status.
Cost and Works Accountants Act, 1959	Statutory Body: Institute of Cost Accountants of India (ICAI). Also has IPA status.
Legislative Responsibilities of MCA	<ul style="list-style-type: none"> ⇒ Companies Act 1956-> 2013. ⇒ Limited Liability Partnership Act ⇒ Partnership Act ⇒ Societies Registration Act, 1860: for registration of literary, scientific and charitable societies.
E-governance initiatives of MCA	<ul style="list-style-type: none"> ⇒ INC-29 online form to registration of new company. ⇒ MCA-21 portal, where companies can file online documents related to Companies Act compliance.



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9.13 CORPORATE GOVERNANCE (कॉर्पोरेट शासन)

It is a way of directing the company to protect the interest of all stakeholders, and ensure three types of compliance:

Compliance	Example(s)
Legal-Regulatory	<ul style="list-style-type: none"> ⇒ Company obtaining Legal Entity Identifier (LEI) number as mandated by RBI. ⇒ Company setting up 'Internal Complaints Committee' as mandated by Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 / "POSH Act"
Technical	<ul style="list-style-type: none"> - Companies keeping balance sheets as per the Ind-AS accounting standards. - Automobile company producing car engines as per BHARAT-Stage emission norms.
Moral-Ethical	Gillette scrapping the ad-contract with cricketer Hardik Pandya for his sexist comments against women on Koffee with Karan Show.

- ⇒ Absence of Corporate Governance leads to fraud, embezzlement (ग़बन), erosion of investors' confidence. E.g. Satyam Computer Scandal (Chairman Ramalinga Raju manipulated account books), Boardroom battles at Tata Group (Cyrus Mistry vs Ratan Tata) and Infosys Group (Narayana Murthy vs Vishal Sikka), ICICI (Boss Chanda Kochhar gave ₹3000 crore loan to Videocon company without due-diligence, which turned NPA.)
- ⇒ Therefore, Companies Act 2013 mandates companies to impose term limits on directors, appoint independent directors, one person can't become director in more than "X" number of companies, one CA can't audit more than "Y" number of companies, companies have to setup whistleblower protection mechanism, Company can't give loan to its directors and so forth.
- ⇒ Notable Committees for improving corporate governance in India: Kumar Mangalam Birla (1999), Narayana Murthy (2003), Adi Godrej (2012), Uday Kotak (2017).
- ⇒ Further, SEBI too can issue directives to Public Limited Companies in the interest of investors, beyond what is required in Companies Act. Such as...

SEBI implemented Uday Kotak committee's suggestions	From 2019-Apr	From 2020-Apr
Split CEO/MD and Chairman. One person can't occupy both positions in his company (e.g. Gautam Adani)	N/A	Top 500 listed cos.
Companies Act requires min.3 directors in Public Listed company, but SEBI mandated to have min. 6 directors	Top-1000 listed cos	Top-2000 listed cos
Companies Act doesn't prescribe gender of independent director but SEBI mandated atleast one independent woman director.	Top 500 listed cos.	Top 1,000 listed cos.
one person can serve as director in how many companies? (Companies Act: Max.10), but SEBI required	8	7

SEBI also tightened norms related to salaries to directors, 'related party transactions' (meaning not important but the fact that term associated with corporate governance / companies act).



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9.13.1 Corporate Social Responsibility (कॉर्पोरेट सामाजिक जिम्मेदारी)

- ⇒ Mandated under Companies Act 2013: Last 3 years' avg. profit=> spend 2% of that on CSR (education, environment, public health, sanitation, disaster management etc.)
- ⇒ Applicable on both public ltd and private ltd. with very huge profit / turnover / networth (*what's the difference between these terms, what's the exact figure? Ans. UPSC is not Chartered Account exam.*)
- ⇒ Ministry of Corporate Affairs (MCA) gives National CSR Awards to companies.

9.14 MOCK QUESTIONS FOR MAINS (GSM3/250 WORDS EACH)

1. "Just as good governance is necessary for vibrant Indian democracy, corporate governance is necessary for vibrant Indian economy." elaborate. "जिस प्रकार जीवंत भारतीय लोकतंत्र के लिए सुशासन आवश्यक है, उसी प्रकार जीवंत भारतीय अर्थव्यवस्था के लिए कॉर्पोरेट शासन आवश्यक है।" विस्तृत कीजिए।
2. Discuss the significance of deepening the capital market to resolve the Twin Balance sheet Syndrome (TBS) in Indian Economy. भारतीय अर्थव्यवस्था में दोहरे तुलन पत्र की चुनौती को हल करने के लिए पूँजी बाजार को गहरा करने के महत्व पर चर्चा करें।
3. Why are Indian financial regulators apprehensive about (1) P-Notes (2) Cryptocurrencies? भारतीय वित्तीय नियामक (1) पी-नोट्स (2) क्रिप्टोकरेंसी के बारे में आशंकित क्यों हैं?
4. Craze for gold in Indians have led to a surge in import of gold in recent years and put pressure on balance of payments and external value of rupee. In view of this, examine the merits of Sovereign Gold Bond Scheme and Inflation Indexed Bonds (IIB). भारतीयों में सोने के लिए सनक के चलते हाल के वर्षों में सोने के आयात में वृद्धि और भुगतान के संतुलन और रुपये के बाहरी मूल्य पर दबाव बढ़ा है। इसे देखते हुए, संप्रभु स्वर्ण बॉन्ड स्कीम और मुद्रास्फीति सूचकांकित बांड की खूबियों की जांच करें। संतुलन और रुपये के बाहरी मूल्य पर दबाव डाला है। इसे देखते हुए, संप्रभु स्वर्ण बॉन्ड स्कीम और मुद्रास्फीति सूचकांकित बांड की खूबियों की जांच करें।



1D: Insurance, Pension & Financial Inclusion

10 INSURANCE (बीमा): MEANING AND SIGNIFICANCE

- Meaning: insurance policy is a Debt instrument / Legal contract against eventualities of death or damage.
- 2 parties in this contract: 1) Insured / client 2) Insurer / Underwriter.
- Insurance provide stability to the households (against death, disability, damage) and entrepreneurs (against fire, theft, natural disasters etc.)
- Insurance companies invest clients' premium (बीमा-किस्त) in various public and private sector projects, thereby channelizing savings towards economic growth.

10.1.1 Insurance Principles (For ethics case studies)

1. Uberrima fides- Good faith, hide nothing. (HIV+ve in Health Insurance)
2. Indemnity- Only "REAL" loss, not imaginary. (couldn't give CAT exam due to fire)
3. Subrogation- Insurer can recover from negligent 3rd party.
4. Causa Proxima - Direct loss link. Bollywood fan can't buy policy for Bachchan.
5. Insurable interest- If "risk-x" not happen, client remains in same position, "risk-x" happens client in bad position.

10.2 HISTORY OF INSURANCE IN INDIA (भारत मे बीमा कं. का इतिहास)

- (1818): Europeans started insurance companies in India, but they charged higher premium on Indian clients with racist bias that inferior race = higher probability to die.
- (1870): Bombay Mutual Life Insurance was the first Swadeshi life insurance company and they did not charge extra premium for being India.
- (1912): Life Insurance Companies act to regulate them, but the norms were lax, so just like the banking industry, the insurance industry too faced problems in the aftermath of Great Depression. So, **1938**: Insurance Act for tougher regulation.
- Just like the banking industry, the insurance industry had to be nationalized after independence due to scams, financial inclusion and Five-Year Plans.

	Bank	Insurance
1948-49	--- nationalized	
1955	--- nationalized	
---		LIC Act took over ~245 (private owned) Life insurance companies.
1969	Nationalization of 14 Private Banks	
---		GIC Act: GIC and its 4 subsidiaries tookover ~107 (private owned) General insurance companies.
1980	Nationalization of 6 Private Banks	
Reforms	Narsimhan '91 & '98	Malhotra Committee 1993-> Private insurance companies were allowed, FDI was liberalized
Safeguard	CRR, SLR, BASEL	Investment Pattern, Solvency Margin. E.g. They must invest minimum "x%" of premium in G-Sec, they can't invest more than "y%" of premium in pvt



	Bank	Insurance
		companies shares/debentures etc. They must not invest in companies having less than “AA” credit rating etc. Exact norms not imp.
Financial Inclusion, Welfarism	PSL norms, 25% branches in unbanked rural areas	Rural & Social Obligation Norms: every year “x” number of policies must be sold in rural areas, PH/backward etc. Further Insurance companies required to invest minimum “x%” in affordable housing projects, state Govt’s fire equipment etc. Else IRDAI imposes penalty. Exact norms not imp.
Delivery Channel	Bank branch, Business Correspondence Agent (BankMitra)	<ul style="list-style-type: none"> - Agents & brokers. - Banks selling insurance (Bancassurance) - Surveyor/ Loss Assessor. - Third Party Administrators (e.g. Hospital where treatment is given)

10.3 LIFE INSURANCE

Life Insurance Type ⇒ Money returned?	At maturity	At death
Whole life= Longer policy: (e.g. 35-40 yrs) Endowment= Shorter policy: (e.g. 10-20)	Yes, savings returned**	YES
Term = Short Policy, Low Premium e.g. PM Jeevan Jyoti Bima Yojana	---	---
ULIP: Unit Linked Insurance Plans: Part of money goes in insurance, part in Mutual fund	Yes, savings returned**	YES
ELSS: Equity Linked Savings Scheme (entirely invested in shares)- so it's not an insurance.	YES	NO

10.3.1 Life Insurance ⇒ notable entities in public sector

10.3.1.1 Post Office Life Insurance

- Initially started as postal life insurance for the postal employees (1884), later extended to rural people as well.
- Presently, 6 schemes for govt employees** and 6 schemes for rural areas (usually with prefix of “GRAM” e.g. gram Suvidha / Suraksha / Santosh.)

Sampoorna Bima Gram Yojana (2017)

- by Ministry of _____
- In every district, atleast 1 village identified → In that village, cover all households with a minimum of one RPLI (Rural Postal Life Insurance) policy.
- All villages under the **Saansad Adarsh Gram Yojana** will also be covered. (will learn this scheme in pillar#5).

10.3.2 Life Insurance Corporation of India, 1956

- Was setup by an act of parliament, to take over the private life insurance companies.
- Rigveda: “योगक्षेम” (Yogakshema: well being) – name of LIC HQ, Mumbai & corporate magazine.
- Gita: “योगक्षेमं वहाम्यहम्” (Yogakshemam Vahamyaham:- I ensure safety and well being (of my devotees) – LIC motto.
- 2018: became majority shareholder in IDBI bank.



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LIC- Aam Admi Bima Yojana (AABY)

- 18-59: Below Poverty Line (BPL) and marginally above poverty line people.
- **Premium?** Rs.200 per year. (out of that Rs. 100 by Union Government. And remaining Rs.100 by either State Government / NGO).
- **Payment?** Children scholarship** and ₹30-75k depending on natural death/accidental death / disability.
- **Previously** Janshree Bima Yojana –Unorganized workers “group insurance but merged with AABY (2012).
- Administrative control of this AABY scheme? Previous with DFS, now with Labour Ministry (2017)

10.3.3 PM schemes for Life Insurance & Accidental (Gen) insurance

Table 1: 2015: Dept of _____ launched these two schemes.

Features	Pradhan Mantri (PMJJB)	Pradhan Mantri (PMSBY)
Age	18-50 years with Bank account in India. NRIs eligible but payment in rupee currency only.	18-70 years. Remaining same as PMJJB
Purchase from	LIC or any empaneled pvt. life insurance company.	4 Public Sector, or any empaneled pvt Gen. Insurance company.
Premium amount	Rs. ____ per person/ annum	Rs.12/- per person/ annum
Type	LIFE Insurance	General Insurance
Nature of Plan	1 year “term” insurance. Term LIFE insurance = no death, no money returned	1-year “term” accident cum death.
Return?	Any type of death: ₹_ lakhs	Accidental Death: murder, natural disaster etc. ₹2 lakhs - 1 eye/hand/leg: 1 lakh - 2 organs/>: max. 2 lakhs Suicide, alcohol-drugs related death: not eligible

Neither scheme gives hospitalization cost.

10.4 GENERAL INSURANCE (सामान्य बीमा)

An insurance policy other than ‘life insurance’, is called General Insurance. e.g. Accident insurance, health insurance, crop insurance, fire-theft-marine & vehicle insurance.

10.4.1 Public Sector General Insurance Entities

- 1948-52: Employees' State Insurance Corporation (ESIC) under Labour Ministry – through an act of Parliament to protect selected category of workers.
- 1957: Export Credit Guarantee Corporation of India (ECGC) under Commerce Ministry. Gives insurance cover to exporters, and credit guarantee to Bank/NBFC who loan to exporters.
- 1961: DICGCI Act: banks must take deposit insurance from it- covers up ₹1 lakh. Although not considered a General Insurance Company in textbook sense because doesn't directly sell insurance policy to any individual household/business firm.



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- 1972: General Insurance Nationalization Act: 107 (private) general insurance companies were taken over by GIC and its 4 subsidiaries (viz. National insurance, New India Assurance, United India, Oriental). Later, Govt took direct control over these 4 subsidiaries, and left GIC to take care of re-insurance biz.
- 2002: Agriculture Insurance Company Ltd, (formed with funding of GIC, above 4 public sector Gen. Insurance Cos and NABARD.)

10.4.2 Employees' State Insurance Corporation (ESIC कर्मचारी राज्य बीमा निगम)

- 1948: Employees' State Insurance Act -> 1952: ESIC corporation under Labour Ministry.
- Where does it apply? Any establishment with 10/> employees.
- Who are the ESIC subscribers? Employee in above establishment, with salary less than ₹21,000/-
- Who pays ESIC premium? "x%" from employee's wages, "y%" from employer's side.

An ESIC subscriber gets following benefits:

- 1) Medical insurance for the worker and his family from day 1 of joining
- 2) Maternity Benefit to women employees
- 3) Monthly payment to family, if worker dies by employment related injuries.
- 4) Sickness benefit: partial wages during medical leave.
- 5) Monthly payment of disability
- 6) Unemployment allowance if involuntary loss of employment

Project _____: digitization and automation of ESIC processes by WIPRO (2017), whereas **Project _____:** Modernization of India Post (2008)

MCQ [Asked in UPSC-Pre-2012] Consider the following:

- | | |
|-----------------------------|---------------------------------|
| 1) Hotels and restaurants | 2) Motor transport undertakings |
| 3) Newspaper establishments | 4) Private medical institutions |

The employees of which of the above can have coverage under ESIC?

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

10.5 GEN-> HEALTH INSURANCE SCHEMES (स्वास्थ्य बीमा योजनाएं)

10.5.1 Niramya Health Insurance

- **Boss?** By Dept. of Empowerment of Person with disabilities (दिव्यांगजन सशक्तिकरण विभाग)-> Insurance Company (Oriental).
- **Benefit?** upto ₹1 lakh health insurance for handicapped and mentally challenged.
- **Fee?** Orphan Minor PWD= ZERO; other PWDs: Rs.250-500, depending on poverty/income status**.

10.5.2 Rashtriya Swasthya Bima Yojana (RSBY: 2008)

- **Fee?** One time registration Rs.30. No premium by beneficiary. Govt pays premium.
- **Benefits?**
 - o ₹ 30k for medical treatment [smartcard, cashless: even existing ailment, even private hospital.]
 - o ₹ 25k for accidental death. And if Breadwinner dies: Rs.50 x 15 days.
- ++Senior Citizen Health Insurance Scheme (SCHIS) –if 60/>:- they get additional 30k for treatment.
- Both RSBY and SCHIS are subsumed in PM-JAY (2018)



10.5.3 Ayushman Bharat

In last decade, in-patient hospitalization expenditure in India has increased nearly 300%. More than 80% of the expenditure met by out of pocket (OOP). So, rural households are forced to use household savings and borrowings = vicious cycle of poverty. So, Ayushman Bharat launched in Budget 2018, with two components:

- __ lakh Primary Health Care Centers (PHC) to be transformed into Health & Wellness Centres (स्वास्थ्य और कल्याण केंद्र). Free drugs, checkup, mother-child care etc.
- National Health Protection Scheme (AB-NHPS) -> Later renamed 'PM Jan Arogya Yojana (PMJAY)' and launched with Motto " _____ " from Ranchi, Jharkhand (2018, Sept). It has subsumed Senior Citizen Health Insurance Scheme (SCHIS) and Rashtriya Swasthya Bima Yojana (RSBY).

10.5.3.1 PM Jan Arogya Yojana (PMJAY, 2018)?

- What is given?** A FREE insurance cover upto ₹ _____ for secondary and tertiary hospitalization. All pre-existing disease covered from day 1. Pre and post hospitalization & medicine expenses. Cashless and paperless access [NITI partnered web portal with privacy protection]
- Beneficiaries?** Socio-Economic Caste Census (SECC) data-> _____ = ~50 crore people. No limit on family size or age of members.
[SECC: सामाजिक आर्थिक जाति जनगणना]
- Where to get treatment?** All public hospitals and empaneled private hospitals (by the respective States). Hospitals to have **Pradhan Mantri Aarogya Mitras** (PMAMs) to help patients with admin procedures. These PMAMs are trained using National Skill Development Corporation (NSDC) and Ministry of Skill Dev.

10.5.3.2 National Health Authority (राष्ट्रीय स्वास्थ्य प्राधिकरण)

- Originally it was "Agency", then restructured & renamed into "Authority" (2019, Jan).
- NHA oversees the implementation of PM-JAY, operational guidelines, collaborate with insurance companies & IRDAI, running web-platform etc.
- NHA is an 'attached (Adjunct) office' with health ministry. i.e. Health Min only looks after parliamentary matters like replying in question hour, tabling annual reports etc. thus giving NHA more freedom in day to day functioning.
- NHA has a CEO Dr. Indu Bhushan with status of Secretary to Govt of India.
- Above NHA, there is "Governing Board" Chaired by the Minister of Health & Family Welfare, and Members: NITI Ayog CEO, NHA-CEO & other govt officials and domain experts. States will be represented in the Governing Board on rotational basis.

10.5.3.3 State Health Agency (SHA)

- Each State to form a trust / society / Not-for-Profit Company / Nodal Agency -> that will act as SHA.
 - SHA can directly implement the scheme by themselves OR.
 - SHA can tie up with an insurance company to implement the scheme. Although these administrative nuances / modalities are not soIMP.
- Cost Sharing?**
 - Union bears 100% cost for UT without legislature.
 - Union: State = 60 : 40 for ordinary states
 - Union: State = _____ (for NE+3 Himalayan states viz. J&K, Uttarakhand, HP)



10.5.3.4 Challenges in PM-JAY?

- **Cooperative Federalism** (सहकारी संघवाद) spirit is missing. States have to sign MoU with Union to begin operations. But, W.Bengal already has state-govt sponsored "Swasthyasathi" scheme in State with similar features so CM Mamta has left PM-JAY (2019, Jan). Similar issues in other Non-BJP states.
- **Fiscal Challenges** (राजकोषीय चुनौतियाँ): Budgetary allocations insufficient. If govt borrows more money-> rise in fiscal deficit. Private hospitals may perform unnecessary surgeries & prescribe excessive amount of medicines to extract more money from govt.
- **Administrative Challenges:** Beneficiary identification, Doctor to patient ratio, Physical and IT infrastructure, transport & connectivity upto village level. Medical privacy of Patient- data may be leaked to pharma companies for their clinical trials and commercial motives.

10.5.3.5 Conclusion (PM-JAY)

- Sustainable Development Goal SDG#3 Ensure healthy lives and well-beings at all ages. PM-JAY is a right step in this regard, provided aforementioned challenges are addressed. OR
- Disease burden robs a poor person of his wages and savings. If aforementioned challenges are addressed, PM-JAY can greatly help in poverty removal and human development in India. OR
- If above challenges are addressed, PM-JAY can improve health outcomes, productivity and efficiency of Indian population, thus leading to improvement GDP and in quality of life.

10.6 GENERAL INSURANCE → OTHER THAN HEALTH INSURANCE

10.6.1 Pradhan Mantri Fasal Bima Yojana (2016)

- Against natural calamities, pests, diseases; Protects before, during and after harvest.
- Premium paid by farmers against the total insured amount: Rabi winter crops (1.5%) – Kharif summer monsoon crops (2%) – Horticulture & Commercial crops other than oilseed & pulses (—%). Remainder premium is paid by Union: State Govt (50:50). It's optional for States to join.
- It's compulsory for farmer to buy a crop-insurance IF he's taking crop-loan from banks
- **Nodal Ministry:** _____ ⇒ Public sector general insurance companies, and empaneled private sector insurance companies.
- **Challenges?** States not paying their portion, Pvt insurance companies not settling claims quickly.
- **Related Schemes?**
 - o PM Fasal Bima subsumed National Agricultural Insurance Scheme and Modified NAIS
 - o Apart from PM Fasal Bima, there is Restructured Weather Based Crop Insurance Scheme (RWBCIS, 2016)- protects against weather only. (so not pests/diseases).

10.6.2 Third Party Motor Insurance (थर्ड पार्टी मोटर इंश्योरेंस)

- Motor Vehicles Act (1988) requires all motor vehicle owners to purchase it.
- When your vehicle hits another vehicle, person or property-> that victim (third party) registers a case, gets compensation. IRDAI regulates premium rates & other norms.



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- Comprehensive Vehicle Insurance covers both third party as well as you & your vehicle against accident, vandalism, natural disasters etc but then it has higher premium than simple 3rd party-walla insurance.

10.7 RE-INSURANCE (पुनर्बीमा)

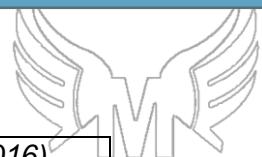
- DICGCI Act (1961) requires banks to take deposit insurance from DICGCI. Similarly, _____ Act (1938) requires insurance companies take 're-insurance' on their business.
- Previously, only _____ was the sole-reinsurer, but then norms liberalized (2015). New re-insurance cos allowed. e.g. India's ITI Reinsurance Ltd. Even foreign re-insurers such as Swiss Re, Munich Re, General Reinsurance (Warren Buffet) are permitted.
- **Benefits of multiple re-insurance cos?** GIC's monopoly in dictating re-insurance premium rates is gone. So, insurance cos' cost of operations to decline -> biz. expansion, launch innovative products etc.

10.8 IRDAI: THE INSURANCE SECTOR REGULATOR

Org	<ul style="list-style-type: none"> - 1996: IRDA setup-> given statutory status in 1999 - 2014: Its name changed to _____ (IRDAI: भारतीय बीमा विनियामक एवं विकास प्राधिकरण) - HQ: @Hyderabad, Telangana
Structure	1 Chairman: Dr. Subhashchandra Khuntia (IAS) (5/65), 9 members (5/62) = Total 10. They can be re-appointed.
Functions	<ul style="list-style-type: none"> - IRDAI gives separate licenses for life, general & re-insurance companies. - Prescribes norms for insurance companies for accounting, solvency, audit, commission to agents etc. It can penalize companies, suspend or cancel registration. Appeal-> _____ - Norms for Agents & brokers, banks selling products (Bancassurance), Surveyor/ Loss Assessor, and Third-Party Administrators (e.g. Hospital) - Consumer grievance redressal via Insurance Ombudsman. - IRDAI is member of Financial Stability and Development Council (FSDC).

10.9 CHALLENGES TO INSURANCE INDUSTRY

- 1) Capital intensive industry: Private players not generating enough profits esp. post-subprime crisis. Bleeding in commission rates and marketing
- 2) Products are not cheap, innovative tailormade policies not available for MSME. So, problem of Underinsurance= not taking sufficient insurance to cover losses.
- 3) Insurance agents need more skill, network than banker. For bankers- loan recovery easier (SARFAESI, I&B) compared to an insurance company that invested into shares/bonds of a failing company (like IL&FS).
- 4) Rural people: either disinterested / un-served despite schemes & IRDAI norms.
- 5) People hesitate in buying House / Factory / Fire / Theft insurance due to fear of discovery of 'asset value'- IT/GST raids & ransom demands. As a result, India's "insurance gap" is high i.e. total assets (in value) divided by insured assets (in value).
- 6) Insurance: Highly regulated, but Healthcare: highly unregulated, so supply demand mismatch: between (doctors-hospitals) vs. patients. Standardized treatment costs difficult to ascertain, unlike car damage. Delays in claim settlement= fewer repeat customers.



<i>Insurance _____ (3.5%, 2016)</i>	<i>Insurance _____ : less than Rs.60, 2016)</i>
(Total insurance premium / Total GDP)	Total Premium / Total population

For India, both indicators have improved in last decade, but both are low compared to many developing countries due to aforementioned challenges.

10.9.1 Should we increase FDI from present 49%?

Pro, yes we should raise FDI limits	No we shouldn't raise FDI limits
<ul style="list-style-type: none"> - Indian insurance companies will get additional capital from Foreign investors = this can help mitigating above challenges. - They can expand overseas, mobilize money from Bangladesh/Kenya etc. for Indian economy. - IRDAI prescribes “Investment pattern”, there is ombudsman for customer complaints. Further, Companies Act has norms for independent directors, auditing, whistleblower protection, CSR. So, apprehension that Foreign investors will cause mischief = unlikely. 	<p>Foreign investors will put pressure on Indian insurance companies to generate more profit. So</p> <ul style="list-style-type: none"> - speculative trading & investment in junk bonds that offer higher return =>Collapse. - Company may reject insurance claims for frivolous reasons to increase its profitability.

11 PENSION

11.1 EMPLOYEE PROVIDENT FUND ORG. (कर्मचारी भविष्य निधि संगठन)

- 1951-51: EPFO was setup initially by ordinance & then act. Nodal: Labour Ministry.
- EPFO governed by Tri-partite “Central Board of Trustees” त्रिदलीय केन्द्रीय न्यास बोर्ड -
 - I. Government (Union + state) – 15 nominees
 - II. Employers (Boss) - 10 nominees
 - III. Employees (worker) – 10 nominees
 - o They make policy decision about where to invest money (usually G-sec>C-Bonds>Shares; with minimum and maximum slabs) and they decide how much interest should be paid to subscribers.
- **3 schemes:** Provident Fund (1955), Deposit Linked Insurance (1976) & Pension (1995).
- EPFO subscribed **worker** has _____ (Universal Account Number) that remains the same even if he changes jobs. Whereas, **factory owner** has LIN (Labour Identification Number)- which he uses while uploading the compliance documents on _____ webportal of Labour Ministry.
- EPFO transactions can be done through both public and pvt sector banks and through Ministry of Electronics and Information Technology (MeitY)'s _____ App (Unified Mobile Application for New-age Governance).

11.1.1 2016: Pradhan Mantri Rojgar Protsahan Yojana (Labour Min)

- Private sector employers hire workers informally, but don't report them in official formal records lest they've to contribute to EPFO-funds under statutory norms, face harassment of EPFO officials.
- As a result, worker is hired informally, denied job-security & social security. Economic Survey 2015-16 diagnosed it as “EPFO Regulatory Cholesterol preventing formal-job creation.)



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- Hence, to encourage pvt companies to hire new workers ‘formally’-> Govt pays employer (Factory owners) portion for the first 3 years.**

EPFO applies to any establishment with 20/> workers**



But, our boss is not ‘showing on records’ that he’s recruited us. “we are Informal labourers”.



Well, its EPFO’s regulatory cholesterol that prevents me from hiring you “ON PAPER”

Salary is 15k/

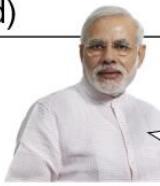
Employee: 12%

12% into EPF (Provident Fund)

Employer (Factory owner / Boss) co-contribute (12%)

3.67% EPF (Provident Fund)

8.33% EPS (Pension)



@Factory owner : “Formally” hire them on paper, & other new recruits, we’ll pay your side of contribution for first 3 years= *Pradhan Mantri Rojgar Protsahan Yojana*

11.2 PENSION FOR GOVT EMPLOYEES & MIDDLE CLASS?

Govt Employees (from 2004)	Middle Class (from 2009)
<ul style="list-style-type: none"> - New Pension Scheme- नवीन पेंशन योजना. - Subscriber? Those who joined govt. service on / after 01/01/2004** - Mechanism? Employees (10 % of basic pay) + Govt. contribution (14% of basic pay: since Interim-Budget-2019)->goes to PFRDA empaneled NPS-Fund-manager -> Invested G-sec, Corporate Bonds and Shares depending on your preference in Tier1/T2**. 	<ul style="list-style-type: none"> - Same scheme renamed into “National Pension System (NPS: राष्ट्रीय पेंशन प्रणाली)”, made open for all citizen (and NRIs) on voluntary basis. - 2010: NPS-Lite (Swavlamban): If poor person from unorganized sector joined NPS, then govt to co-contribute money for five years**.

NPS subscribers have _____: Permanent Retirement Account Number, Just like EPFO subscriber has _____ Number.

11.2.1.1 Jeevan Pramaan (2014)

- Previously, A pensioner (in any Govt / public sector org.) has to submit a physical Life Certificate in November each year to prove that he’s alive = hardship, bribery.
- "Jeevan Pramaan" – an "Aadhar-based Digital Life Certificate" by Ministry of Electronics & Information Technology (_____)
- pensioner's Aadhar number + biometric reading device-> PC, Mobile-> "Digital Life Certificate"-> submit to the authority -> pension released.



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11.3 PENSION FOR SENIOR CITIZENS WITH CAPACITY TO INVEST?

11.3.1.1 Pradhan Mantri Vaya Vandana Yojana (2017-DFS, LIC)

- Post-demonetisation, Banks were flush with deposits, so deposit interest rates were likely to fall -> so to protect the senior citizens' income government launched this.
- A ___ years / > senior citizen can join, latest by 31/3/2020.
- He can invest min. ~1.5 lakhs to maximum 15 lakhs.
- Guarantees ___ interest on investment, which results into a monthly pension of ₹1000-10000, for a period of ___ years. Then original amount returned. In between, if senior citizen dies then nominee (spouse, children) gets original amount back.
- If LIC can't generate guaranteed return, then Govt (DFS) to pay subsidy for shortfall.
- Other similar schemes: Senior Citizen Savings Scheme, LIC Varistha Pension Bima Yojana but they are old schemes so poor cost: benefit in preparing the difference / comparisons.

MCQ [Asked in UPSC-CDS-2019-1] Consider the following passage about a scheme : It was launched to provide social security during old age and to protect elderly persons aged 60 years and above against a future fall in their interest income due to uncertain market conditions. The scheme enables old age income security for senior citizens through provision of assured pension / return linked to the subscription amount based on government guarantee to Life Insurance Corporation of India (LICI). Identify the scheme.

Answer Choices:

- | | |
|--|---------------------------------------|
| a) Pradhan Mantri Swasthya Suraksha Yojana | b) Pradhan Mantri Vaya Vandana Yojana |
| c) Liveability Index Programme | d) Rashtriya Vayoshri Yojana |

11.4 PENSION FOR POOR PEOPLE WITH CAPACITY TO INVEST?

Yojana (APY)	Pradhan Mantri
By Dept of Financial Services, 2015	Interim Budget-2019.
Only 18-40 age Indian citizen residing in India (No NRI)	Scheme yet to be fully notified.
No minimum or maximum income limits. Mukesh Ambani can also join, but given that fact that maximum pension is ₹5,000 a month so target-audience is poor people, unorganized workers outside EPFO security.	unorganized sector workers with monthly income upto ₹_____. E.g. street vendors, rickshaw pullers, construction workers, rag pickers, agricultural workers, beedi workers etc.
Monthly pay ₹42-210 rupees till the age of 60	Monthly invest ₹55-100 (depending on age). Govt to co-contribute equal amount. Till the age of 60
₹____ monthly pension- depends on @which age joined, how much contributed?	Fixed ₹____ pension per month.
One person-1-subscription only.	Same
<ul style="list-style-type: none"> - If husband dies after 60, then wife continues to receive pension. - If husband dies before 60 age, wife gets premium OR if she continues to pay then she gets pension when she reaches 60. - Both die, then beneficiary (child) receives the entire principal (premium). 	Scheme yet to be fully notified, but we can hope for similar.



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MCQ [Asked in Prelim 2016] Find correct statement(s) regarding 'Atal Pension Yojana':

1. It is a minimum guaranteed pension scheme mainly targeted at unorganized sector workers.
 2. Only one member of a family can join the scheme.
 3. Same amount of pension is guaranteed for the spouse for life after subscriber's death.
- Codes: (a) 1 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

11.5 PENSION FOR POOR PEOPLE WITHOUT CAPACITY TO INVEST?

- For such Below Poverty Line (BPL) people, _____ Ministry's National Social Assistance Programme (NSoAP: राष्ट्रीय सामाजिक सहायता कार्यक्रम) in 1995, where direct money is given without asking for any premium.
- It's a core of the core scheme i.e. 100% paid by Union. It's optional for state govt. to contribute money in if they want to enhance the scheme's features:

NSoAP Components	Union	State (Optional to give extra)
Old age pension @60	₹200-500*	May give extra.. & rename it e.g. Samajwadi Pension
Widow pension 40-59	₹200	May give extra and rename it e.g. UP Vidhva Pension @1k
Disability pension: 18-59	Same as widow	e.g. Guj: Sant Surdas Scheme
National Family Benefit INSURANCE	Death of bread winner: ₹10k	e.g. Guj: Sankat Mochan (Total 20k)
Annapurna (2001)	If senior citizen uncovered in any other scheme 10kg grain / pm for FREE.	May give additional.. जोकि न बुर्जग खा भी कितना सकता है!

11.6 PFRDA, THE PENSION FUNDS' REGULATOR

Org	2003: executive order to setup PFRDA- Pension Fund Regulatory and Development Authority (पेंशन निधि विनियामक एवं विकास प्राधिकरण) 2013: given statutory status. HQ: _____, just like IBBI.
Structure	1 Chairman: Hemant G Contractor (5/65), 5 members (5/62) = 6 people. Can be re-appointed.
Functions	<ul style="list-style-type: none"> - Implement National pension system (NPS), select its fund-managers. - Regulate all public and private pension funds except EPFO, J&K, Seaman, Coal miners, Assam tea plantations related pension schemes as they've their separate acts / mechanisms. - Protect Clients, Pensioners - Prescribe Liquidity, auditing, investment norms for Pension funds. - Powers of civil court. Documentation, fin awareness - Pension FDI is linked with insurance FDI (49%) so not decided by PFRDA.



12 FINANCIAL INCLUSION (वित्तीय समोकेशन)

- **Financial Inclusion:** providing access to banking, investment, pension, insurance and credit (loan) facilities to each citizen. This ensures social, economic and transaction security (लेनदेन में सुरक्षा) (S-E-T), improves social harmony, women empowerment, helps reaping the benefit of “LESS CASH Economy” (Ref: Handout#1)
- **Social Security (सामाजिक सुरक्षा):** a system of payments / assistance by the government to citizens who are ill, handicapped, poor, aged or unemployed. The foundation of SS in our constitution @DPSP Article 41- State to provide public assistance to its citizens in case of unemployment, old age, sickness and disablement; and DPSP Article 42- The State shall make provision for securing just and humane conditions of work and for maternity relief.
- **Social Justice (सामाजिक न्याय):** distribution of wealth, opportunities, and privileges within a society- through reservation in jobs, admissions and election and through legal safeguards for protection of civil rights, prevention of atrocity and personnel laws.
<Homework: Write Constitutional Article No. & its provision keywords in margin>
- Collectively, these three (FI,SS,SJ) help in human development, inclusive economic growth and Sustainable Development Goals (SDG: सतत विकास लक्ष्य).

12.1 FINANCIAL INCLUSION: BANK ACCOUNTS FOR EVERYONE

- Nationalization of Banks (1955, '69, '80) → 1961: _____ Act → 1966 Cooperative Banks under RBI's Ambit → 1969 Lead Bank Scheme (SCB:Pvt or Public) given lead role in district → 1971 State level Bankers' Committee → 1976 Regional Rural Bank (RRB).
- Further, RBI requires commercial banks to setup atleast 25% of their branches in unbanked rural areas. Similar norms for White label ATM Cos.
- 2005: RBI permitted no-frills account with zero balance
- 2006: RBI permitted Banking Business Correspondent Agents (BCA)
- 2011: Government's Swabhiman to increase banking presence in rural area.
- 2013: eKYC permitted.
- 2014: JDY, new Private Commercial Banks (Bandhan, IDFC First), BMB
- 2015: Small Finance Banks and Payment Banks.
- 2017-18: India Post Payment Bank

12.1.1 Pradhan Mantri Jan Dhan Yojana (प्रधान मंत्री जन धन योजना)

- 2014: launched by Dept of _____, with two phases, 6 objectives:

PM JDY – phase I (2014-15)	PM JDY – phase II (2015-18)
1. Financial literacy 2. Banking within 5 kms 3. Account for every family with overdraft, with Rupay ATM-cum-DEBIT Card	1. Credit guarantee Fund (For Overdraft defaults) 2. Direct Benefit Transfer (DBT) 3. Sell Micro insurance & pension products through bank.

- PM-JDY bank account can be opened in any commercial or Cooperative Bank provided that (1) bank has CBS (2) bank is tied with _____ Payment Gateway.
- Basic Savings Bank Deposit Account - Age ____/>; Zero balance- no penalty. But, Chequebook only with “balance”;
- There are restrictions on max. number of money withdrawals per month.



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- Overdraft upto ₹_____ depending on balance history of min. 6 months. Overdraft given on only one account holder in household (preferably woman). Money has to be returned with interest within 3 years. Banks to decide the loan rate**.
- EVERY Jan Dhan account comes with FREE Rs.1 lakh Accident Insurance; Premium by _____, it's therefore necessary to regularly use card- atleast for checking balance. Union Government employees, and income tax payers not eligible for this free insurance.
- **Significance?** JAM trinity (JanDhan, Adhar, Mobile) for targeted and direct transfer of subsidies, scholarship and payments to beneficiaries.
- **Criticism?** PM-JDY accounts were used as money mules during demonetization.

MCQ [Asked in Pre-2015] Pradhan Mantri Jan-Dhan Yojana' has been launched for:

- (a) providing housing loan to poor people at cheaper interest rates
- (b) promoting women's Self-Help Groups in backward areas
- (c) promoting financial inclusion in the country
- (d) providing financial help to the marginalized communities

12.2 FINANCIAL INCLUSION: INVESTMENTS OTHER THAN BANK ACCOUNT

What if poor / lower middle-class person wants better returns than bank deposit rates? He may opt for...

Act	Small Savings Schemes: लघु बचत योजनाएं
<i>Govt Savings Bank Act 1873</i>	Post Office schemes: monthly, 5 year, savings, time deposit
<i>Govt Savings Bank Act 1873</i>	Senior Citizen Savings (2004)
<i>Government Savings Certi Act '59</i>	National Savings Scheme (NSC)'59
<i>Government Savings Certi Act '59</i>	Kisan Vikas Patra 1988-11, 2014
<i>PPF Act 1968</i>	Public Provident Fund (PPF)
<i>No Act.</i>	Sukanya Samridhi Yojana '2005

- Money (usually) goes into national small savings fund (NSSF)-> loans to Union and (selected States) with caveats not imp for us.
- Interest rates are decided by FinMin's Dept of _____ on quarterly basis.
- Individual eligibility, upper-lower limits etc. poor cost: benefit...except Sukanya Samridhi.

12.2.1 Sukanya Samridhi Yojana (2005)

- Parents open a (fixed deposit type) bank account in the name of a 0-10 years girl child, and deposit annually ₹____ to 1.5 lakhs till she reaches age of 14.
- FinMin's Dept of Economic Affairs announces interest rate (originally 9.1%, presently 8.5%)
- Money (principal and interest) can be withdrawn @ the age of 18-21** depending on whether married or not. So, it indirectly prevents child marriages & empowers the grown-up daughter with money to pursue higher education, small business etc.

12.2.2 Proposed Government Savings Promotion Act (in 2018)

It aims to merge (outdated) laws related to small saving schemes (ref: previous table)
Benefits?

- Easier withdrawal during medical emergency, college fees etc,
- Clarification on Minor account, PH people- guardian rights; Grievances redressal.



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12.2.3 Chit Funds (चिट फंड)

- Chit fund is a type of “contract” = subject to Concurrent list. So, UNION has Prize Chits and Money Circulation Schemes 1978, Chit Funds Act 1982; Further state have their own acts / rules / State regulator of Chit Funds.
- **Chit fund mechanism?** collective investment scheme wherein members make regular contribution to chit fund, and it's loaned to one of the members via bidding system. From this activity, chit fund manager gets fees, members earn profit (interest). ~~How does that work? How's that different from NIDHI companies (regulated by Ministry of Corporate Affairs) = B.com thing not. Imp. For UPSC.~~

12.2.4 What is Chit Fund Scam?

- Saradha Chit Fund scam, Rose Valley Chit Fund Scam: The scamsters ran multiple schemes in W.Bengal and neighbouring states, invested money in sharemarket, real-estate, shopping malls etc. thus violating the chit-fund laws.
- Further, any collective investment scheme of ₹100 cr/> requires SEBI permission. Yet they didn't obtain permission.
- They also engaged in Multi-level marketing (MLM) / Pyramid /Ponzy Selling = they'd use new investors' money to pay-off old investors. But once new investors stop coming, it'll collapse. ~~Further Modus Operandi / Timeline not IMP.~~
- **Action?** CBI & other agencies investigating. Union Govt proposed “Banning of Unregulated Deposit Schemes Bill 2018”, already covered in Bitcoin lecture.

12.3 FINANCIAL INCLUSION: PENSION & INSURANCE

Various schemes are given in previous sections: But just to quickly recall the notable terms:

12.3.1 Micro Insurance (सूक्ष्म बीमा)

- ⇒ Insurance policy may be Life / General Insurance with a very low premium.
- ⇒ When small sum insured (upto ₹50k) & target audience is poor / villagers / farmers. It may be an individual / group based insurance.
- ⇒ Intermediaries such as NGO, SHG, MFI help in selling such policy.
- ⇒ Policy/ Contracts are given in local language.
- ⇒ e.g. LIC's Jeevan Madhur and Jeevan Mangal

12.4 FINANCIAL INCLUSION: CREDIT (LOANS: ऋण)

12.4.1 Micro Finance Institutions (MFI: सूक्ष्म वित्त संस्थान)

- They give loan (upto ₹50k) to poor without collateral, flexible EMI; but interest rates higher than banks as MFI can't accept deposits- they arrange funds via banks/NBFC/AIFI & keep their profit margin in between.
- E.g. Bandhan (WB- got PvB license), SKS (Andhra), Cashpor (UP), Ujjivan (Karnataka).
- **Regulator:** RBI + Ministry of Corporate Affairs



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12.4.2 Priority Sector Lending (PSL), MUDRA, Standup and others

- **PSL:** Banks required to lend 40-75% of their loans to farmers, weaker section, MSME and other priority sectors as per RBI norms. *REF: Monetary Policy Handout.*
- **MUDRA Itd:** Shishu, Tarun, Kishor upto Rs.10 lakh. *REF: Bank Classification Handout.*
- **Standup India:** Each Bank Branch to give Rs 10 lakh and Rs 1 Crore loan to atleast 1 SC/ST, and 1-woman borrower for a greenfield non-farm enterprise.

12.4.3 Kisan Credit Card (1998)

- 1998: Launched by RBI +NABARD.
- Farmer gets credit card from PSB, RRB, State Cooperative Banks.
- Can swipe it to buy farm inputs (seeds, fertilizers, pesticides etc.)
- Can withdraw cash (as loan).
- Money to be repaid with interest. Accidental insurance also given.
- **Budget-2018:** Kisan Credit Card (KCC) extended to Animal Husbandry and Fisheries farmers. Interim-Budget-2019: they (animal/fisheries-walla) too will get the interest subvention
- **Interim-Budget-2019:** comprehensive drive with a simplified application form to get all farmers under KCC cards.

12.4.4 Interest Subvention (ब्याज सहायता)

Government pays part of the interest rate for borrower. (farmer, MSME, affordable housing etc) such as:

- Farm loans upto 3 lakhs-> 9% MINUS 2% (to all farmers) MINUS 3% (regular paying farmers)= only 4% interest rate farmer has to pay.
- **Interim-Budget-2019:**
 - o KCC-card-walla Animal Husbandry and Fisheries farmers also eligible.
 - o If natural disaster- then crop loans are rescheduled, we'll streamline the subvention norms there.
 - o **MSME:** incremental loans upto ₹1 crore to GST registered MSME industry= % subvention. (As such already announced by Modi last year)

12.4.5 Credit Guarantee (ऋण अदायगी गारंटी)

- **Meaning?** if borrower defaults, then losses of banks/NBFCs will be covered by credit guarantor. So, Bank/NBFC may lend without requiring borrower to pledge collaterals.
- Earlier DICGCI used to give credit guarantee for PSL borrowers, but now this work is done by organizations such as:

Organization	Credit Guarantee Fund	Loans covered
SIDBI + Govt	Credit Guarantee fund trust for Micro & Small Enterprise (CGTMSE)	Loans to Micro & Small Enterprise
Dept. of ___	National Credit Guarantee Trustee Company (NCGTC)	, Skill & Education loans
-- Ministry	Export Credit Guarantee Corporation of India fund (ECGC)	Exporters

12.4.6 Co-origination of (PSL) loans (2018, Sept: ऋण की सह-उत्पत्ति)

- **Meaning?** Commercial Banks and NBFC-ND-SI can jointly pool money and lend to a PSL-borrower.
- **This is good for bank:** Saves their time in finding / approaching PSL-clients. Risk of NPA/default is shared with an NBFC.



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- **This is good for NBFC:** They've better network & intelligence of PSL-clients (Farmers, Small Entrepreneurs etc). and risk of default is shared.
- Hence RBI permitted in 2018-Sept, with caveats**.

12.4.7 Refinance (पुनर्वित)

- When an AIFI (or MUDRA) gives new finance to Banks/NBFCs based on the quantum of finance they (Bank/NBFC) have already given to end-borrowers. Usually works via the process of securitization of the previous loan papers.

12.5 FINANCIAL INCLUSION: CUSTOMER PROTECTION

Bank/NBFC (under RBI)	Finances (SEBI)	Insurance (IRDAI)	Pension
Ombudsmans: Bank, NBFC, Digital Transaction (given below)	_____ Portal-> SEBI->SAT	Insurance Ombudsman via IRDAI Act '1999, hear matters upto ₹30 lakhs. If higher claim then consumer courts / other courts.	<ul style="list-style-type: none"> - NPS: NSDL-> PFRDA. - If EPFO- then its internal machinery

12.5.1 RBI's 3 Ombudsman (ओमबड़समेन/ शिकायत निवारण अधिकारी)

	Banking Ombudsman	NBFC Ombudsman	Digital Transactions Ombudsman
When	1995	2018	2019
RBI designates a senior RBI official under	Banking Regulation Act, _____	powers to regulate NBFCs under RBI Act, _____	Act, 2007
Where does he sit?	21 offices across India	4@ Chennai, Kolkata, New Delhi and Mumbai, looking after respective zones.	Same as BO
Customer can file free complaint against	Any type of bank	<ul style="list-style-type: none"> - Any NBFC-Deposit-taking (e.g Mahindra, Jindal, Sriram), OR - Any NBFC with assets size of ₹1 billion & customer interface. <p>Although Exempt: Infrastructure finance/debt companies, Core Investment Companies, NBFCs under liquidation. (for them NCLT, SEBI-SCORE).</p>	Prepaid payment instruments, Mobile wallets, Apps, NEFT/RTGS and other digital transactions
For amounts	upto ₹20 lakhs	upto ₹10 lakhs	upto ₹20 lakhs
Penalty	Ombudsman can order penalty upto ₹1 lakh for customer's mental agony, waste of time and money		
Higher Appeal?	-----		



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12.6 FINANCIAL INCLUSION: INDIA'S PERFORMANCE (भारत का प्रदर्शन)

12.6.1 Global _____ Report 2018

- To measure financial inclusion levels, this report is prepared by Accion global NGO's Center for Financial Inclusion (CFI) & partners like Bill & Melinda Gates Foundation, Metlife foundation.
- **Ranking?** Columbia (1), India (4) among 55 nations.
- Report identified following challenges:
 - × full interoperability across payment systems. lack of financial literacy, no trust in financial system or buying insurance.
 - × digital divide, grievances redressal. extreme poverty, no surplus to save / invest.
 - × No land / property records-> access to loans is difficult.

12.6.2 Global _____ Database 2017: (released in 2018, April)

- By _____ with help of Bill & Melinda Gates Foundation
- Appreciated PM-Jan Dhan, now we are parallel to China. Financial inclusion helps bringing rich poor divide through targeted delivery of subsidies via J-A-M.

12.7 MOCK QUESTIONS FOR MAINS (250 WORDS)

- 1) Explain the significance of financial inclusion & social security for achievement of Sustainable Development Goals for India. भारत के लिए सतत विकास लक्ष्यों की प्राप्ति के लिए वित्तीय समावेशन और सामाजिक सुरक्षा के महत्व को समझाएं।
- 2) Discuss the significance of crop insurance and health insurance in eradication of rural poverty. Enumerate the notable initiatives of the Government in this regard. ग्रामीण गरीबी उन्मूलन में फसल बीमा और स्वास्थ्य बीमा के महत्व पर चर्चा करें। इस संबंध में सरकार की उल्लेखनीय कदमों की सूचि दीजिए।
- 3) How is Ayushman Bharat-PM-JAY different from the previous centrally sponsored schemes on health insurance? Identify the fiscal and administrative challenges in its implementation. राष्ट्रीय स्वास्थ्य संरक्षण मिशन इससे पूर्व की केंद्र सरकार द्वारा प्रायोजित योजानाओं से अलग कैसे है? इस योजना को लागू करने आनेवाली वित्तीय व् प्रशासनिक चुनौतियों को चिन्हित कीजिए।
- 4) (Asked in Mains-2016) Pradhan Mantri Jan-Dhan Yojana (PMJDY) is necessary for bringing unbanked to the institutional finance fold. Do you agree with this for financial inclusion of the poorer section of the Indian society? Give arguments to justify your opinion. प्रधान मंत्री जन-धन योजना (पीएमजेडीवाई) बैंकिंग से वंचित लोगों को संस्थागत वित्त /ऋण के दायरे में लाने के लिए आवश्यक है। क्या आप भारतीय समाज के गरीब वर्ग के वित्तीय समावेशन के लिए इससे सहमत हैं? अपनी राय को सही ठहराने के लिए तर्क दें।



13 PILLAR #2: BUDGET → AN INTRODUCTION

- **Fiscal Policy (राजकोषीय नीति)?** Fiscal Policy means the Govt. decisions regarding Government's taxation, expenditure, subsidies and other financial operations. Using fiscal policy, Govt influences the savings, investment and consumption in an economy to accomplish certain national goals such as income redistribution, socio-economic welfare, inclusive growth etc.
- **Budget (बजट)?** Budget is an annual financial statement containing estimated revenues and expenditures for the next financial year. Budget is the primary tool used by Govt to implement its fiscal policy.

MCQ. “Fiscal policy” means (UPSC-Indian-Engg-Service-2018)

- a) Balancing the revenue collection and expenditure
- b) Establishing equilibrium between demand and supply of goods and services
- c) Use of taxation, public borrowing and public expenditure by Government for purposes of stabilisation or development.
- d) Deficiency as an instrument of growth

13.1 THREE FUNDS RELATED TO BUDGET

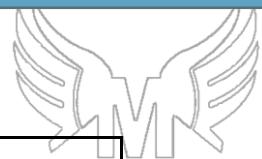
Art. ---	----- Of India संचित निधि	Incoming Taxes, loans raised, loans recovered. Withdrawal need Parliament Permission (- except for Charged Expenditure like Judges' salaries).
Art. ---	----- Of India लोक लेखा	Incoming provident fund, small savings, postal deposit etc. Govt acts like banker transferring fund from here to there so parliament permission not necessary. If separate fund is to be created for the first time, for a specific expenditure, then needs parliament permission to “create” it e.g. Central Road Fund Act 2000, where Road Cess on Petrol, Diesel would be deposited.
Art. ---	Contingency Fund of India आकस्मिकता निधि	Unforeseen events ₹ 500 cr by FinSecy on behalf of President. Parliament approval “subsequently” obtained, after expenditure. Money refilled from CFI.

MCQ-Prelims-2011. The authorization for the withdrawal of funds from the Consolidated Fund of India must come from:

- | | |
|---------------------------------|--------------------------------|
| (a) The President of India | (b) The Parliament of India |
| (c) The Prime Minister of India | (d) The Union Finance Minister |

13.2 THREE DOCUMENTS RELATED TO BUDGET

Budget comes from a French word 'bouquette' which means a leather bag. Finance Minister would keep the documents in it, & present to the parliament. While term 'budget' is not given in our constitution, but for each Financial Year, the Government is required to present:



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Art.	Annual Financial Statement (AFS: वार्षिक वित्तीय विवरण) containing receipt and expenditure of last year (and projections for the next year). The revenue expenditure must be shown separately from other expenditures.
Art.	Finance Bill (धन विधेयक) to obtain Parliament's permission to collect taxes. Parliament can reduce or abolish a tax but cannot increase it.
Art.	Appropriation Bill (विनियोग विधेयक) to obtain Parliament's permission to spend money from Consolidated Fund of India(CFI). Such expenditure can be of two types : <ul style="list-style-type: none"> - The expenditures 'charged' upon the Consolidated Fund of India e.g. Judges salaries: They can be discussed but they are non-votable & automatically approved. (भारत की संचित निधि पर भारित व्यय) - The expenditure 'made' from CFI. E.g. funds for a scheme. They're discussed and voted. (भारत की संचित निधि से किये गए व्यय)

- The finance bill and appropriation bill are considered money bills (धन विधेयक) under article _____. Therefore Rajya Sabha approval is _____, at maximum they can discuss it for 14 days and give suggestions to Lok Sabha for amendments, but it's not binding on the Lok Sabha to accept it.
- Sometimes, the ruling party does not have majority in Rajya Sabha to pass other type of ordinary bills (e.g. a bill to transfer NHB's ownership from RBI to Govt. or abolishing some low-profile statutory body or enacting some law to make Aadhar card compulsory), so ruling party packs those ordinary bills' proposals inside Finance Bill to get it approved without Rajya Sabha's obstruction.
- In such scenarios, whether a given bill is money bill or not? = _____'s decision is final [Art.110(3)] and it cannot be enquired by any Court (Art.122).

MCQ-Prelims-2013. What will follow if a Money Bill is substantially amended by the Rajya Sabha?

- a. The Lok Sabha may still proceed with the Bill, accepting or not accepting the recommendations of the Rajya Sabha
- b. The Lok Sabha cannot consider the Bill further
- c. The Lok Sabha may send the Bill to the Rajya Sabha for reconsideration
- d. The President may call a joint sitting for passing the Bill

MCQ-Prelims-2015: Find correct statement(s)

1. The Rajya Sabha has no power either to reject or to amend a Money Bill.
2. The Rajya Sabha cannot vote on the Demands for Grants.
3. The Rajya Sabha cannot discuss the Annual Financial Statement.

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



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13.3 SIX STAGES OF PASSING THE BUDGET

The budget goes through the following six stages in the Parliament:

1. _____ of budget (बजट का प्रस्तुतिकरण)
2. _____ Discussion (आम बहस)
3. _____ by departmental committees (विभागीय समितियों द्वारा जांच)
4. _____ on demands for grants, cut motions, guillotine. (अनुदान की मांग पर मतदान)
5. Passing of _____ Bill (विनियोग विधेयक का पारित होना)
6. Passing of _____ Bill (वित्त विधेयक का पारित होना)

For more, Self-Study from Indian Polity by M.Laxmikanth's chapter 22 on Parliament.

13.4 VOTE ON ACCOUNT- (लेखा अनुदान)

- The Constitution does not mandate any specific date for presentation of the Budget but it is presented to the Lok Sabha on such day as the President directs.
- Before 2017, it was presented in the last working day of February. Then it'll pass through aforementioned six stages- consuming all the time upto May month.
- But in between, on 31st March Financial year will be over so previous year's Appropriation Act's validity will be over. Then government cannot withdraw money from the consolidated fund of India even for the routine expenditure like staff salary, electricity bills. So, to avoid such crisis, government will put a motion for vote on account. Here, parliament (= practically Lok Sabha) will allow the government to spend some money from the CFI, till the Appropriation Act for next Financial Year is passed.
- Vote on Account is generally granted for two months for an amount equivalent to one-sixth of the total budget estimation.

Vote on Account is no longer necessary because

- Constitution has no compulsion to put budget on a specific date. So from 2017, Modi Govt. began tabling the budget on the first working day of February.
 - All the six stages are completed by the last week of March.
 - Appropriation bill gets passed and signed by President before completion of 31st March.
- So they do not require vote on account anymore (irrespective of what Yashwant Sinha or TheHindu believes).**

Similarly, under our Constitution,

- No compulsion to show _____ Budget separately. So, merged in 2017.
- No compulsion to show _____ Budget separately. So, merged in 2017.

13.5 INTERIM BUDGET (अंतरिम बजट)

- Our constitution does not define or require interim budget. But, during election year or extreme situation (E.g. when coalition government may collapse before its term) then it's considered immoral / unethical for such caretaker / outgoing Govt. to make drastic changes through budget like "1.5 x times MSP to farmer or 2-tola gold for the marriage of every BPL-girl."



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- So, while they'll present a budget in the regular fashion i.e. 3 documents(AFS, FinBill, Appro.Bill) & 6 Stages of Passing. But it (should) not have grand populist announcements. Such budgets are called Interim Budgets, and were presented in 2004 (Yashwant S.), 2009 (Pranab M.), 2014 (Chidambaram P.) and 2019 (Piyush G.)
- just like a regular budget, the Interim budget is valid for the whole financial year, however in between if new government is formed they may present another budget to change the things. E.g. 2014-Feb Chidambaram presented (interim) budget in 15th Lok Sabha, but then UPA/Congress defeated in general election→ 2014-July: Jaitley presented (general) budget in 16th Lok Sabha.

MCQ-Prelims-2011: difference between “vote-on-account” & “interim budget”?

1. The provision of a “vote-on-account” is used by a regular Government, while an “interim budget” is a provision used by a caretaker Government.
2. A “vote-on-account” only deals with the expenditure in Government’s budget, while an “interim budget” includes both expenditure and receipts.

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

13.6 ECONOMIC SURVEY (आर्थिक सर्वेक्षण)

- A (two volume) document prepared by Chief Economic Adviser (CEA) in the finance ministry. It shows annual data of past year and prospect / suggestions for the future years. There is no constitutional obligation to prepare or present it but usually it's labelled in the parliament a day before the Union Budget.
- 2019: No economic survey was presented before the interim budget. However, it's expected that after General Elections 2019 (in April/May), the new Govt may present a (general) budget with an economic survey.
- Similar case happened in 2014: Interim Budget without Economic Survey @Feb-2014, then (General) Budget with Economic Survey @July-2014.
- While Budget is labelled after next financial year, the Economic survey is labelled after previous Financial Year. e.g. The survey table on Feb-2018's is labelled as "Economic Survey 2017-18".

13.6.1 Chief Economic Advisor (CEA: मुख्य आर्थिक सलाहकार)

- Falls under Finance ministry's Department of ___
- Usual tenure 3 years, reappointment possible, but not a constitutional or statutory body. Has control over Indian Economic Service (IES)
- Notable CEAs in Past: Manmohan Singh, Raghuram Rajan, Arvind Subramanian (2014-18). 2018-Dec: _____ became the new CEA.



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13.7 FINANCE MINISTRY AND ITS DEPARTMENTS: (वित्त मंत्रालय और उसके विभाग)

Department (विभाग)	associated with
Department of _____ (आर्थिक कार्य विभाग)	<ul style="list-style-type: none"> - Preparation of budget, interest rates of small saving schemes. - Chief economic advisor (CEA) comes under this dept.
Department of Expenditure (व्यय विभाग)	<ul style="list-style-type: none"> - Controller General of Account (CGA: महालेखा नियंत्रक from ICAS service) prepares the estimate of how much money will have to be spent from the consolidated fund of India
Department of _____ (राजस्व विभाग)	<ul style="list-style-type: none"> - Central Board Direct Taxes (CBDT) - Central Board of Indirect Taxes and Customs (CBIC). Before-2018-March, it was known as Central Board of Excise and Customs (CBEC).
Department of _____ (वित्तीय सेवाएँ विभाग)	<ul style="list-style-type: none"> - Bank board Bureau, PSB recapitalisation, public sector financial intermediaries, financial inclusion schemes.
DIPAM	Department of Investment and Public Asset Management (DIPAM) (निवेश एवं लोक परिसंपत्ति प्रबंधन विभाग) looks after Disinvestment.

The highest official in each of these 5 department is called 'Secretary' (usually an IAS), and among those 5 secretaries, the senior-most is designated as the **Finance Secretary, who signs one rupee note.**

MCQ-Prelims-2015: Find correct Statement(s):

1. The Department of Revenue is responsible for the preparation of Union Budget that is presented to the Parliament.
2. No amount can be withdrawn from the Consolidated Fund of India without the authorization from the Parliament of India.
3. All the disbursements made from Public Account also need the authorization from the Parliament of India.

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



14 BUDGET → REVENUE PART → RECEIPTS → TAX RECEIPTS

बजट → राजस्व भाग → प्राप्तियां → कर प्राप्तियां

14.1 TYPES OF TAXES: DIRECT / INDIRECT: प्रत्यक्ष कर/ अप्रत्यक्ष कर

Parameter	Direct Tax (e.g. 5% Tax on your income)	Indirect Tax (e.g. 18% GST on purchase of Biscuit)
Incidence of Tax: Point from where government collects the tax. (करापात)	Income Tax Assessee	Shopkeeper
Impact of Tax: point where the burden of tax is ultimately felt and can't be transferred elsewhere. (कराधात/कर का प्रभाव)	Income Tax Assessee	Customer
The incidence and impact of tax is....	On the same person	Not on the same person.

14.2 TYPES OF TAXES: PROGRESSIVE VS REGRESSIVE VS PROPORTIONAL

Type of Tax	example
Proportional (समानुपाती)	If Govt. had a single flat rate slab 10% income tax irrespective of your whether you're middle class, upper middle class or a rich person. Then each taxpayers' same proportion of income will go into taxes.
Progressive (प्रगामी)	- 5%-20%-30% income tax slabs depending on your income. - Thus, richer the person, bigger proportion of his income will go into taxes.
Regressive (प्रतिगामी)	- 18% GST on Biscuits worth ₹100 = ₹18 paid as (indirect) tax. - When Mukesh Ambani buys one packet, and a poorman buys one packet, greater proportion of poorman's income is gone in taxes.

MCQ. Which one of following is a progressive tax structure? [UPSC-CDS-2015-II]

- (a) Tax rate is the same across all incomes
- (b) Tax rate increases as income increases
- (c) Tax rate decreases as income increases
- (d) Each household pays equal amount of tax

14.2.1 Adam Smith 4 canons of taxation (कराधान के चार सिद्धांत)

1. Canon of _____ (समानता का सिद्धांत): Tax should be equal /proportionate to income. Rich people should pay more taxes than poors.
2. Canon of _____ (निश्चितता का सिद्धांत): dates, slabs, % should be definite & told in advance. Randomly govt should not demand “x%” tax to build statue, temple or mosque.



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3. Canon of _____ (सुविधा का सिद्धांत): tax payer shouldn't be made wait for a mile long queue & fill up 50 pages worth tax forms.
4. Canon of _____ (मितव्यता का सिद्धांत): to collect 100 crore tax, govt shouldn't be spending 90 crores in salaries of tax officials.

MCQ-UPSC-CDS-2019-1: Which of the following canons of taxation was not advocated by Adam Smith?

- a) Canon of equality b) Canon of certainty
 c) Canon of convenience d) Canon of fiscal adequacy

MCQ-UPSC-CDS-2016-1: Find Correct Statements

1. Ability to pay principle of taxation holds that the amount of taxes people pay should relate to their income or wealth
2. The Benefit Principle of taxation states that individuals should be taxed in proportion to the benefit they receive from Government programmes
3. A progressive tax takes a larger share of tax from poor families than it does from rich families
4. Indirect taxes have the advantage of being cheaper and easier to collect

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

14.3 DIRECT TAXES: TYPES (प्रत्यक्ष करों के प्रकार)

Direct Taxes	of Union Govt. * Means Abolished	Of State Govt.
On income (आय पर)	<ul style="list-style-type: none"> - Corporation tax, Minimum Alternative tax (MAT) - Income Tax - Dividend Distribution Tax (DDT) - Capital Gains Tax (CGT) 	<ul style="list-style-type: none"> 1. Agriculture Income tax 2. Professional tax (Although Constitutional ceiling of maximum ₹2500 per year)
On assets, transactions (संपत्ति, लेनदेन पर)	<ul style="list-style-type: none"> - Securities Transaction Tax (STT) & Commodities Transaction Tax (CTT) - *Wealth Tax - *Banking Cash Transaction Tax - *Estate Duty 	<ul style="list-style-type: none"> 1. Land Revenue 2. Stamp/Registration duty 3. Property tax in urban areas
On expenditure (खर्च पर)	<ul style="list-style-type: none"> > *Hotel Receipt Tax, *Gift Tax > *Fringe Benefit Tax i.e. When the employer give benefits to employee apart from salary e.g. subscription to gymkhana or golf-club. 	

Interim-Budget-2019: (Expected collection-wise): _____

MCQ. Corporation tax is imposed by [UPSC-CDS-2013-II]

- (a) State Government (b) Central Government
 (c) Local Government (d) State as well as Central Government

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14.4 DIRECT TAXES: MERITS AND DEMERITS प्रत्यक्ष करों के लाभ व् नुकसान

Merits of Direct Taxes	Demerits
<ol style="list-style-type: none"> 1. _____ (समानुपाती: richer the person higher the tax) So, income inequality can be reduced 2. To encourage savings & investment: Income tax deduction/exemptions can be given on NPS/PPF/LIC policy etc. 3. Elasticity, quick results when raised / lowered. 4. Certainty (when and how) 5. Can reduce volatility in International currency exchange rates by imposing <i>Tobin Tax</i> on such transactions. (<i>More in Pillar#3</i>) 	<ol style="list-style-type: none"> 1. Collection expensive (IT staff salary, database Management etc.) so narrow base. 2. _____ (बाह्यता) not counted: Academic Books Company vs Film star promoting cigars [30% Tax on both]. 3. Hardship not counted: Working Carpenter [5%] vs sleeping landlord [5%] 4. High level of direct tax= laziness, less foreign investment. 5. Prone to litigation & loopholes, tax evasion, avoidance. (<i>More in Blackmoney Handout</i>)

14.4.1 Corporation Tax (निगम कर)

Levied on Company's profit, under the Income-tax Act, 1961. (Technically levied on "NET Income" but we're not here for CA-exam)

_ %	If Indian company's turnover is upto ₹250 cr.
_ %	If Indian company's turnover is higher than ₹250 cr.
_ %	foreign company's profit in India

- Additionally "x%" surcharge (अधिभार) amount on above Corporation Tax amount, depending on the company's turnover.
- Additionally 4% _____ cess (उपकर) on above [Corporation Tax + Surcharge] amount. (Before Budget-2018, there was only 3% Education Cess).
- *Related Topics: Laffer Curve, Base Erosion and Profit Shifting (BEPS)- in black money handout.*
- **Interim-Budget-2019:** Gave some tax benefits to real-estate sector for their unsold-inventories. Exact provisions not imp.

14.4.2 Equalisation Levy / Google Tax (समकारी लेवी/ गूगल टैक्स)

- If a foreign company makes profit in India, they have to pay 40% Corporation Tax.
- If an Indian businessman purchases digital advertisement slots in google-adsense / facebook = those (foreign) e-ad companies are making profit. But earlier, they did not pay tax on that profit, claiming this business activity (of displaying digital-ads) is done outside India on global servers.
- So, Budget-2016 imposed 6% tax on such income of foreign technology companies. Officially called "Equalisation Levy", unofficially nicknamed "Google Tax". It's not part



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of “Income Tax” or “Corporation Tax” under the Income Tax Act 1961, but a separate levy altogether imposed by the Finance Bill 2016.

- Foreign Company can't dodge it saying we're protected under the Double Taxation Avoidance Agreement in our home country.

MCQ-Prelim-2018: With reference to India's decision to levy an equalization tax of 6% on online advertisement services offered by non-resident entities, which of the following statements is/are correct?

1. It is introduced as a part of the Income Tax Act.
2. Non-resident entities that offer advertisement services in India can claim a tax credit in their home country under the “Double Taxation Avoidance Agreements”.

Answer Codes: a) 1 only b) 2 only c) Both 1 and 2 d) Neither 1 nor 2

14.4.3 Minimum Alternative Tax (MAT: न्यूनतम वैकल्पिक कर), since 1996

- Some industrialists use tax-deduction-exemptions-deprecations and accounting tricks to become “_____ Companies” & escape paying Corporation Tax. So,
- Budget-1996 (Chidambaram) introduced 18.5% MAT on book profit using a different type of formula. (~~What was the formula, not important~~)
- **Budget 2017:** not possible to reduce or abolish MAT at present.
- **Budget 2018:** If such company is in GIFT city IFSC, then for them MAT only 9%. (*We'll learn GIFT City-IFSC in Pillar#3.*)

14.4.4 Dividend Distribution Tax (DDT: लाभांश वितरण कर), since 1997

- Levied on a shareholder's dividend income. In reality, company (=source) will cut that much portion from shareholders' dividend, and directly deposit that portion to govt. as DDT.
- DDT Rate: 15% + cess + surcharge.
- **Budget-2018:** If equity-Mutual Fund then also 10% + surcharge + cess.
- Previously, big industrialists would form not for profit trust and transfer their dividend from company to the trust so to avoid tax liabilities but Budget-2017 tweaked the norms to fix this loophole. (~~How exactly, is not important~~).

14.4.5 Capital Gains Tax (CGT: पूँजीगत लाभ कर)

- When owner makes profit by selling his capital assets such as non-agro-land, property, jewellery, paintings, vehicles, machinery, patents, trademarks, shares, bonds & other securities- then he has to pay CGT.
- CGT is subdivided into _____ capital gains tax (LCGT: 20% दीर्घावधि) and _____ capital gains tax (SCGT: 15% अल्पावधि) depending on how long did the owner keep that asset before selling it.
- **Before-Budget-2018:** Listed companies Shares, Mutual Funds Units etc. were exempt from LCGT. But, since large amount of money is invested here and owners make good profits by selling them so government decided to apply the long term capital gains tax system on them as well @10%.
- In practice, the buyer will deduct that much portion from the payment to seller, and deposit to the government. However, some people form shell companies abroad & do transactions from there to avoid paying taxes to India.
- *Related Topics: DTAA, GAAR, Round Tripping, Angel Tax etc- in black money handout.*

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- **Interim-Budget-2019:** If person sells his house on profit, then he has to pay CGST. However, if he uses the profit to invest in two more residential houses in India, then no need to pay CGST. He can use this scheme only once in his lifetime. (Before Budget-2019, it was for only 1 new residential house.) Similarly the Income Tax computation on the notional rental income from second house also tweaked but we're not here for CA exam.

MCQ-Prelims-2012: Under which of the following circumstances may 'capital gains arise?

1. When there is an increase in the sales of a product
2. When there is a natural increase in the value of the property owned
3. When you purchase a painting and there is a growth in its value due to increase in its popularity

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

14.4.6 Income Tax on Individuals (आयकर) in Interim Budget-2019

Suppose gross income of an Indian Resident (age less than 60) is ₹9 lakhs.

- Out of this gross income, first we have to subtract the tax-deductions and tax-exemptions like income from agriculture, investments made in Provident Fund, NPS, LIC, Medical Insurance etc (upto a certain limit), house rent allowance (HRA), repayment of home/education loan, money donated in eligible charitable funds and so forth.
- Afterward subtracting such things, suppose taxable Income is: ₹5,50,000/-
- From this amount, Salaried individuals get standard deduction of ₹50000. (Previously, it was ₹40,000). So, ₹5,50,000 - 50000 = ₹5 lakh is the taxable income, THEN

Total Taxable Income: ₹5 lakh	Income Tax	Amount
Out of that upto 2.5 lakhs	0%	0%
From 2,50,001 to 5 lakhs = ₹2.5 lakhs left	5% of 2.5 lakhs*	-----
From 5,00,001 to 10 lakhs = ₹5 lakhs	20% of that 5 lakhs	N/A
From 10,00,001 & above	30% of that amount	N/A
	Total Income Tax	₹12,500
Minus Tax Rebate of ₹12,500 (if taxable income is upto ₹5l)**		-(MINUS) ₹12,500
Total Income Tax to be paid		—
Surcharge (अधिभार): 10%-15% surcharge on Tax amount, IF taxable-income is above ₹50 lakhs	0% of 0% =0%	
Cess (उपकर): 4% Health and education cess on (Tax + Surcharge). (Before Budget-2018, there was only 3% Education Cess).	4% x (0+0) = 0.	
Total payment to IT Dept: Income Tax + Surcharge + Cess		—

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- **Previously, rebate was ₹2500 if taxable income upto ₹3.5 lakhs but Interim-Budget-2019 raised it to keep middle-class voters happy before Gen. Elections.
- ***Before Budget-2017:** there were three tax slabs in income tax: 10%, 20%, 30%; After Budget-2017: 5%-20%-30%.
- Income tax slabs for senior citizens are slightly relaxed. e.g
 - **Age 60+** but less than 80 Years: upto 3l(0%), 3-5(5%)...remaining slabs are same as youngsters.
 - **Age 80+** years: upto 5l(0%)...remaining slabs are same as youngsters.

14.4.7 _____ (HUF) (हिंदू अविभाजित परिवार):

- A Hindu, Buddhists, Jains, or Sikhs family can come together, pool their assets and form an HUF under the Income Tax Act.
- HUF is taxed separately from its members, & helps saving taxes due to certain provisions/loopholes of Income Tax Act. How exactly? Ans. not here for CA exam.

14.4.8 _____ (प्रकल्पित कराधान)

- Salaried employees can easily compute their taxable income from their annual salary, & pay income tax.
- Companies hire full time accountants to prepare the balance sheets, compute income, expense and pay Corporation tax.
- But self-employed freelance consultants / professionals such as lawyers, doctors, fashion designers face difficulty in keeping such account books. So, for them Income Tax Act has Presumptive Taxation System (प्रकल्पित कराधान प्रणाली) i.e. their 'income' is computed as "x%" of their gross receipts, and on that amount they've to pay income tax (depending on slab 5%, 20%, 30%) + applicable cess and surcharges.
- To encourage less-cash-economy, Budget-2017 had given benefits in this presumptive taxation computation formula, If the entrepreneur received payments in cashless format (NEFT, RTGS, Cheque, Card etc..

14.4.9 _____ ? (अग्रिम कर)

- New financial year starts from 1st April 2019 and ends on 31st March 2020.
- If everyone paid all of their direct taxes at 11:59PM on 31st March 2020, then govt. will face money-shortage for the whole year till 31st March midnight comes.
- So, Advance Tax mechanism requires people to pay their Income tax and Corporation tax in advance-installments on quarterly basis (every 3-3 months), If their annual tax liability is ₹10,000 or more.
- *What is authority on advance ruling for direct taxes, Advance pricing mechanism, GAAR, DTAA? Ans. in Blackmoney Handout.*

14.4.10 _____ (TDS): (स्रोत पर कर कटौती)

- Suppose a college pays ₹10,000 to a freelance visiting faculty or a bank/NBFC/post-office pays ₹10,000 as interest to a depositor, then how to ensure that payment-recipient reports his income to the tax authorities?
- Hence, Income Tax Act requires such organizations to deduct a portion of the payment at source and deposit it to IT-dept. along with PAN card number of the recipient.



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- Then, payment-recipient will be forced to file his tax return, to unlock his TDS amount.
- TDS creates hardship for lower middle class persons, because part of their payment is cut in advance. So, in each budget, government will relax the norms to keep the voters happy. e.g. in Interim-Budget-2019, TDS threshold for interest earned on bank and post office deposits was raised from ₹20,000 to ₹40,000. It means that TDS will not be deducted unless your deposit interest income crosses this limit.
- Similarly, TDS threshold on house rent also tweaked.

14.4.11 ----- (TCS): (स्त्रोत पर संगृहीत कर)

- Mika Singh buys an SUV car worth ₹50 lakhs. How to ensure he is paying Income Tax regularly (apart from TDS mechanism)?
 - So, the car showroom owner (seller) is required to collect extra 1% from Mika (Buyer) and deposit to IT-dept. Mika will have to file tax-return to unlock this amount.
 - E-commerce sites also required to TCS before releasing money to merchants, Refer to GST subtopic of this handout.
- ~~Does this apply on used cars? Ans. we are not here for CA exam.~~

14.4.12 Tax refund? (कर वापसी)

- A person is eligible to receive income tax refund from IT-dept IF he has paid more tax to the govt than his actual tax liability. e.g. If college deducted 10% TDS from freelance visiting faculty payment, but what if he was in 0% or 5% Income Tax slab? Then, Income Tax Department will refund his money with interest.
- Similarly, GST refund can be claimed by an entrepreneur from GSTN webportal.

14.4.13 Financial Transaction Taxes (वित्तीय लेनदेन कर)

14.4.13.1 (Concept) Tobin Tax / Robinhood Tax

- 1970s: Nobel recipient American economist James Tobin proposed a small tax everytime currency is converted into another currency (e.g. \$ to ₹).
- Such tax will discourage short term speculative investment and flight of capital from one country to another = stabilizing the global economy and currency exchange rates. *More in pillar#3*
- In India, foreign currency conversions are subjected to (previously Service Tax) and now GST.

14.4.13.2 STT & CTT (प्रतिभूति लेनदेन कर और वस्तु लेनदेन कर)

- Securities Transaction Tax (STT: प्रतिभूति लेनदेन कर) is levied on the sale and purchase of shares, ETF-units, derivatives and other securities at stock-exchanges. Its rate (0.001%-2%) varies as per the nature of the securities.
- Commodities Transaction Tax (CTT: वस्तु लेनदेन कर) is levied on non-agricultural commodities traded at Commodities-Exchanges. Rate ~0.01%.



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14.5 UNION TAX, CESS AND SURCHARGE (केंद्रीय कर, उपकर और अधिभार)

Any Union Tax (संघ कर)	<ul style="list-style-type: none"> - Computed on taxable income, profit, transaction. Goes to _____ Fund of India → Later divided between Union and states as per the _____ formula. (except if IGST, then divided based on GST Council's formula.)
_____ (अधिभार)	<ul style="list-style-type: none"> - Computed on Tax amount. So, it is a 'tax on tax'. This amount will also go to Consolidated Fund of India. It is not divided with States using Finance Commission Formula. - Usually, surcharge will not have any clear objective in 'prefix', so it may be used for any objective. Exception is Budget 2018 that introduced 10% Social Welfare Surcharge (समाज कल्याण अधिभार) on the customs duty on imported goods. So, here the collected money will be specifically used for social welfare schemes of the Union.
_____ (उपकर)	<ul style="list-style-type: none"> - Computed on (Tax + Surcharge, if any). - Clear objective is mentioned. E.g. Krishi Kalyan Cess, Swachh Bharat cess, Road & infrastructure Cess, Health & Education Cess, GST compensation cess. - By default, it'll go to Consolidated Fund of India→ from there it may go to a specific fund in Public Accounts e.g. Central Road Safety Fund, Prarambhik Shiksha Kosh etc. - Cess is not shared with States using Finance Commission Formula. (Although some of cess money will go to states as a part of scheme implementation e.g. Sarva Shiksha Abhiyan, Pradhan Mantri Jan Arogya Yojana, PM Gram Sadak Yojana etc.) - GST Compensation Cess is shared with States, as per _____ formula. <i><More in the GST segment of this handout></i>



15 BUDGET → REVENUE → RECEIPTS → TAX → INDIRECT TAXES

बजट → राजस्व भाग → प्राप्तियां → कर → अप्रत्यक्ष कर

- Tax _____ (**करापात**) = @Person from whom govt collects the tax. (e.g. shopkeeper)
- Tax _____ (**कराधात/कर का प्रभाव**) = @Person who finally bears the tax & can't pass on further. (e.g. Consumer)
- In the indirect taxes, tax incidence and tax impact does not fall on the same person. E.g. Customs Duty on import and export, Excise duty on manufacturing of goods, Service tax on services, Sales Tax, Value Added Tax (VAT), and Goods and Services tax (GST).
- Indirect taxes fall under the Ambit of FinMin → Department of Revenue (राजस्व विभाग) → Central Board of Excise and Customs (CBEC): (केंद्रीय उत्पाद एवं सीमा शुल्क बोर्ड) → Budget-2018 it was renamed as Central Board of Indirect Taxes and Customs (CBIC): (केंद्रीय अप्रत्यक्ष कर और सीमा शुल्क बोर्ड)

15.1 INDIRECT TAXES: TYPES (अप्रत्यक्ष करों के प्रकार)

Ad- Valorem tax (यथामूल्य कर)	Specific Tax per unit (विशेष कर प्रति यूनिट)
Taxes based on the value of something. E.g. 35% Customs Duty on import of orange juice. So, if juice priced at ₹100 imported, then ₹35 as tax.	Tax based on quantity of items. E.g. ₹ 260 Excise duty on production of every 1000 cigarettes of 65-70mm length. Here we're taxing them irrespective of their manufacturing or selling price.
Easier to administer.	Difficult to administer, leads to inspector-raj & litigation. But, if slight increase in this tax, then greater burden passed on to the consumer so it helps reducing harmful consumption. (How exactly? Ans. microeconomics graph is not imp)

15.2 INDIRECT TAXES: MERITS AND DEMERITS (अप्रत्यक्ष करों के लाभ व नुकसान)

Merits	Demerits
<ul style="list-style-type: none"> → Convenient to collect. Wider base because everyone covered e.g. 18% GST on Biscuit. → Elastic (लचीला): small increase brings large revenue, because everyone is affected. → Can reduce harmful consumption by imposing higher taxes on cigar, alcohol, soft drinks & fast food. 	<ul style="list-style-type: none"> → _____ (प्रतिगामी) in nature, Both poor and rich taxed equally for the same item then poor people end up paying more portion of their income in indirect taxes. → Single point taxes (एकल बिंदु कर)=high level of corruption, evasion, cascading effect. e.g. sales tax.



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15.3 (CONCEPT) ----- TAX (पिगोवियन कर)

- An externality (बाह्यता) is a positive or negative consequence of an economic activity experienced by unrelated third parties. E.g. Cement company (related parties: labourers & consumers benefit); whereas unrelated third parties (local community, flora and fauna) are harmed by cement company's air-pollution.
- English economist Arthur C. Pigou proposed taxing the companies that create such negative externalities: e.g. polluting industries, cigarettes (passive smoking), alcohol (social disharmony).
- We **HAVE** high level of indirect taxes on petroleum, tobacco and alcoholic products.
- We **HAD** "Clean environment cess" on Rs 400 per tonne of coal (but abolished in GST-regime)

15.4 ----- EFFECT OF INDIRECT TAXES (अप्रत्यक्ष करों का सोपानी प्रभाव)

If a government levies 10% indirect tax everytime an item is sold then customer has **to pay tax on tax**. This 'cascading effect' of tax raises the price of final product. Observe,

Suppose,	Price	10% Tax on price	Total
Retailer bought from wholesaler	₹100	₹10	₹110
Retailer sold to customer with ₹10 profit	₹120	₹12	₹132

Breakdown the ₹132 paid by the final customer: $132 = 100 + 10 + 10 + 10 + 1$

- $132 = 100$ (price of original product) + 10 (tax paid by retailer to wholesaler) + 10 (as retailer's profit margin) + 10 (tax paid by customer to buy from retailer) + 1**.
- **1** this one rupee** is 10% of 10(tax paid by retailer to wholesaler). So, it's "TAX on TAX paid at previous stage" / cascading effect of tax on the end-customer.
- Then, both buyer and seller will prefer transaction without bills, to entirely avoid tax liability and its cascading effect → Govt.'s revenue collection ↓, Fiscal deficit ↑, black money ↑
- This problem can be solved, if government gives some type of cashback, reward points or input tax credit to the sellers, on the indirect taxes they've already paid in previous stage.
- To claim such input credit or reward, the sellers will have to show the bills/ invoices for each stage = self-policing = black money ↓.

15.5 INPUT CREDIT FOR INDIRECT TAXES (अप्रत्यक्ष कर पर इनपुट कर प्रत्यय)

Time	Who?	Reform in Indirect taxation
1944	Union	Central Excise Act (केंद्रीय उत्पाद शुल्क अधिनियम) to levy Excise duty on goods produced or manufactured in India. Abolished on most items after GST.



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1956	Union	Central Sales Tax Act (केंद्रीय बिक्री कर अधिनियम) to levy tax on inter-state commerce. In practice, CST was given to the source/exporting state from where goods went to the destination/importing state. Abolished after GST.
1962	Union	Customs Act (सीमा शुल्क अधिनियम) levy Customs Duty on import and exports <ul style="list-style-type: none"> - Budget 2018: Raised customs duty on a range of imported products—from fruit juice, perfumes, TVs, mobile phones etc. to encourage Make in India programme. It also introduced 10% Social Welfare Surcharge on imported goods. - Budget-2019: revised scheme for duty-free import of capital goods & machinery. Digitalization of export/import transactions for ease of doing biz.
1986	Union	Modified Value Added Tax system (MODVAT: केंद्रीय बिक्री कर अधिनियमसंशोधित मूल्य वर्धित कर प्रणाली) based on LK Jha Committee recommendations, Entrepreneur gets Input credit for Excise duty he already paid in previous stage E.g. Ratan Tata getting input credit for rubber, tires and steel he bought to make Nano car. But, he'll NOT get input credit for the States' Indirect taxes like Sale Tax/ VAT.
1994	Union	FM Manmohan Singh introduces 5% _____ Tax (सेवा कर) on telephone bills, non-life insurance and tax brokers. Over the years, more services were subjected to Service Tax, except those in "Negative List". Successive govt. also increased tax amount, and added Swachh Bharat Cess & Krishi Kalyan Cess on it. Ultimately, Service Tax+Cess =15% had to be paid. Abolished after GST.
2004	Union	Central Value Added Tax system (CENVAT: केंद्रीय मूल्य वर्धित कर) Entrepreneur gets Input credit for Excise duty and service tax he already paid in previous stage. But he'll NOT get input credit for the state taxes like Sale Tax/ VAT.
2005	States	<ul style="list-style-type: none"> - Previously, State governments levied sales tax on sale of goods however these rates varied from state to state, no input credit & therefore cascading effects & tax evasion. - From 2005 onwards, State governments begin replacing Sales Tax system with _____ (VAT: मूल्य वर्धित कर) wherein a dealer gets input credit for the VAT he already paid in the previous stage. But he'll not get input credit for Union's Indirect Taxes like Customs Duty, excise duty or Service tax. He'll not even get input credit for various other indirect taxes of the state like Luxury Tax, Entertainment Tax, etc. which were not been subsumed in the VAT. So cascading effect continued. - Uttar Pradesh was the last state to implement it from 2008.
2017	Both	From 1st July, 2017: Goods and Services Tax (GST: वस्तु एवं सेवा कर) became effective. Here, supplier gets input tax credit for (most of the) indirect taxes of Union & States that he paid in the previous stage.

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MCQ-UPSC-CDS-2013-I. Which of the following are direct tax in India?

1. Corporation tax 2. Tax on income 3. Wealth tax 4. Customs duty 5. Excise duty
Ans. Codes: (a) 1, 2 and 3 (b) 1, 2, 4 and 5 (c) 2 and 3 (d) 1, 3, 4 and 5

MCQ-UPSC-Pre-2014. The sales tax you pay while purchasing a toothpaste is a:

- (a) tax imposed by the Central Government
(b) tax imposed by the Central Government but collected by the State Government
(c) tax imposed by the State Government but collected by the Central Government
(d) tax imposed and collected by the State Government

MCQ. Which one of the following is not a feature of “Value Added Tax”? (Asked in UPSC-Pre-2011)

- (a) It is a multi point destination based system of taxation.
(b) It is a tax levied on value addition at each stage of transaction in the production-distribution chain.
(c) It is a tax on final consumption of goods or services and must ultimately be borne by consumer.
(d) It is basically subject of the central government and state government are merely facilitator for its successful implementation.

16 GST: TIMELINE (समयरेखा)

2004	Vijay Kelkar Task Force on Fiscal Responsibility and Budget Management (FRBM) recommends GST.
2006	In Budget speech, P.Chidambaram announces the launch of GST from 2010
2011	UPA government introduces 115 th Amendment Bill 2011 to implement GST lapsed with the dissolution of 15th Lok Sabha.
2014-16	Modi govt. introduces 122 nd Constitutional Amendment Bill 2014 in 16th Lok Sabha. Since GST aimed to change federal financial relations, hence as per Art.368 , this constitutional bill required: - @Union Parliament Lok Sabha and Rajya Sabha each: ___% majority of the total membership, and ___ majority of all members present and voting. - @State Vidhan Sabha: approval by Majority of state assemblies (i.e. 15 Vidhan-sabhas of India at that time) Ultimately, it passed & became ___ st Constitutional Amendment Act, 2016.



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16.1 ONE HUNDRED & FIRST 101ST CONSTITUTIONAL AMENDMENT ACT, 2016

101 वां संवैधानिक संशोधन अधिनियम, 2016 amended following articles in our Constitution.

246-A	<ul style="list-style-type: none"> - States given power to tax goods and services. (previously, they couldn't tax services.) - But only UNION will have the power to tax inter-state supply of goods and services in the form of "IGST"
268-A	Previously, this article empowered Union to levy Service Tax. But, since tax on services has been brought under GST, this article was deleted.
269-A	IGST (on inter-state trade) will be distributed between Union and states, as per the formula by the _____ (जीएसटी परिषद)
270	CGST (=new indirect tax of Union, which replaced Excise Duty & Service Tax)..this CGST will be distributed between union and states as per the formula by the _____ (वित्त आयोग)
----	President of India to appoint a constitutional body, "GST Council" (जीएसटी परिषद) headed by Finance Minister.
366	Alcoholic liquor for human consumption is kept out of GST. (i.e. State govt can levy State Excise on its production and State VAT on its sale.)

16.2 GST COUNCIL: COMPOSITION? जीएसटी परिषद

Union representatives (2)	States' representatives (31)
1. Finance Minister as the Chairman 2. Union Minister of State for Finance or revenue.	Each state government (including Delhi & Puducherry) can nominate one minister to GST council- it may be their minister of finance or Dy.CM or any other minister as per their wish. One of them will be selected as the Vice-Chairman of GST council.
Voting power: _____	Voting power: _____

- ✓ To pass any proposal, minimum ____ votes required in favour of the proposal.
- ✓ Council Meetings to proceed only with quorum of 50% of total membership.



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16.2.1 GST Council: Functions? They'll decide following-

1. List of indirect taxes, cess, surcharge of the union and states to be subsumed under GST-regime.
2. Decide the date from which Crude oil, Petrol, Diesel, Aviation Turbine Fuel and LPG will be put under GST regime. (Until then excise-VAT on these five hydrocarbon fuel products, will be unilaterally decided by Union and individual States).
3. Standard rates for GST (i.e. CGST, SGST and UTGST). $IGST = \{CGST + (SGST \text{ or } UTGST \text{ depending on destination})\}$
4. Special rates for GST, during natural disaster / calamity (if required. E.g. 2019-Jan, GST-Council also allowed Kerala to levy a 1% calamity cess on intra-state trade for next two years, for rehabilitation of 2018's flood-victims).
5. Integrated GST (IGST) system during interstate commerce, and its tax-sharing.
6. Norms related to GST registration of businessmen. If Bizman has turnover above "x" lakhs, he must register @GSTN online portal, he must collect GST from consumers and deposit it there. Originally the "x" was ₹20 lakhs for ordinary states; ₹10 lakhs for Sp.cat states**. However, in 2019-Jan the GST council doubled this limit to ₹40l & ₹20l respectively (Turnover limits are separate J&K but hairsplittery not REQ).
7. Protecting the interests of the special category states i.e. 8 North Eastern states and 3 Himalayan states (JK, Himachal and Uttarakhand.)
8. Compensation to the states for their revenue loss in switching over to GST (through Cess mechanism).
9. Dispute settlement mechanism between Union vs state(s), state(s) vs state(s).

So, Constitutional Amendment → set up GST council → GST council's meeting → laws passed by Parliament and Vidhan Sabhas, to implement the GST related mechanisms.

1. Parliament has passed:
 - ✓ Central Goods and Services Tax Act (CGST: केंद्रीय वस्तु एवं सेवा कर अधिनियम)
 - ✓ Integrated Goods and Services Tax Act (IGST: एकीकृत माल और सेवा कर अधिनियम)
 - ✓ Union Territory Goods and Services Tax Act (UTGST: केंद्र शासित प्रदेश माल और सेवा कर अधिनियम)
 - ✓ Goods and Services Tax (Compensation to States) Amendment Act. माल और सेवा कर (राज्यों को मुआवजा) संशोधन अधिनियम।
 - ✓ Parliament originally passed them 2017, later amended in 2018 As per the recommendations of the GST Council.
2. State Legislatures have passed State Goods and Services Tax Acts. (SGST:)
3. **Jammu & Kashmir** passed SGST Act on 8th July, 2017 → then GST system became effective there as well.



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16.3 GST INPUT TAX CREDIT (ITC: इनपुट कर प्रत्यय)

GST is a destination based indirect tax on consumption. It is applicable on supply of goods or services as against the previous indirect taxes that worked on the concept of manufacture, sale, exchange, transfer etc.

When Goods / Services (produced &) supplied →

in same the State (or UT without legislature) = Intra-state supply (अंतःराज्य)	in another State (or UT w/o LSR) = Inter-state supply (अंतरराज्यीय)
1. Union levies → CGST 2. State / UT without legislature levies → SGST / UTGST	1. Union levies IGST = CGST + (SGST or UTGST depending on destination). 2. From this IGST → CGST goes to Union, and the other portion goes to the Destination State/UT without legislature.

Suppose in Jan-2019: a Gujarat based Calendar printing company is doing following

Bought (Input) in 2019-January	Price ₹	CGST	SGST (Guj)	IGST, if inter-state supply
Printer from Mumbai @18% GST	1 lakh	N/A	N/A	18k
Ink from a factory in Guj @18% GST	10k	900	900	N/A
Paper from Himachal @12% GST	20k	N/A	N/A	2400
Total	1.30 lac	900	900	20,400

Suppose company manufactures (prints) and sells calendars @₹100 each, @12% GST

Sold (Output) in 2019-January	Price	CGST	SGST Guj)	IGST, if inter-state supply
500 Calendars within Gujarat	50k	3000	3000	N/A
500 Calendars to Rajasthan	50k	N/A	N/A	6000
Total	20k	3000	3000	6000

So, how much tax will the Calendar company have to deposit online at the GSTN webportal?

GST liability in 2019-January	CGST	SGST (Guj)	IGST
GST Taxes collected on Output (from wholesalers, retailers or customers)	3000	3000	6000
MINUS GST Taxes paid on Input (in previous stage for raw material, intermediate goods)	-900	-900	-20,400
=Company must deposit how much tax @GSTN webportal?	2100	2100	-14400**

** this is the input tax credit (ITC) company can use for offsetting its tax-liability in future.

- Suppose in Feb-2019, company did not purchase any inputs and sold 1,500 magazines in Tamilnadu @₹100 each = ₹ 1,50,000 + 18,000 (IGST) it must have collected from the Wholesalers/ retailers/ end-customers of Tamilnadu.



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- But in Feb-2019, Company need not deposit ₹18000 @GSTN webportal, because already it has ₹14400 IGST credit so Company only needs to deposit 18000 MINUS 14400= ₹3600.
- **Cross-utilization of ITC:**
 - IGST credit can be used for payment of all GST taxes.
 - CGST credit can be used only for paying CGST or IGST.
 - SGST credit can be used only for paying SGST or IGST.

If the goods or services are sold in union territory without legislature, then instead of SGST, they will levy UTGST but *the funda* will remain similar as above.

MCQ. Goods and Services Tax likely to be levied in India is not a [UPSC-CDS-2017-I]

- | | |
|---------------------|---------------------------|
| (a) gross value tax | (b) value-added tax |
| (c) consumption tax | (d) destination-based tax |

16.4 CENTRE'S INDIRECT TAXES SUBSUMED IN CGST

केंद्र के अप्रत्यक्ष कर जो केंद्रीय वस्तु एवं सेवा कर (सीजीएसटी) में सम्मिलित / विलीन हो गए

Indirect Tax of Union	Whether replaced by CGST?
For import-export: Basic Customs Duty, cess / surcharge on it. सीमा शुल्क और विभिन्न उपकर / अधिभार)	<ul style="list-style-type: none"> - No. Customs Duty is NOT replaced with GST. It's separate from GST-regime. - Previously, imported goods were subject to Customs Duty + education cess (शिक्षा उपकर) but Budget 2018 replaced it with Customs Duty + 10% Social Welfare Surcharge (समाज कल्याण अधिभार).
On imports: Special Additional Customs Duty (SAD), Countervailing Duty (CVD)	They're not 'replaced' with CGST, but simply abolished.
Central Sales Tax (CST-केंद्रीय बिक्री कर)	CST was the Union tax levied on sale of items in inter-state trade, and it was assigned to the 'Origin state'. It's replaced with IGST (= CGST + SGST)
On providing services: Service tax (सेवा कर) and Krishi Kalyan Cess and Swatchh Bharat Cess	Yes completely replaced by CGST. No cess / surcharge on it.
On manufacturing/production of goods: Excise duty and various Cess / surcharges on it.(उत्पाद शुल्क और विभिन्न उपकर / अधिभार)	<ul style="list-style-type: none"> - Yes completely replaced by CGST (except 5 hydrocarbon fuels petrol, diesel etc.) - Excise on manufacturing medicinal and toilet preparations containing alcohol (e.g. Cough syrups, deodorants and perfumes) also replaced by CGST. - Alcoholic Liquor for human consumption- falls in States' purview so Union Excise / CGST not applicable on it.

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Indirect Tax of Union	Whether replaced by CGST?
Excise duty on Tobacco products	<ul style="list-style-type: none"> - It's replaced with 28% CGST. Further, Union also levies + GST Compensation Cess + National Calamity Contingency Duty** (NCCD:-राष्ट्रीय आपदा आकस्मिकता इयूटी) on them - **because 101st Constitutional Amendment allows Union to tax tobacco products separately. - NCCD money goes to Public Account → National Disaster Response Fund set up under Disaster Management Act, 2005.
Excise duty on production/refining of Crude oil, Petrol (Motor Spirit), Diesel, Aviation Turbine Fuel and LPG: कच्चे तेल, पेट्रोल (मोटर स्पिरिट), डीजल, विमानन टरबाइन ईंधन और एलपीजी पर उत्पाद शुल्क	<ul style="list-style-type: none"> - Once GST council decides the date they'll be brought under GST-regime. Until then refineries / oil-drilling companies have to pay excise duty+cess/surcharges to Union for production / manufacturing of these items. (and petrol pump owner, LPG-distributors etc will have to pay VAT to states on their sale.) - Presently, Petrol & Diesel are also subjected to Union's Road and Infrastructure Cess (सड़क और बुनियादी ढांचा उपकर) which goes into Public Account→ Central Road & Infrastructure Fund setup under Central Road Fund Act 2000 (The word "Infrastructure" was added by Budget-2018).
Corporation Tax, Income Tax, Capital Gains Tax, STT, CTT	Arre Bhai, they're DIRECT Taxes of the UNION so not replaced by GST. The GST is meant to replace INDIRECT Taxes only!

Figures taken from Interim Budget-2019

Year	2017-18	2018-19	2019-20
CGST	2 lakh crores. (GST started from July 2017 hence low collection)	Originally projected 6 lakh cr but not revised projection of 5 lakh crores only.	6.1 lakh crores projected.



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16.5 STATES' INDIRECT TAXES SUBSUMED IN SGST

राज्यों के अप्रत्यक्ष कर जो राज्य वस्तु एवं सेवा कर (एसजीएसटी) में सम्मिलित /विलीन हो गए

Indirect Tax of State Govt.	whether replaced by SGST?
<i>On sale of goods: State Value Added Tax (VAT) (In some states it is also known as "Commercial tax")</i>	Yes, By default VAT is replaced by SGST, but read below:
<i>State VAT on selling of ___</i>	Once GST council decides the date they'll be brought under GST-regime. Until then, petrol pump owners, LPG gas distributors etc. will have to collect VAT (+ any cess / surcharges) from the customers and deposit to the state government.
<ul style="list-style-type: none"> - <i>State Excise on production of liquor for human consumption.</i> - <i>State VAT on sale of liquor for human consumption.</i> - मानव उपभोग के लिए बनी शराब के उत्पादन पर राज्य उत्पाद शुल्क। - मानव उपभोग के लिए बनी शराब की बिक्री पर राज्य टैट। 	No, they're completely kept out of GST. [unlike above petro items where GST council will implement it after "x" date]. Since inception of our Constitution, the power to tax liquor was with States, & it constituted a major source of revenue for them, so States were unwilling to hand it over in GST regime. Had Modi govt tried to bring liquor in GST-regime, then majority of the Vidhan-Sabhas may not have passed this Constitutional Amendment Bill.
<i>Electricity Duty बिजली शुल्क</i>	No, it's not replaced by SGST
<i>Road Tax on vehicles.</i>	No, it's not replaced by SGST
<i>Purchase tax on vehicle, boats, and animals- खरीद कर</i>	Yes replaced by SGST
<i>Advertisement tax on hoarding, banners etc.- विज्ञापन कर</i>	Yes replaced by SGST
<i>Luxury tax at Hotels, Spas, Resorts etc.- अस्याशी विलासिता कर</i>	Yes replaced by SGST
<i>Entry tax/Octroi for entry of goods in an area - प्रवेश के लिए कर, ऑक्ट्रोई</i>	Yes replaced by SGST
<i>Taxes on Lottery, horse race betting, gambling etc.</i>	Yes replaced by SGST. Since they're 'sinful/demerit goods', they're subjected to highest slab : _____
<i>Entertainment Tax on Cinema, Live Performance shows etc.- मनोरंजन कर</i>	Yes, replaced by SGST unless levied by a local body. e.g. Kerala local bodies 10% on movie tickets.

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Indirect Tax of State Govt.	whether replaced by SGST?
<i>Income tax on Agriculture, Professional tax, Property tax, Stamp Duty, Land revenue</i>	Arre Bhai, they're DIRECT Taxes of State so not replaced by GST. The GST is meant to replace INDIRECT Taxes only.

16.6 GST RATES ON SERVICES: सेवाओं पर जीएसटी की दर

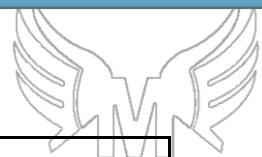
What is the difference between Nil rated vs Exempted? **Ans.** CA-giri = Poor cost:benefit.

<0% or Nil GST or Exempt on following services: List is not exhaustive>

1. Services provided by union government, state government, local bodies, constitutional bodies, department of post (except premium services like speed post), Railways (except premium services like first class AC ticket)
2. Services by Reserve Bank of India and other financial regulators.
3. Services by Banks/NBFCs in connection with Government sponsored banking, insurance and pension schemes. (Refer to financial inclusion handout)
4. ESIC, EPFO services to the subscribers
5. Religious, charitable activities, cooperative societies, Public libraries, Public toilets, Crematorium, Burial grounds.
6. Hotel room rent less than 1000 rupees per day, Rent on residential accommodation
7. Aviation Services in Northeastern States
8. Transport services to milk, newspaper, defence equipment, relief material during natural disasters etc.
9. Doctors, para-medics, Ambulance, Blood bank.
10. Agriculture warehouse, cold storage, renting of Agro machinery, Contractor who is supplying farm labourers, APMC (Agricultural produce market committee)
11. Agriculture pre-processing of food e.g. ripening, waxing, retail packing, labelling of fruits and vegetables which do not change or alter the essential characteristics of the said fruits or vegetables.
12. Veterinary doctor, Animal husbandry related services except race horses
13. Educational services by Educational Institutes (like schools colleges universities Vocational institutes. NOT COACHING Institutes)
14. Private training partners in government skill development schemes
15. Sports training and events by recognised sports body
16. Sports, Art, Culture etc. clubs with member-fees less than "X" rupees.
17. Circus, dance, drama or ballet, award function, concert, pageant, musical performance or any sporting event where admission fees is less than "X" rupees.
18. Admission to a museum, national park, wildlife sanctuary, tiger reserve, zoo, ASI-recognized Heritage sites.
19. Any service EXPORTED outside India (technically called "ZERO RATED Export")

In the Pre-GST era, many of above services were in the "**NEGATIVE LIST**" i.e. they were exempt from Service Tax.

If a given service is not in the above list, then it will be subjected to GST: <see next table>



Example of services (List not exhaustive)	If supplied in the same State or UT w/o LSR then	If supplied to another State or UT w/o LSR (: IGST)
plumbing, carpentering, Ads in print media, Ebooks	<ul style="list-style-type: none"> - Union gets 2.5% CGST - State/UT gets 2.5% SGST or UTGST 	IGST 5% (its bifurcation is same like left cell. Union gets half in CGST, and other half goes to "DESTINATION" State/UT as SGST/UTGST amount.)
<ul style="list-style-type: none"> - Accommodation in hotels, inns, guest houses with daily charges ₹1,000 to 2499/- - Movie tickets upto Rs. "x" (presently ₹100) 	Similar as above but 6+6	IGST 12%
<ul style="list-style-type: none"> - Real estate services, Coaching Services, - Ads in digital media, Legal and accounting services - DTH/TV channels, Movie tickets above Rs."x" 	Similar as above but 9+9	IGST 18%
Five Star luxury hotels, Gambling, Horse Race club, Casino	Similar as above but 14+14	IGST 28%

For more, you may refer to: <https://cbec-gst.gov.in/gst-goods-services-rates.html>

16.7 GST RATES ON GOODS : सामान पर जीएसटी की दरें

<0% or Nil GST or Exempt on following Goods: List is not exhaustive>

1. Fresh milk, Pasteurized Milk
2. Live animals (except race horses), poultry, pigs, shrimps, fishes, insects etc. and their "UNBRANDED" eggs, meat, honey, rawsilk etc. fresh products.
3. Fresh flowers, leaves, fruits and vegetables, unroasted coffee beans & tea leaves, Salt.
4. Unbranded grain crops/ cash crops like wheat, maze, rice, oat, barley, coconut, etc & their unbranded flour; seeds for sowing.
5. Bread (**except when served in Restaurant/ pizza)
6. Prasadam supplied by religious places.
7. Deities made of stone, marble or wood; Puja Samagri like Rudraksha, Panchamrit
8. Rakhi, Kumkum, Bindi, Sindur, Plastic / glass bangles without precious metal.
9. Fresh unpacked - water, coconut water, Non-alcoholic Toddy, Neera
10. Human blood, contraceptives, sanitary napkins, tampons, hearing aid
11. Electricity, Firewood
12. Judicial / Non-judicial stamp papers, Court fee stamps, ordinary post cards etc.
13. Printed Books, Maps, Cheque Books; Newspapers, journals and periodicals irrespective of whether they containing advertisement or not.
14. Khadi sold by Khadi and Village Industries Commission(KVIC) certified outlets



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15. Gandhi topi, Charkha, national flag, Earthen pot, clay idols
16. Agricultural hand tools like spade, axes, sickle.
17. When a constitutional / public authority auctions the gifts received by him.
18. Spacecraft, satellites and their launch vehicles.
19. Any Goods EXPORTED outside India (technically called “ZERO RATED Export”)

If a given goods is not in the above 0% list (and not kept out the GST-regime like *Petrol-Diesel-Daaru*), then it will be subjected to GST: such as:

Example of Goods (list not exhaustive)	If supplied in the same State or UT w/o LSR	If supplied to another State or UT w/o LSR (: IGST)
Diamond, Semi-precious stones like agate, amber, topaz, lapis lazuli etc.	Union gets 0.125% CGST State/UT gets 0.125% SGST or UTGST	IGST 0.25% (its bifurcation is same as left cell. But “DESTINATION” state/UT gets the SGST/UTGST portion)
Jewellery, Pearls, Gold, platinum, silver etc.	Similar as above 1.5%+1.5%	IGST 3% (funda same as above)
Milk powder, Baby food, Pizza bread, Mineral ores*, certain medicines	2.5%+2.5%	IGST 5%
Fruit Jams, Butter, Cheese, Canned Fish, Sugar cubes, Textile**, certain medicines & surgical items	_____	IGST 12%
<ul style="list-style-type: none"> ➤ Ice cream, cakes, biscuits; ➤ Soap, perfume, paint ➤ Electronics, Computer & Mobile accessories** ➤ Certain medicines ➤ Paint, Polish, Wax and similar petroleum products 	_____	IGST 18%
Luxury goods, Sin Goods, Demerit goods (विलासिता /पाप/ अवगुण सामान): <ul style="list-style-type: none"> ➤ Tobacco products, Pan Masala ➤ Cement, Granite, Marble ➤ Air Conditioners, TVs of “x” size ➤ Motor vehicles, Aircrafts, Yacht ➤ Guns, Lottery ticket. 	_____	IGST 28%
Alcohol for human consumption	-----	



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**Crude oil, Petrol (Motor Spirit),
Diesel, Aviation Turbine Fuel and
LPG**

- As of 2018-December, there are only 28 items left in the 28% slab. PM Modi has announced to bring 99% of the items in 18% or lower slab.
- **CAUTION:** As the elections come near, GST Council will bring down more items in lower GST-slabs to keep the voters happy, so above tables/lists are “not static”. Keep following the newspapers, and update as necessary. For more, you may refer to: <https://cbec-gst.gov.in/gst-goods-services-rates.html>

MCQ. Consider the following items:(Asked in UPSC-Pre-2018)

- | | |
|------------------------------|---|
| 1) Cereal grains hulled | 2) Chicken eggs cooked |
| 3) Fish processed and canned | 4) Newspapers containing advertising material |
- Which of the above items is/are exempted under GST (Good and Services Tax)?
- | | |
|---------------------|-------------------|
| (a) 1 only | (b) 2 and 3 only |
| (c) 1, 2 and 4 only | (d) 1, 2, 3 and 4 |

16.8 GST COMPOSITION SCHEME (जीएसटी संरचना योजना)

GST (Regular) scheme	GST Composition Scheme
If an industrialist or seller is registered with GST, he has to collect the taxes at above varying rates, and deposit them on the monthly basis at GSTN webportal.	Such monthly compliance is very tedious for small entrepreneurs / small merchants so they may opt for GST Composition scheme wherein instead of above (5-12-18-28%) rates they'll have to collect only flatrate GST of 1% on goods, 5% on restaurants, 6% on all services.
Good: He will get input tax credit, Bad: He'll have to deposit tax & forms on monthly basis @GSTN webportal	Bad: He'll _____ Input Tax Credit. Good: He'll not have to deposit tax/forms on monthly basis to GSTN webportal. He'll have to do it on Quarterly basis (3-3-3-3 months)
Compulsory if turnover is above “x” lakhs / crores.	Optional scheme, NOT compulsory. NOT every supplier is eligible. Only if turnover is below “y” lakhs / crores, and doing “z” type of biz, then you'll be eligible.

There are total ~1.30 crore GST registered suppliers, out of them ~17 lakhs have opted for Composition Scheme. (As of Feb 2019).

16.8.1 Tax Collection at Source on E-Commerce (TCS: स्रोत पर संगृहीत कर)

- Merchant Jethalal sells mobiles through Amazon @10k+18% GST.
- Customer pays 10k+18% GST to Amazon.
- Amazon is then required to deduct 1% of 10k & upload to GSTN portal, and gives (remaining amount+GST) to Jethalal. (=1% Tax collection at Source).
- If Jetha wants to get that deducted amount, he'll have to upload things at GSTN portal. TCS ensures nobody can evade taxes while _____

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- This norm became effective from 1st October 2018. Further CA/PHD not required like presently, 1% TCS but If GST council wants they may even order upto maximum 2%, and this is not applicable if turnover less than "x" or if supply is related with "y" category of services).

16.8.2 Reverse Charge Mechanism (विपरीत प्रभार की व्यवस्था)

- Normally, a seller has to collect the GST tax from buyer and deposit it to the government.
- However, in selected cases when seller is not registered with GST number, while buyer is registered with GST number, then buyer will have to deposit the tax to government.
- How / when / why = NOT IMPORTANT, EXCEPT the **MCQ word Association** that 'reverse Charge Mechanism' is associated with GST, just like 'E-way bill' mechanism is associated with GST.

16.8.3 E-way Bill System (ई-वे बिल प्रणाली) from 2018 onwards

- When goods worth ₹50,000/> are moved within a state (intrastate) or from one state to another (inter-state), then the truck/transport/cargo/shipping/aeroplane company has to generate E-way Bill from GSTN Portal / App / SMS.
- E-way bill's self-declaration (*that our truck is carrying "x" type of goods worth "y" value*) reduces the scope of bribery, delay, red-tape, harassment at the check post, thereby ensuring a hassle free rapid movement for transporters throughout the country.
- E-way bill system became effective from 2018.

16.8.4 Compensation to States: WHY? राज्यों को मुआवजा

- ✓ Recall Definition: GST is a destination based indirect tax on consumption of goods and services. (जीएसटी वस्तुओं और सेवाओं की खपत पर आधारित अप्रत्यक्ष कर है।)
- ✓ For the Union government, largest source of tax collection were corporate tax and personal income tax. Both are direct taxes and therefore kept out of the GST regime.
- ✓ For the state governments, VAT was largest source of tax income, but it is to be subsumed under GST, along with other indirect taxes, cess and surcharges levied by the states. Therefore, states were afraid their revenue income will decline.
- ✓ Secondly, GST is a Destination-based tax, therefore industrialized states are not happy with it. Consider a Nano car manufactured in Tata's Plant in Gujarat and sold in Uttar Pradesh. (Destination) UP gets SGST, While (Source) Gujarat gets nothing. Although reverse is also true- UP's bicycle sold in Gujarat, then Gujarat will earn SGST and UP will get nothing. But the industrialized states such as Gujarat, Maharashtra, Tamil Nadu, Haryana feared they'd get less SGST revenue in absolute terms compared to erstwhile VAT regime.

Notable States that witnessed revenue increase in SGST (compared to VAT)	Notable States that witnessed revenue decline in SGST (compared to VAT)
Andhra Pradesh and five NE states -- Mizoram, Andhra Pradesh, Manipur, Sikkim, Nagaland	Punjab, Himachal, Chattisgarh, Uttarakhand, J&K, Odisha, Goa, Bihar, Gujarat and Delhi and others.

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16.8.5 Compensation to States: HOW?

Parliament enacted GST Compensation to States Act 2017 (राज्यों को मुआवजा अधिनियम)

- ✓ Under its provisions, GST council recommended Union Govt to impose “**GST Compensation Cess**” (जीएसटी प्रतिपूर्ति उपकर) on specified luxury & demerit goods, like pan masala (60%), tobacco products (cess varies as per product), aerated water (12%), coal / lignite (₹400 per tonne), motor vehicles-aircraft-yacht (3-22% depending on type of vehicle). [These rates may change/update, but don't worry figures.]
- ✓ The cess thus collected is used for compensating States for their revenue losses during the first five years since inception of GST.
- ✓ The formula uses 2015-16 as base year to measure States' revenue.
- ✓ Liquor Taxes are outside GST-purview so Bihar / Gujarat / Nagaland / Lakshadweep / Parts of Manipur can't ask more ₹ for compensation from this fund for having liquor prohibition (मदयनिषेध).

Year →	2017-18	2018-19	2019-20 (estimated)
GST Compensation Cess प्रतिपूर्ति उपकर	62k crores	90k crores	1 lakh crores

16.8.6 GST Revenue Collection Figures: जीएसटी राजस्व प्राप्ति के आंकड़े

- GST registered suppliers have to deposit the GST at the GSTN portal on monthly basis (except some of them who opted for the GST composition scheme).
- In monthly collection of GST, there are ups and downs based on seasonality. Still, the average monthly tax collection was ₹ 89,700 crore per month (2017). It has improved to ₹97,100 crore per month (2018). (as per the Interim budget speech 2019).

Figures taken from Interim Budget-2019 (in ₹ crores)

Indirect Taxes of Union →	2017-18 (Actual)	2018-19- revised	2019-20 (Estimated)
CGST, IGST, GST Compensation Cess	4.4 lakh cr	6.4 lakh cr.	7.6 lakh cr.
- Excise Duty (petrol, diesel etc.) & their road infra cess - National Calamity Contingent Duty on Tobacco products	2.58 lakh cr	259612 cr	259600 cr.
Customs Duty & Social Welfare Surcharge	1.29 lakh cr	1.30 lakh cr	1.45 lakh cr

Interim Budget-2019 Projections for Union Taxes in Descending order of Revenue:

- Indirect taxes in ↓ order of revenue: _____ > _____ > _____.
- Direct taxes in ↓ order of revenue: _____ > _____ > _____.
- Direct & Indirect taxes: _____ > _____ > _____ > _____ > _____. [Before GST-regime, Corporation Tax used to be the highest source of revenue for Union].



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16.9 GST RELATED ORGANIZATIONS

We already learnt about the GST council in the previous pages of handout. Apart from that...

16.9.1 Group of Ministers (GoM: मंत्रियों का समूह)

These committees are set up by the GST Council to look into specific issues from time to time

(list not exhaustive) GoM headed by ↓	Objective ↓
2019-Jan: Nitin Patel, Dy.CM of Guj	Real Estate Sector's issues under the GST
2019-Jan: Sushil Modi, Dy.CM of Bihar	Identify the factors responsible for revenue shortfall in SGST faced by several states, & how to solve it.
2018-Sept: Sushil Modi, Dy.CM of Bihar	Modalities for revenue mobilisation in case of natural calamities and disasters.

16.9.2 Distribution of Admin. Responsibilities प्रशासनिक जिम्मेदारियों का विभाजन

	In Excise-VAT regime→	In GST-regime
Union	Central Board of Excise and Customs (CBEC: केंद्रीय उत्पाद एवं सीमा शुल्क बोर्ड) officials looked after the indirect taxes of the union, [They're recruited by UPSC and SSC].	<ul style="list-style-type: none"> Budget-2018: CBEC renamed into Central Board of Indirect Taxes and Customs (CBIC: केंद्रीय अप्रत्यक्ष कर और सीमा शुल्क बोर्ड) For tax-payers'with turnover below ₹1.5 crores: their supervision / administrative workload divided between union and state officials in 10:90 ratio. If turnover ₹1.5 cr/> then 50:50.
State	State department officials would look after the indirect taxes of the state, recruited by respective State PSC.	

16.9.3 _____ (NAA/NAPA)

राष्ट्रीय मुनाफाखोरी निरोधक प्राधिकरण

- GST provides input credit for most of the direct and indirect taxes of the Union and State Government. So, entrepreneur's cost of production should decline, then he should also reduce the prices for consumers, yet many companies have not reduced their prices e.g. Dominos Pizza,Nesle, Hindustan Unilever toothpaste, detergents etc.
- To teach them a lesson, To curb their profiteering, Union govt has **set up NAA under Central Goods and Services Tax Act, 2017.**
- Depending on the case, NAA can order the culprit company to 1) reduce the prices 2) refund money with interest to consumers 3) deposit money to Consumer Welfare Funds at union & state level 4) Impose penalty, cancel registration. Further appeal→ HC.
- This Authority shall cease to exist after two years from its inception, unless GST council renews it.



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16.9.4 _____ (AAR-अग्रिम फैसलों के लिए प्राधिकरण)

- Diabetic foods supplements are subjected to 12% GST whereas pasteurized milk is subject to 0% GST. Amul plans to launch 'Amul Camel Milk' with bottle label saying "Camel milk is easy to digest and is high in an insulin-like protein, hence beneficial for diabetic person." So, whether Amul's product be subjected to 0% GST or 12% GST? An entrepreneur would like to such have clarification from Tax authorities before starting the production, lest he gets tangled in raids and litigations afterwards.
- Hence CGST Act, 2017 provides for a **statutory body** called Authority for Advance Ruling (AAR), where entrepreneur can seek such advance clarification.
- **Higher appeal?** Appellate Authority for Advance Ruling (AAAR: अग्रिम फैसलों के लिए अपील प्राधिकरण).
- **Benefit?** reduces litigation & harassment afterwards → Ease of doing business (व्यापार करने में आसानी) → attract Foreign Direct Investment (FDI: प्रत्यक्ष विदेशी निवेश).

16.9.5 GSTN Network (Not for Profit Company- मुनाफ़ा रहित कंपनी)

2013: Goods and Services Tax Network (GSTN) "Not for Profit" Private Ltd. company was set up under the Companies Act.

Original Partners	Ownership from 2013-18	Ownership in future**
Union govt	24.5%	50%
All states of India (incl. Delhi & Puducherry)	24.5%	50%
Non-Government Financial Institutions such as HDFC Bank (20%), ICICI Bank (10%), NSE (10%), LIC Housing Finance (10%)	51%	0%

- ****2018-May:** GST Council approved acquisition of entire 51% equity held by non-Governmental institutions & distribute it equally between Centre and the State Governments.
- This company runs the GSTN online portal, where the suppliers register themselves, pay their GST, claim input tax credits, generate e-way bills etc. [Infosys Ltd. helped develop this portal.]
- GSTN Network Ltd. also provides the IT infrastructure and software services to GST officials for monitoring the tax compliance, issuing notices, data mining etc.
- In future, such data could also be shared with the RBI's _____ so the lenders can have a 360 degree profile / complete picture of the borrower's business.
[Homework: the Fill blank from earlier handouts by yourself.]
- **GST Suvidha Providers (GSPs):** These are selected private IT/Fintech companies that develop apps / softwares That help the taxpayers interact with GSTN portal.

16.9.6 Project Saksham: Digital/ICT integration (2016)

- Previously, the CBEC used to collect the excise and service tax online using a digital portal called ACES (Automated Central Excise & Service Tax).For Customs Duty they had another online portal called Indian Customs Single Window Interface for Facilitating Trade (SWIFT).



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- In GST-regime, service tax is completely subsumed; Union excise duty is applicable on selected items only (Petrol, Diesel etc), and Customs Duty is out of GST-regime. So accordingly, the previous portals, softwares and digital processes had to be re-engineered to align with the GSTN portal. So,
- **2016:** CBEC/CBIC launched, “Project Saksham” for Digital/ICT re-engineering/web portals’ integration.
- **2018: Indian Railways** also launched Project Saksham but with different objective of employees’ training and skill-upgradation for doing railway related work.
- Recall: **ESIC:** Project _____, **Postal Dept:** Project _____ [**Homework:** Fill blanks from earlier handouts by yourself.]

16.9.7 HSN and SAC Codes

- **Service Accounting Code (SAC)** are used for classifying services for GST rates. e.g. coaching services = SAC Code 999293 = 18% GST.
- **Harmonized System of Nomenclature (HSN)** developed by the World Customs Organization (WCO) is used for classifying goods for GST rates. e.g. Jarda scented tobacco = HAC code 24039930 = 28% GST.
- **Benefit?** HSN-SAC coding helps in accounting, billing, digitization, surveillance & big data analytics by Tax authorities.

16.10 PAN vs GSTIN

Difference	PAN: स्थायी लेखा संख्याक	GSTIN: वस्तु एवं सेवा कर पहचान संख्याक
Full form	Permanent Account Number issued by the Income Tax Department	Goods and Services Tax Identification Number issued by the Central Board of Indirect Taxes & Customs (CBIC, previously known as Central Board of Excise and custom CBEC)
example	Suzlon Energy Ltd: AADCS0472N	Suzlon Energy Ltd: 24AADCS0472N1Z8
Format	10 digit alphanumeric number (=containing both alphabets and numbers)	2 digit state code+ 10 digits PAN number + 3 characters = total 15 characters (=containing both alphabets and numbers)
Who has to get it?	Every income tax assessee-individual, HUF, firm, company, trust (internal different not imp.)	<ul style="list-style-type: none"> - IF Individuals / firms registered under the Pre-GST law (i.e., Excise, VAT, Service Tax etc.) OR - IF your biz. turnover is above a threshold limit of “x” lakhs for ordinary states or “y” lakhs in Sp.cat. States. OR - Merchants who sell through e-commerce aggregators like Amazon.
Do all taxpayers have it?	Every PAN card holder is not REQUIRED to have GSTIN. (e.g. a salaried employee)	Every GSTIN holder is required to have PAN card number. (Because its format is like that, observe “format” row above).

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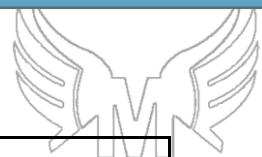


Difference	PAN: स्थायी लेखा संख्याक	GSTIN: वस्तु एवं सेवा कर पहचान संख्याक
How many numbers / cards can one have?	<ul style="list-style-type: none"> - Only 1 PAN number allowed per individual. - Only 1 PAN number allowed per company. - Subsidiary firms will have to get separate PAN numbers. 	<ul style="list-style-type: none"> - If firm operates from more than one state, then a separate GST registration is required for each state. - If a firm has multiple subsidiaries, they have to get GST number for each e.g. “Faith Hospitality Chain Ltd→ Sam’s Pizza restaurant, Sankalp Dosa restaurant, Saffron Punjabi restaurant”
Objective	Prevent the evasion of direct taxes.	Prevent evasion of GST, and help the entrepreneurs claim their input credits.

- PAN number is required for various activities like opening of bank account, opening of demat accounts (for trading in securities), obtaining registration for GST, VAT-Excise registration (for Petrol-Liquor dealers) etc.
- So, PAN is slowly becoming a Common Business Identification Number (CBIN) or simply **Business Identification Number** (BIN: सामान्य व्यवसाय पहचान संख्याक)- because if a Department knows your PAN number they can dig all information about you, know whether you’re eligible to fill up a particular tender or contract or a scheme application form or not?

16.10.1 PAN/GSTIN vs UID (=Aadhar Card)

PAN and GSTIN	UID (=Aadhar Card)
Issued by the direct and indirect tax authorities that function under Ministry of Finance.	issued by a Statutory body- Unique Identification Authority of India (UIDAI:भारतीय विशिष्ट पहचान प्राधिकरण) that functions under Ministry of Electronics and Information Technology (MeitY).
These Tax authorities derive powers from: <ul style="list-style-type: none"> - Income Tax Act 1961 - Goods & Service Tax Acts in 2017. 	Aadhaar Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (“आधार एक्ट 2016”)
Primary objective of these id-numbers is to reduce tax evasion by tracking the transactions.	Primary objective is to eliminate bogus beneficiaries in government schemes & reduce subsidy leakage. Auxiliary benefits: Identifying dead bodies, tracking criminals, mobile number ownership, tax evasion etc.
Their format contains both numbers and alphabets.	Unique Identification number (UID) or Aadhaar is a 12 digit number. No alphabets.
Issued for individual humans, HUF/firms/companies/trusts**.	Only for living resident HUMANS of India. Not given for companies.
One HUMAN → one PAN number only. No age limit. Minors can also join.	same



PAN and GSTIN	UID (=Aadhar Card)
<ul style="list-style-type: none"> - ~₹110 Fees to get PAN card. - No fees to get GSTIN 	No fees to get Aadhar. मुफ्त में मिलता है.
Compulsory to enroll (अनिवार्य है), if your income or turnover is beyond “x” rupees**.	Voluntary to enroll. आधार कार्ड बनवाना स्वैच्छिक है. अनिवार्य / बाध्यकर नहीं है. **
<p>They contain</p> <ul style="list-style-type: none"> - Name - Photograph & Date of Birth (in case of “Human”) - Address. 	<p>Demographic info:</p> <ul style="list-style-type: none"> - Name, Date of Birth, Gender, Address. - Mobile & Email (optional) <p>Biometric info:</p> <ul style="list-style-type: none"> - Ten Fingerprints, Two Iris Scans, and Facial Photograph.

Self-Study? Right to Privacy debate / judgement; Aadhaar virtual ID

16.11 GST: BENEFITS (लाभ)

- ✓ GST covers both goods and services, with standard rates, minimal number of cess/surcharges.
- ✓ GST online portal and e-way bill system reduces the interface between tax-officials and the assesses, thereby reducing the scope of harassment, bribery and Inspector Raj. (=Ease of doing business).
- ✓ GST provides input credits to suppliers thereby incentivizing them to sell with invoice at every stage. Thus, GST will expand our tax base and improve tax collection, and deter tax evasion.
- ✓ GST Input credit system reduces the cascading effect of taxes, ↓ cost of manufacturing & selling, while its anti profiteering authority ensures that such benefits are passed on to the customers in the form of reduced MRP.
- ✓ Federal nations such as Canada and Australia shifted from VAT to GST regime. It helped boosting their revenue, GDP and exports.

Before GST	After GST
Central Sale Tax (CST) was levied on interstate trade of goods. On the “trade” but not “transport”, so car companies, TV/Fridge companies would set up warehouses in multiple States to avoid paying CST.	<ul style="list-style-type: none"> - Company has no incentive to setup warehouses in every state, just to avoid tax burden. Because CST no longer exists and company will get IGST, SGST and CGST credits on their inputs= efficient logistics and transport. - Thus, GST will help to create a unified common national market for India, & catalyse “Make in India”
A car company would aim for “in-house production” of all necessary intermediate-goods and accessories (e.g. tires, windshield, car-stereo player) because if they buy those raw / intermediate goods from outside, they’ll	GST provides input credits in more efficient and comprehensive manner therefore, instead of trying to become Jack of all trades, company will pursue Ancillarisation, Subcontracting and Outsourcing to procure



Before GST	After GST
have to pay variety of taxes / cess / surcharges on which Input credit may not be available.	from MSME industry and freelance professionals.= More jobs.(अनुषंगीकरण, उपठेका और आउटसोर्सिंग)
Suppose, a mobile is manufactured at ₹10,000/- & is subject to 9% Excise duty and 9% VAT. Then - 9% Union Excise duty = 900. (calculated on base of 10,000) - 9% State-VAT = 981 (calculated on base of 10,900 after including excise duty).	Both CGST and SGST are computed on the same base (₹10,000), therefore tax burden on final consumer is less in GST regime, than in Excise-VAT regime. Thus, GST will reduce overall impact of tax on end-customer, so his purchasing power will improve, leading to more demand, more sales, more business expansion and GDP growth & jobs.
State government charged VAT on sale of goods, but VAT rates were not uniform throughout India. A laptop bag might attract 12%VAT in one state and 18%VAT in another. This provided scope for ‘rate arbitrage’ (दर मध्यस्थता) i.e. buying from another state for profiteering, even if same item available in home state. Then State government will have to deploy more officials at the check posts, leading to bribery, harassment, inspector-raj.	SGST/UTGST rates are uniform throughout India, so there is no scope of rate arbitrage. Whether you buy a laptop from Chennai or Mumbai the GST% tax rate will be same.

16.11.1 GST Benefit: Zero Rated Exports (शून्य रेटेड निर्यात)

- When company buys raw material or intermediate goods it will have to pay GST but if final product is exported outside India (or sent to Special Economic Zone/SEZ in India), it'll be subjected to 0% IGST.
- So, whatever GST the company had paid on the inputs, all of that will become its “Input Tax Credit” (and company can use this ITC to pay for the taxes on the purchase of raw material and intermediate goods in the next time), thus reducing its cost of production.
- This will improve price competitiveness of Indian products in foreign markets.
- Australia and other GST countries also follow similar “zero rated export” regime.

MCQ. What is/are the most likely advantages of implementing ‘Goods and Services Tax (GST)? (Asked in UPSC-Pre-2017)

1. It will replace multiple taxes collected by multiple authorities and will thus create a single market in India.
2. It will drastically reduce the ‘Current Account Deficit’ of India and will enable it to increase its foreign exchange reserves.
3. It will enormously increase the growth and size of economy of India and will enable it to overtake China in the near future.

Select the correct answer using the code given below:

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



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16.12GST: CHALLENGES FOR MAINS & INTERVIEW (चुनौतियां)

16.12.1 High Rates and Multiple Slabs (उच्च दर और कई स्लैब)

- If Union and States abolished existing indirect taxes (Excise, Custom and VAT), then their revenue income will obviously decline. Therefore, GST rate needed be high enough to sustain any fall in revenue collection. Such 'ideal' rate of GST, is called Revenue Neutral Rate (RNR). In, Singapore GST only 7%, Australia GST only 10%.
- Whereas in India we've 5-12-18-28% slabs. Many daily necessities are in 18% GST slab. Indirect taxes are regressive in nature & harm the purchasing power of poor families.
- Petrol, diesel, electricity are not subjected to GST regime yet, So, businessman cannot claim GST-input credit on them. Even when the crude oil prices are falling in the international market, the Union and State governments do not reduce their Union excise and state VAT on the petroleum fuels, which further aggravates the inflation and business cost.

16.12.2 Inconvenience to Small Traders (छोटे व्यापारियों के लिए असुविधा)

- In GSTN webportal, the traders have to deposit the GST on monthly basis, upload various forms & invoice details, generate e-way bills. While government has tried to keep these online forms/ mechanisms as simple as possible, but since many small traders are not proficient with computer, excel / accounting software, internet, digital payments- GST-compliance creates inconvenience to them, and forces them to hire full time accountants, raising their cost of operations. (**Counter:** Even in erstwhile VAT system they had to upload similar things so, it's not entirely new or alien system imposed upon them. Besides, they can opt for the GST composition scheme where they have to upload things on quarterly basis instead of monthly basis)
- GSTN server crashes often so traders can't upload things on time, and then they've to pay penalty for crossing monthly deadlines. (**Counter:** GST Council has reduced the late-fees, GSTN portal has been given technical upgrades to reduce the glitches/outages.)
- Malaysia scrapped GST in 2018 due to popular uproar against it, So it will not be successful in India either! (**Counter:** Malaysia had subjected all the goods and services to a flat rate of 6% and the opposition parties were blaming it for the inflation, and there were many political dimensions to the entire controversy. Whereas in India, we have kept many daily necessity goods at 0% to 5% GST. RBI has been successful in keeping the inflation within 2-6% CPI limit. GST is implemented through Constitutional Amendment so even if RAGA promises to "UNDO" this Gabbar Singh Tax, he'll have to go for another Constitutional Amendment to scrap the GST which is not so easy.)



16.13 CONCLUSION TEMPLATE: (SUMMARIZE /END ON POSITIVE NOTES)

1. (if asked to examine critically the challenges or obstacles in GST) Any new change is accompanied by difficulties and problems at first. A tax reform as comprehensive as GST is bound to pose certain challenges not only for the government but also for business community, tax authorities and even common. But ultimately, <write any of above benefits>
2. With the aforementioned features / benefits, GST will help India progress towards “ONE NATION, ONE TAX, ONE MARKET”. OR
3. Indeed, the introduction of GST is truly a game changer for Indian economy as it has replaced multi-layered, complex indirect tax structure with a simple, transparent and technology-driven tax regime. OR
4. Thus, GST eliminates cascading of taxes and reduces transactional and operational costs, thereby enhancing the ease of doing business and catalysing “Make in India” campaign.

16.14 MAINS QUESTIONS ANSWER IN 250 WORDS EACH

1. (Asked in GSM2-2017) Explain the salient features of the constitution (One Hundred and First Amendment) Act, 2016. Do you think it is efficacious enough ‘to remove cascading effect of taxes and provide for common national market for goods and services’? १०१ वे संविधानिक संशोधन अधिनियम, 2016 की मुख्य विशेषताओं को स्पष्ट करें। क्या आपको लगता है कि करों के सोपानी प्रभाव को हटाने और आम राष्ट्रीय बाजार बनाने के लिए यह पर्याप्तरूप से प्रभावकारी है?
2. With respect to ease of doing business in India, discuss the importance of following (1) E-Way Bill System (2) Authority for Advance Ruling. भारत में व्यापार करने में आसानी के संबंध में, निम्नलिखित के महत्व पर चर्चा करें (1) ई-वे बिल प्रणाली (2) अग्रिम फैसलों के लिए प्राधिकरण
3. “Is GST a boon or a bane?” examine critically from the small traders’ perspective. “क्या जीएसटी एक वरदान या अभिशाप है?” छोटे व्यापारियों के दृष्टिकोण से गंभीर रूप से जांच करें।



17 TAXATION → FINANCE COMMISSION (वित्त आयोग)

Article 280: President of India forms a Finance Commission (a quasi judicial body) every 5th Year or earlier, with 1 chairman and four members. Eligible for re-appointment.

Recommendations are not binding on the government but usually they are not rejected.

Further self-study@ M.Laxmikanth's Indian Polity ch.45.

14th FC: YV Reddy	Recommendation Period: 1st April, 2015 to 31st March, _____
15th FC: NK Singh	Recommendation Period: 1st April, 2020 to 31st March, _____

17.1 VERTICAL TAX DEVOLUTION FROM UNION TO STATES

संघ से राज्यों तक कर का सीधा हस्तांतरण

- Finance commission will recommend the vertical devolution from the 'divisible pool' of union taxes. (Here, CGST, Cess, Surcharge not counted.)
- 12th Rangarajan: 30.5%, 13th Vijay Kelkar: 32%, 14th Y.V. Reddy: __%, 15th NK Singh: __% (*Homework update when report is released*).

17.2 HORIZONTAL TAX DISTRIBUTION AMONG STATES

राज्यों के बीच समस्तरीयकर वितरण

Finance Commission also gives formula for How to distribute that share horizontally with individual States (Guj | Bihar | MH | TN...). 14th FC (YV Reddy)'s formula was...

14th FC horizontal distribution formula components		Weight %
आबादी	Population: as per Census 1971	17%
जनसांख्यिकीय बदलाव	Demographic Change as per Census 2011 (To consider the migration angle.)	10%
आय-दूरी	Income-Distance: <ul style="list-style-type: none"> - Find the best State of India in per capita income ($GSDP \div$ its population). - Compare your state's per capita income with them. Accordingly, poorer states get more weight	-- %
क्षेत्र	Area: more area more weight	15%
वन-आवरण	Forest-Cover: more forest cover more weight because of Opportunity cost (State can't allow industries there, else it could have obtained some taxes)	8%

Based on above formula, Highest to Lowest: _____ > Bihar > MP > WB > MH > Raj> > Mizoram > Goa > Sikkim.

17.3 GRANTS FROM UNION TO STATES संघ से राज्यों को अनुदान

Apart from the tax devolution and tax distribution, the finance commission would also suggest Union to give grant to the states (grant: NOT loan, so need not return with interest). 14th FC suggested three types of grants→



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1. **For All States:** Grants for Panchayati Raj Institutions (PRI) and Urban Local Bodies (ULB). These grants will be subdivided into two parts: basic grant and (10-20%) performance based grants.
2. **For All States:** Disaster Management Grants.
3. **For 11 (केंद्रीय राज्य) States:** Post-Devolution Revenue Deficit Grants for ~11 States.

17.4 FIFTEENTH FC COMPOSITION (SETUP IN 2017-Nov)

Chairman	----- (Retd. IAS, Ex-Member of Parliament)
Member1	----- (Retd. IAS, RBI Gov)
Member2	Dr. Anoop Singh, Professor
Member3 (Part Time)	Dr. Ashok Lahiri, Bandhan Bank
Member4 (Part Time)	Prof. Ramesh Chand. He's member of NITI Aayog & Agri Economist.
Secretary	Arvind Mehta (IAS)

Deadline? 15th FC has to give report by 30th October, 2019.

Validity? From 1st April, 2020 to 31st March 2025.

17.4.1 15th FC Terms of Reference (TOR: विचारार्थ विषय)?

President of India has ordered them to study and recommend following:

1. Union Taxes' Vertical devolution to the states, and its horizontal distribution among the states. (except cess, surcharge and CGST).
2. Union's grant-in-aids to the states.
3. How to augment State Govts' Consolidated funds to help their PRI/ULBs
4. Any other matters referred by the President of India such as:
 - ✓ Use Census-2011 for your calculation.
 - ✓ Keep in mind Union's responsibilities for New India 2022 vision.
 - ✓ Recommend measures for Fiscal discipline, Fiscal consolidation for the Union and State governments. Whether union government should continue to provide revenue deficit grants to States?
 - ✓ How to finance the disaster management initiatives?
 - ✓ Performance based incentives to the state governments?

17.5 15TH FC'S TOR: APPREHENSION OF THE STATES (राज्य आशंकावान क्यों हैं)

17.5.1 States Fear#1: New India 2022

- 15th FC is required to keep New India 2022 vision in mind (*wherein Modi government aims to double the farmers' income, provide housing for all, achieve 175GW of renewable energy etc.*).



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- 15th FC also required to keep in mind Union's additional burden regarding defence, internal security, infrastructure, railways, climate change, commitments towards administration of UTs without legislature etc.
- So, TOR indirectly implying that 15th FC should give less than 42% to state governments because union government needs more ₹ for aforementioned activities. So, Non-BJP states are angry- "Tax evolution is our constitutional right".

17.5.2 States fear#2: Performance based incentives (प्रदर्शन आधारित प्रोत्साहन)

15th FC will recommend performance-based incentives based on (list not exhaustive)

Performance parameter	Why states apprehensive?
<i>State's Efforts in expansion of GST tax-net</i>	<ul style="list-style-type: none"> ➤ Manipur can't do as much as Maharashtra in deepening the GST tax net, owing to the variety of economic, geographic and political factors (frequent bandh and blockades). ➤ Secondly, Constitution provides for a separate GST council with representatives of state governments. FC doesn't have state representatives.
<i>State's Efforts in achieving replacement level of population growth i.e. Total Fertility Rate 2.1 or lower</i>	Gangetic plain states' total fertility rate higher, so they're apprehensive that Kerala & other Southern States will get more money.
<i>State's Efforts in controlling the expenditure on populist measures (लोकतंत्रभावन उपाय).</i>	Southern states have been running populist schemes for free TV, Fridge, Mixer, farmers' debt-waiver, Idli at ₹ 1 etc. Similarly Northern states run schemes for free bicycle, mobile & laptop schemes. They fear they'll be reviewed negatively, and union will get to keep more money for itself.
<i>State's Efforts in controlling power sector losses</i>	Electricity theft is a rampant problem in certain Gangetic states but their ruling parties turn blind eye because of electoral populism. Now they are apprehensive of getting less money.
<i>Behavioral changes to end open defecation.</i>	States resent that Modi's Swatchh Bharat mission is 'imposed upon them'. FC devolution is their Constitutional right, and not an alms (खेरात) tied to their implementation of central schemes.

17.5.3 States fear#3: Census-2011 (जनगणना -2011)

- For horizontal distribution of taxes among states, 14th FC had used Census-1971 data. Census-1971 population was given 17% weight i.e. more populous state will get more funds.



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- 15th FC's Terms of Reference (TOR) requires NK Singh to use ONLY Census-2011 data. But, Southern states have reduced their fertility rate between 1971 to 2011, whereas Northern states could not- due to poverty, illiteracy and lack of healthcare infrastructure. So, Southern states fear Northern states will get proportionately more funds, if Census-2011 is used.

17.5.4 States fear#4: Debt and Grants (ऋण और अनुदान)

- Article 293: States can't borrow without consent of the Union. So, what additional conditions should the Union impose on the states when they (states) borrow from market / external sources? TOR even requires 15th FC to make recommendations in this regard. States fear it'll reduce their autonomy in raising loans from the market.
- 15th FC will also examine whether to abolish revenue deficit grants be given to the States.

17.6 15TH FC: CONCLUSION निष्कर्ष

- ✓ SDG#10 reduce inequality within and among the countries. SDG#16 requires nations to build effective, accountable and inclusive institutions at all levels. An equitable distribution of revenue tied with performance incentives will help greatly in this regard. Therefore, we should wait till 15th FC's final report is released, before judging its adverse impact on states. OR
- ✓ States have limited avenues for collecting direct and indirect taxes. Hence, they are more dependent on the union devolution, and apprehensive of any reduction due to TOR. Union finance minister and 15th FC Chairman have already tried to allay states' fears through letters and meetings. Picture will become clear when final report is submitted latest by 30th October 2019. OR
- ✓ Economic Survey 2016-17 had observed 'aid-curse' in context of Redistributive Resource transfer (RRT) i.e. over the years, Special Category States received large amount of funds via Planning Commission and Finance Commissions yet couldn't perform well in poverty removal or economic growth due to lack of accountability and poor governance. The 15th FC TOR aims to link the fund transfers with performance and accountability parameters. While states are apprehensive, but such measures are the bitter pills that we'll have to swallow eventually to improve India's human development and economic growth.

Error in Answer Writing: Don't digress to unsolicited suggestions & overthinking like "Southern states should help Northern states in their family planning programs."



17.7 FC vs PC vs NITI: WHAT'S THE DIFFERENCE?

Finance Commission (FC) वित्त आयोग	Planning Commission (PC) योजना आयोग	NITI Aayog
Constitutional body	Created by executive resolution, so neither constitutional nor statutory. Both headed by _____ as the chairman.	
1951: 1st FC setup under KC Neogy	<ul style="list-style-type: none"> - 1951: PC set up and over the years designed 12 Five Year plans (12th FYP: 2012-2017) - 2014: Dissolved by Modi Government. 	<ul style="list-style-type: none"> - 2015: Formed. - Three Year Action Agenda (2017-20). - Seven Year Strategy Document. - Fifteen Year Vision Document(2017-32).
<ul style="list-style-type: none"> - Taxes' Vertical Devolution and horizontal distribution among states. - + any other matters referred by the President in TOR - Each finance commission arrived at its own methodology. E.g. 14th FC: 42% vertical, and 5 factor formula for horizontal distribution. 	<ol style="list-style-type: none"> 1. How much money should union give to each state for implementation of centrally sponsored schemes (CSS)? 2. How much money should union government give to the five year plans of the state governments? <p>To answer these Qs, PC would use _____ formula (designed in 8TH FYP)-based on population, per capita income, special problems etc. of a state.</p>	<p>It is not in its scope of work to decide how much money should be given to each state. That component is decided by the Finance Ministry.</p> <ul style="list-style-type: none"> - NITI's primary objective is to serve as the think tank of the Government of India, - Helps in policy design. - Helps in monitoring schemes' implementation through its dashboard e.g. 'School Education Quality Index (SEQI)', 'SDG India Index' and the 'Digital Transformation Index' (DTI).

We will see more about planning commission and Niti Aayog in Pillar 4

17.7.1 Special category states? विशेष श्रेणी के राज्य?

- **1952:** The National Development Council was set up, consisting of PM, CMs and other representatives to approve the five year plans prepared by the Planning Commission. But became obscure with establishment of NITI Ayog.
- **1969:** 5th Finance Commission recommended giving extra funds and tax-relief to certain disadvantaged states. Over the years, NDC added more states into the Special Category List based on (i) hilly and difficult terrain (ii) low population density and / or sizeable share of tribal population (iii) strategic location along borders with neighbouring countries (iv) economic and infrastructural backwardness and (v) non-viable nature of state finances.
- Examples: 8 North Eastern states and 3 Himalayan States (JK, Uttarakhand, HP).
- **Benefits of Sp.Cat. States?**
 - ✓ If Industrialists set factories in these states, they'll be given benefit in Union Taxes.



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- ✓ In Centrally Sponsored Schemes, Union will bear higher burden (90:10).
- ✓ FC & PC would assign more weightage in their formulas to give'em more funds.
- **14th FC:** Previous Finance commissions would assign extra weightage & funds to Sp.Cat states, but 14th FC stopped this practice. But, whenever elections are near, W.Bengal, Bihar and Andhra CMs would demand Sp.Cat. status & blame Union for 'injustice'.
- **Economic survey 2016-17:आर्थिक सर्वेक्षण** Noted that Sp.Cat states have received lot of funds & grant from previous FCs and PCs, and yet they have not made any tangible progress in improving public administration or removing poverty (= "Aid Curse": सहायता का अभिशाप). Similar problem with States having abundant mineral resources ("Resource Curse": संसाधनों का अभिशाप).
- **Economic Survey 2017-18:** Noted that compared to Brazil, Germany and other countries with federal polity, India's state governments and local bodies are collecting less amount of tax for two reasons
 - (1) constitution has not given them sufficient taxation powers
 - (2) even where constitution gave them powers like collection of Agricultural Income Tax, Land Revenue, Property Tax- they are shy of collecting taxes for electoral politics. Hence States/PRI/ULBs unable to deliver public services satisfactorily e.g. Public Schools, Public Transport, Police, Drinking Water and Sanitation.

18 TAXATION → BLACK MONEY & ALLIED ISSUES

Tax Planning / Tax Mitigation कर-नियोजन	When person invests money in LIC/PPF/Pension funds etc.in such manner that he can claim various deductions available in the Income Tax Act. It's neither illegal nor unethical.
Black Money (काला धन)	----- (=concealed from the tax authority.).
Parallel Economy	The economy that runs on black money. (समानांतर अर्थव्यवस्था)
Tax Evasion कर अपवंचन	When person hides income or transaction from tax authorities, and thereby evades paying taxes. It's illegal.
Tax Avoidance कर परिहार	When person discloses his income and transactions to tax authorities but uses legal loopholes to avoid paying taxes. E.g. Bollywood stars who register digital media companies in Tax Havens. It may not be illegal in every case, but still unethical.
Tax Haven कर स्वर्ग	Is a country that demands little taxes from foreigners and offers legal loopholes for Tax Avoidance & opportunities for Tax Evasion. E.g. Liechtenstein, Mauritius, Marshall Islands, Cayman Islands, Panama, Nauru, Vanuatu etc. These countries are geographically small, & without viable



	economy. So they offer such mechanism to attract foreign investors and foreign tourists.
Money laundering (गैरकानूनी तरीके से प्राप्त धन को वैध बनाना / धनशोधन करना)	When drug trafficking, ransom, corruption and other criminal activity generates substantial profits, the person has find ways to spend / invest / hide the money without attracting attention. Money laundering is the process of disguising the source of money, as if it came from a legitimate activity, & then channelize it into banks, share market and other financial intermediaries.
Shell firms Post-box Letter-box companies	They do not have any active business operations, and are created with the sole objective of money laundering and tax evasion. E.g. Ms Mishail Packers and Printers Pvt Ltd. setup by Misa Bharti Yadav to launder ₹1.2 crores (as per Enforcement Directorate).
Panama Papers (2016) Paradis Papers (2017)	German Journalists released these incriminating documents from certain law firms in tax havens & showed how notable people across the world engaged in tax avoidance/ evasion. Bachchan & Aishwarya also named in them.
Tax Terrorism कर आतंकवाद	Happens when tax authorities put undue pressure on an honest taxpayer to pay more taxes. 2012: Vodafone won a case against income tax department in the supreme court related to Capital Gains Tax on purchase of Hutch mobile company. Afterwards, UPA government amended the income tax act with retrospective effect and issued fresh notices against Vodafone. So, Modi called it “UPA’s Tax Terrorism on Corporates”
TDS/TCS	Tax Deduction at Source (TDS) स्त्रोत पर कर कटौती Tax Collection at Source (TCS) स्त्रोत पर कर संग्रह These are the mechanism to discourage tax evasion.
PAN Card स्थाई खाता संख्याक	12 letters alphanumeric numbered assigned to all taxpayers in India by Income Tax Dept. Refer to GST Handout for more.

18.1 BLACK MONEY → NOTABLE ORGANISATIONS

Enforcement Directorate (ED: प्रवर्तन निदेशालय)	FinMin → Department of Revenue → ED is a Specialized financial investigation agency to enforce following laws 1. Foreign Exchange Management Act,1999 (FEMA) 2. Prevention of Money Laundering Act, 2002 (PMLA)
Directorate of Revenue Intelligence	FinMin → Department of Revenue →CBIC → DRI is an agency against Customs/Narcotics/Wildlife/Arms related smuggling & illegal activities. (DRI: राजस्व आसूचना निदेशालय)



Financial Intelligence unit (FIU-2004: वित्तीय आसूचना एकक)	It analyses the suspected financial transactions in domestic and crossborder levels & reports directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.
Financial Action Task Force (FATF-1989: वित्तीय कार्रवाई कार्यदल)	is a brainchild of G7, Combating Money laundering and terror finance. HQ@Paris. India became member in 2010.
OECD (1961:आर्थिक सहयोग तथा विकास संगठन)	HQ@Paris. Works for International cooperation in the matters of economy and taxation. Known for Base erosion and profit shifting (BEPS) Norms. India is a member.

18.2 TAXATION → TAX EVASION (HIDING INCOME / TRANSACTION)

18.2.1 (PMLA-2002)

धनशोधन निवारण अधिनियम

- 1998: UNGA declaration on Money Laundering. 2002 India enacts this law to combat money laundering, search-seizure-arrest-penalty. **Main agency?** Enforcement directorate.
- Cases are heard @ PMLA Adjudicating Authority (न्यायनिर्णयन प्राधिकारी) → PMLA Appellate Tribunal (अपीलीय प्राधिकरण).
- It also empowers the RBI, SEBI, IRDAI and other regulator to make norms for Banks/NBFCs & punish the errant parties.
- E.g. RBI's Know Your Customer (KYC) norms and Anti-Money Laundering (AML) standards. Online Magazine Cobrapost conducted sting operation on ICICI Bank, HDFC Bank and Axis Bank & RBI Imposed a heavy penalties (2013).

18.2.2 (UFIA-2015)

अज्ञात विदेशी आय तथा परिसंपत्ति अधिनियम

- It requires Indian residents to disclose their foreign assets (e.g. bungalow in Dubai, Bank account in Switzerland) and income coming from foreign sources (e.g. shell company in Cayman Island) in their income tax returns.
- Foreign source income will be subjected to 30% income tax. No deduction, exemption or rebate will be given on it.
- **Violation** = Penalty + upto 10 years jail time. If a company is found violating the Act, then every person responsible to the company shall also be liable for punishment unless he proves that it was done without his knowledge.
- It also empowers the Union to enter into agreements with other countries for the tax exchange of information.

18.2.3 (BTPA- 1988, 2016)

- **बेनामी लेनदेन (निषेध) अधिनियम:** Original act in 1988 but did not achieve much results → amended in 2016. **Main Agency?** Income Tax Department.
- Benami refers to properties that buyer registers in the name of his relative, personal staff (driver, gardner) or a non-existent/ fictitious persons to avoid tax authorities'



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attention. E.g. 2018: Misa Bharti Yadav (allegedly) bought farmhouse in the name of her brother-in-law Nilesh Kumar.

- Cases are heard @ PMLA Tribunal → PMLA Appellate Tribunal.
- **Violation** = Confiscation of property + penalty + upto 10 years jail time.

MCQ. With reference to the ‘Prohibition of Benami Transactions Act’, find correct statement(s):(Asked in UPSC-Pre-2017)

1. A property transaction is not treated as a benami transaction if the owner of the property is not aware of the transaction.
2. Properties held benami are liable for confiscation by the Government.
3. The Act provides for three authorities for investigations but does not provide for any appellate mechanism.

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

18.2.4 Tax (Evasion) Amnesty schemes

Under such schemes, a tax-evader can declare his undisclosed income, pay the taxes and penalty. Then, Income Tax Department will not pursue case against him. (Although Police may still pursue case if income is related to narcotics, kidnapping, extortion etc.)

<i>Income Declaration Scheme (IDS)</i> <i>Pradhan Mantri Garib Kalyan Yojana (PMGKY)</i> <i>Launched after Demonetization</i> Validity? <i>2016-Dec: To 2017-April</i>	Offer? 45% of the undisclosed income shall be taken away by govt as (tax 30%+ surcharge 7.5% + penalty 7.5%). Validity? 2016 June to Sept. ~67,000 cr black money was declared. <ul style="list-style-type: none"> - ~50% of the undisclosed income shall be taken away by Govt. as Tax + Penalty + Pradhan Mantri Garib Kalyan Cess. - The PM Garib Kalyan cess, and deposit will be used for schemes related to irrigation, housing, toilets, infrastructure, edu, health etc. - Further, 25% of the undisclosed income shall be deposited in RBI's '<i>Pradhan Mantri Garib Kalyan Deposit Scheme, 2016</i>'. It'll be a fixed deposit for 4 years @ ZERO % Interest - The scheme was not so successful, hardly ~5000 cr. declared.
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18.2.5 Tax Evasion → Other Initiatives

Banking Cash Transaction Tax (BCTT: 2005-09)	A 0.1% direct tax levied on cash withdrawals from banks. Started by Chidambaram but later withdrawn (2005-09). Objective was to encourage less-cash economy and data mining of transactions.
(Suggested) Banking Transaction Tax (BTT)	A proposal given by a Pune based think-tank to Baba Ramdev that all the direct and indirect taxes of the Union and the states should be abolished and replaced with 2% tax on banking transactions. Impracticable because such experiments were tried and failed in Australia and other countries as people shifted to using barter system, diamonds and gold for transaction. 2017: Govt clarified they are not considering any such proposal.
SC's SIT on Black Money 2014	Chairman: Retd. SC Justice MB Shah, and senior tax officials. They recommended various measures against Black Money hidden in India, in overseas banks, P-Notes etc. SC ordered Govt to implement this report.



Operation Clean Money 2017	Income Tax Dept. verified large bank deposits made in the aftermath of demonetisation. Phase 1- Jan 2017, Phase 2 - April 2017.
Project Insight 2017	Income Tax Dept. hired L&T Infotech Ltd to develop an integrated platform for data mining & tracking tax evaders. (Related) Project Saksham 2016: CBEC/CBIC's project for digital re-engineering related to GST. It's not a 'drive against black money' but for 'Ease of Paying Taxes'. <i>More in GSTN handout.</i> (Related) Aaykar Setu: CBDT's mobile app to pay Income Tax.
Restrictions on Cash Transactions, 2017	Budget 2017 → Finance Act, 2017 → if anyone accepts ₹ 2 lakh /> CASH in a day / in multiple transactions related to one 'event', then Income Tax Dept penalty = 100% of the cash received. Banks, post office, government organisations are exempted.
Electoral Bonds, 2017	Ref: SEBI/Sharemarket handout & write the gist in margin.

18.3 TAXATION → TAX AVOIDANCE (कर परिहार / कर टालना)

Here, people will not hide the transaction, they'll blatantly declare it in their balance sheets but use legal loopholes to avoid paying taxes.

18.3.1 Angel Tax on Startup Investments (2012)

- Angel investors are the rich people who occasionally invest equity-capital in startup companies out of hobby / timepass / profit motive. (Whereas Venture Capital Companies do the same thing but on regular & serious basis)
- Startup Entrepreneur Sunder Yadav registers a phoney "Sunder Construction" as an (unlisted) Public Limited Company with ₹ 10 Face Value Shares, & sells them to Angel Investor Sadhu Yadav @a premium price of ₹ 1,000 per share.
- But, even construction sector's (listed) public limited companies like DLF's shares are going around for ₹ 230, then Sundar-startup's shares are above 'fair market price'. So, this is not a genuine "Angel investment" but rather a facade for laundering Sadhu Yadav's money from construction, corruption or extortion business.
- So, UPA/Congress's Budget-2012 required Sunder Construction (the Startup Company) to pay 30%Tax + Penalty on the investment they received from Angel investor Sadhu Yadav. This is dubbed as 'Angel Tax'.
- Norms were further tightened by Modi-regime, but then controversy that it will discourage the growth of startup companies so norms relaxed- 'Angel Tax will not apply if Startup's turnover is less than ₹ "x" crores or if startup was registered for upto "y" years.'

18.3.2 ----- (DTAA) & Round Tripping

दोहरा कराधान परिहार समझौता

- It is a tax treaty signed between two or more countries.
- **Objective?** A taxpayer resides in one country and earns income in another, then he need not pay tax twice in two countries for the same income.
- e.g. India Mauritius DTAA (1982): If a Mauritius person / company buy shares in India and sells them at profit, then he need not pay capital gains tax (CGT) in India. Only the Mauritius government can ask CGT from him.



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- **Loophole?** India has ~10-20% CGT whereas Mauritius has ~0-3% CGT (depending on nature of asset, how long the buyer kept asset before selling etc). So many Indian Politicians, Businessmen and Bollywood actors would transfer the money to shell companies in Mauritius, and then make those Mauritius shell companies to invest back in Indian assets & avoid paying Indian CGT. This process is called **Round Tripping (राउंड-ट्रिपिंग)** i.e. money that leaves the country through various channels and makes its way back into the country as foreign investment.
- Similar loophole in India-Singapore DTAA.
- **2016:** Modi government amended the treaties so that even Mauritius and Singapore investments in India will be subjected to Indian taxes**.

18.3.3 ----- (POEM: पीओईएम)

- Bollywood Producer "A" forms a shell company in Cayman Islands (because it has very low corporation tax). He gives this company international movie distribution rights for his Indian movie @₹ 10 only. Then, Cayman Island company makes ₹ 50 crore profits, but he'd not pay any taxes in India saying its a foreign company making profits from foreign territories, so Income tax department has no jurisdiction!
- But, here the place of effective management is India, from where the Bollywood producer would be really taking the decisions of this shell company.
- So, **Budget-2015** introduced the concept of POEM. Such overseas / foreign company will be subjected to India's 40% Corporation tax + cess + surcharge.

18.3.4 ----- (BEPS: बीईपीएस)

- Multinational company (MNC) "M" opens fast food outlets in India & makes ₹ 50 crores profit. By default, it should be subjected to 40% Corporation tax in India.
- But then MNC shows its Indian outlets had taken loan / raw material / patented technology from MNC's shell firm in Bahamas (where Corporation tax is 0-2%). So, after deducting these operating costs, it has zero profit, so in India, it will pay only 18.5% Minimum Alternative Tax (MAT), instead of 40% Corporation tax.
- Thus, when MNCs shift profit from its source country to a tax haven to avoid / reduce paying taxes, its known as "BEPS". OECD & G20 have made a Framework to tackle this nuisance.

18.3.5 Transfer Pricing (हस्तांतरण मूल्य)

- Transfer pricing happens whenever two subsidiary companies that are part of the same multinational group, trade with each other.
- Suppose Coca Cola (Indian Subsidiary) buys Sosyo Company's shares or soda formula at ₹ 10 crores, and then sells it to Coca Cola (Cayman Islands) at ₹ 10 rupees. Then ₹ 10 is the transfer price.
- Coca Cola (Cayman Islands) further sells Sosyo's shares / Soda-Formula to other companies at very high price. Yet, Indian tax authorities will not get any Capital Gains Tax (CGT) even though Coca-Cola (USA holding company) may be making profit (Capital Gains) of billion\$ from this 'Indian Asset' (Sosyo).
- 2001: Transfer pricing related provisions were added in the Income Tax Act. but they were quite strict leading to 'tax terrorism' by IT officials who'd slap notices on every transaction, resulting into 'No ease' of doing business for MNCs.



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18.3.6 Authority for Advance Rulings (AAR)

- After above episode, Pepsy (India) would like to know in advance whether its transfer price of ₹ “y” or its imported / exported item worth ₹ “z” is agreeable to tax authorities or not? lest it suffers from notices, raids and litigations afterwards.
- For this purpose, Authority for Advance Rulings (and their Appellate bodies) have been set up under the income tax act, Customs act and even GST Act (recall Amul Camel Milk).
- Advance pricing agreement (APA: अग्रिम मूल्य निर्धारण समझौता)= If in previous example, Coca Coal approached AAR and an agreement was signed between taxpayer and a tax authority that “*Transfer price of ₹ y is agreeable to both of us, and will not attract any notices / raids / litigations afterwards.*”

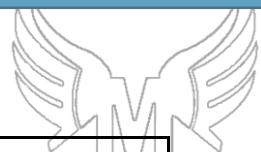
18.3.7 ----- (GAAR: कर परिवर्जन रोधी व्यापक नियम)

- So far in various examples we learned how Indian and foreigners avoid tax payment in India through loopholes like DTAA, POEM, BEPS, Transfer Pricing etc.
- So, UPA/Congress Govt setup economist Parthasarathi Shome panel who suggested General Anti Avoidance Rules (GAAR) → they were incorporated in Income Tax Act in 2012.
- GAAR empowers Income Tax officials to send notices to both Indians and foreigners for suspected tax avoidance. (For Tax evasion, we've separate laws- PMLA, UFIA, BTPA)
- But critics alleged GAAR will result in tax terrorism and harassment of individuals. So successive Budgets kept delaying the GAAR- implementation. Finally done on 1/4/2017.

18.3.7.1 Reforms to reduce Tax Terrorism / Harassment

- In the previous section we learned about the “Tax evasion”, and notable measure → laws, ban on cash transaction of ₹ 2 lakh / >, Operation Clean Money etc. So on one hand, income tax department has to become strict / coercive like that to fight against Tax evasion.
- At the same time, IT dept. also needs to become more friendly towards honest taxpayers, while reducing the scope of tax avoidance. Here notable measures are →

Rajaswa Gyan Sangam 2016 & 2017	Organised by CBDT & CBIC for idea exchange between policy makers and senior tax officers. 2016: Modi gave them RAPID Mantra: R for Revenue, A for Accountability, P for Probity, I for Information and D for Digitization.
Direct Tax Code 2010	This bill aimed to replace the Income Tax Act, 1961 with simpler provisions. But, lapsed with 15th LokSabha dissolution in 2014.
Easwar Panel on Direct Taxes 2015	To simplify the provisions of IT Act, 1961, to remove ambiguities that cause unnecessary litigations & hardships to Tax payers.
Arbind Modi Taskforce 2017	Setup by CBDT to draft New Direct Tax Legislation (Law) to replace IT Act 1961. Later Arbind modi retired & replaced by Akhilesh Ranjan. 2019-Feb: Panel sought 3 months extension ke report not yet prepared.



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-----	2017: CBDT's mobile app that helps you calculate and pay Income Tax, claim TDS refunds etc.
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18.3.8 Global Treaties, Agreements & Indexes

18.3.8.1 *Tax Information Exchange Agreement (TIEA: कर सूचना विनियम समझौता)*

- India has signed such agreements with multiple countries. It enables mutual sharing of information to detect tax avoidance and tax evasion.
- On Indian side, CBDT is the nodal agency for such agreements.

18.3.8.2 *USA's Foreign Account Tax Compliance Act (FATCA-2010)*

विदेशी खाता कर अनुपालन अधिनियम

- USA's FATCA Act requires foreign financial Institutions (such as Indian Banks, Pakistani Insurance Companies, Chinese Mutual Funds etc) to report the assets held by Americans.
- This helps US Tax authorities to detect tax avoidance / evasion by Americans who are hiding income outside USA.

18.3.8.3 *Global Financial Secrecy Index (वैश्विक वित्तीय गोपनीयता सूचकांक)*

- Prepared by London based Think Tank 'Tax Justice Network (TJN)'.
- It uses 20 indicators to measure the countries on their financial secrecy, opportunities for Tax Avoidance, BEPS etc.
- 2018 Ranking: _____ (1st), India (32),

18.4 BLACK MONEY → DEMONETISATION (विमुद्रीकरण)

- **Definition?** Demonetization is the wholesale withdrawal of currency notes from circulation.
- **RBI Act 1934:** Every banknote is a legal tender. However, RBI Central Board can recommend the Government of India to notify specific currency note(s) should no longer be treated as legal tenders. Then FinMin → Department of Economic Affairs makes official gazette notification.
- 1946: ₹ 500 Notes demonetized; 1978: ₹ 1000, ₹ 5000, ₹ 10000 Notes demonetized.
- **2016-Nov-8th:** Public was ordered to deposit the (old) Mahatma Gandhi series currency notes ₹ 500 and ₹ 1,000 (henceforth called "Specified Bank Notes (SBN)") into Banks and post-offices latest by 30th December 2016. And all the banks and post offices where order to deposit such SBN into RBI.
- **Specified Bank Notes (Cessation of Liabilities) Ordinance:** From 31st December 2016, RBI Governor not required to honor "I promise to pay..." or exchange the SBN. Except for NRIs, deadline little bit relaxed, with certain norms. Public prohibited from keeping SBN, except for research or numismatics or museum- and that too in limited amount. This ordinance became Act in 2017.
- India is not the only country in the world to do demonetisation. Sweden (2013), European Union (2016) and even Pakistan (2015) has done it for their currency notes.

18.4.1 Why Demonetise ₹ 500 & 1000?

- Demonetization is usually done in the aftermath of hyperinflation, war & regime-change.
- India did it to combat _____.

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- We had 12.04% Cash to GDP ratio, one of the highest in the world. Currency printing & transportation cost alone was 1.7% of GDP.
- “Soil rate” is the rate at which notes are considered to be too damaged to use and returned to the RBI. For ₹ 500 & 1000 SBN-notes, soil rate was much lower than the currency notes of ₹ 10 to 100. (implying that 500-1000 SBN were used more for ‘storing black money’, rather than using in transactions.)
- So, experts made mathematical comparison of the foreign countries’ economic development, soil rates of their foreign currency notes etc. and arrived at a figure ₹ 3 lakh crores of Indian black money is stored in SBN (=2% of GDP).
- So if SBN were demonetised, the black money holders will not return their currency notes into banks (fearing IT-RAIDS) and thus black money will be destroyed.
- But in reality, 99.30% of the SBN were returned back into the banking system, so hardly ₹ 10,720 crore of black money was destroyed by the demonetisation of 2016.

18.4.2 How did 99.30% SBN returned into banking system?

If the mathematical modelling was correct, then only 80% of the SBN should have returned back, & 20% SBN (presumed to be Black Money) should not have returned. But, Black money owners used following tricks to deposit their SBN in bank accounts:

1. Businessmen / Politicians used their drivers, cooks, gardeners, personal staff members and relatives as Money mules. This is evident from exponential rise in the deposits in Pradhan Mantri Jan Dhan bank accounts.
2. SBN were given out as “loans” to poor & as advance salaries to workers.
3. Agents who tied up with corrupt bankers who exchanged SBN without KYC verification.
4. SBN deposited in Cooperative Banks as back-dated Fixed Deposits (Because Cooperative Banks didn’t use Core Bank Solution so it was possible to temper records)
5. Similarly, SBN deposited in banks and then shown as income from sale of (fictitious) grain stock etc. So, IT-dept can’t demand tax on it (and most state governments not levy tax on agricultural income due to vote bank politics).
6. SBN deposited in shell companies & shown as income from (fictitious) sale and invoices.
7. SBN donated to trust, temples & Political Parties with backdated receipts (and those entities are exempted from Income Tax on their income).... And so on

18.4.3 Even if 99.30% SBN returned, it’s not failed experiment because:

- ✓ Those who could not return their SBN, have lost their black money (₹ 10,720 crore)
- ✓ Those who used poor people are money mules- must have paid some commission to them. So even if government did not get tax from black money, atleast poor people benefited.
- ✓ Further, during Operation Clean money, IT-dept issued notices to the suspicious bank accounts where large amount of money was deposited. Such shell firms & their benami properties are being seized.
- ✓ With Project Insight & Op. Clean Money: IT dept fetched ₹ 1.30 lakh crore in taxes and penalty, attached ₹ 7000 crore worth Benami properties, ₹ 1600 crore worth foreign assets & de-registered ~3.40 lakh shell firms. (*Figures from Int-Budget-2019*).
- ✓ The number of PAN card registration, IT returns, registrations under excise / VAT / GST have greatly increased in the aftermath of demonetisation which proves that crooked



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people have learned lesson. More than 1 crore new income tax assesses are added in 2017.

- ✓ Tax collection has increased from ₹ 6 lakh crores (2013) to ₹ 12 lakh crores (2018).

18.4.4 Demonetization: short term challenge, long term benefit (Eco. survey 2016-17)

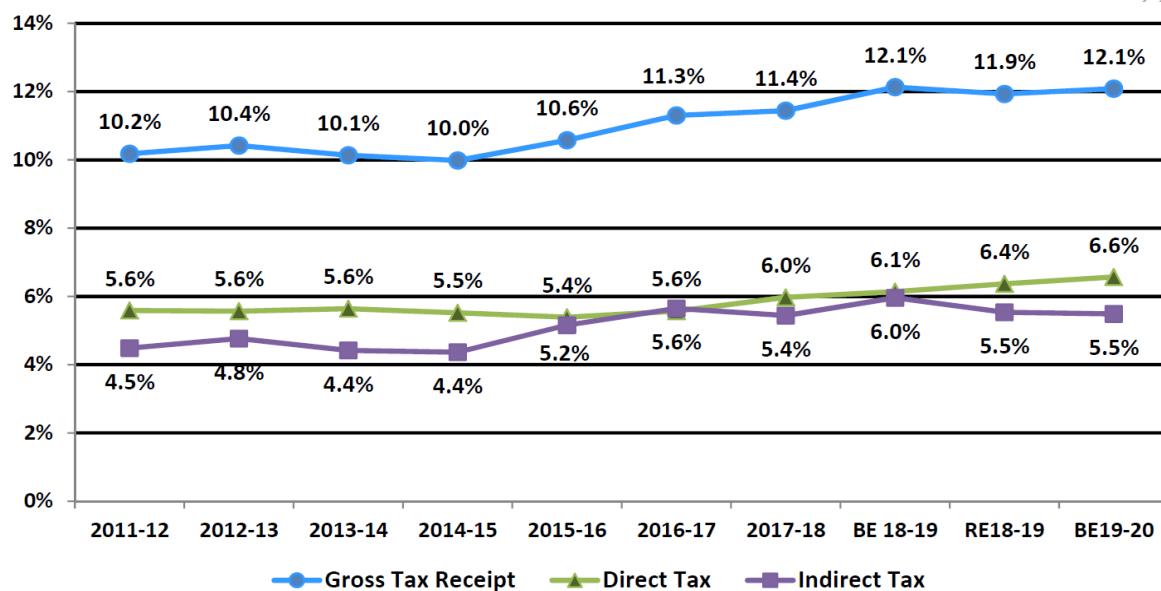
Area	Short term challenges	long term benefits
Banking	Administrative challenges on the bankers to exchange the banned notes	Growth in the deposits → more loans can be given @cheaper interest rate, Less Cash economy & associated benefits.
Real Estate	Sale of houses declined	Prices & rents of houses should decline. Migrants will benefit.
Economy at large	Job loss in cash-intensive sectors like diamond polishing, farm laborer, MSME	Less-cash economy, digitization and formalization of economy, Bizmen getting GST registrations → further surveillance → forced to show their employees on paper → EPFO & ESIC benefits to worker.
Growth rate	Slow down	improvement

SELF-Study for Mains: Economic survey 2016-17 Vol1ch3, table 2 “impact of dem” .

18.5 ECONOMIC SURVEY ON TAXATION AND FISCAL CAPACITY (वित्तीय क्षमता)

The last three economic service have repeatedly observed that

- Democracy is a contract and taxation is the economic glue that binds government and citizens into this contract.
- But, when ever government delivers poor quality of service in public schools, hospital etc. → middle class and rich citizens will “EXIT” towards the private school and hospitals → Then they also feel ‘moral right’ to evade / avoid taxes, because they are no longer using public services. **Result?** hardly _____ are taxpayers (23% is desirable, as per our level of development against BRICS nations.)
- Govt gets less taxes → poor fiscal capacity → poor services → vicious cycle continues and results in decline of govt’s accountability towards citizens.



18.5.1 The reasons for low Tax: GDP in India:

- Lack of civic sense among people that paying taxes is their basic duty.
- Presence of informal sector, parallel economy, cash based economy.
- Low per capita income, high level of poverty.
- Concentration of income in the hands of few- who are greedy to engage in tax evasion & avoidance.
- Election funding as the mother source of corruption, and therefore black money. Politician-Builders-Mafia nexus.
- Due to political considerations, state governments and local bodies do not levy all the taxes authorised by the constitution e.g. tax on agricultural income. So our (direct) tax base is narrow. [Tax base: कराधार means the total value of all the income, property, etc. on which tax is charged.]
- Loopholes in the tax laws which encourage tax avoidance using Domestic and Offshore channels.
- Direct taxes like wealth tax, gift tax and estate duty suffered from loopholes, lax monitoring and evasion, they didn't yield much revenue. Hence even referred as '**paper taxes**'.

18.6 TAXATION: MISC. TERMS

Laffer Curve (लफर वक्र):	<ul style="list-style-type: none"> - American economist Arthur Laffer: if tax rates are increased above a certain level, then tax revenue collection will fall because higher tax rates discourage people from working (and/or engage in tax evasion and tax avoidance). - So, tax-cuts could lead to higher tax revenue collections. - Budget-2017: The lowest Income Tax slab was cut from 10% to 5%; The corporation tax on small sized companies was also brought down from 30 % to 25% - USA Budget-2017: Corporation tax cut down from 35 % to 15%
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Tax buoyancy (कर उत्प्लावकता):	<ul style="list-style-type: none"> - Measures the comparative growth in tax collection against the growth in national output or national income. - E.g. if income tax collection growth rate is 11% when GDP growth rate is 10%, then its tax buoyancy is 1.1
Tax elasticity (कर लचिताता):	If first income tax slab increased from 5% to 15% then in absolute terms how much more IT-revenue will be generated?

18.6.1 Net Tax Revenue of the Govt (शुद्ध कर राजस्व)

Sr.	Budget → Revenue Receipts → Tax Receipts	Expected in 2019-20
A	Union's Direct taxes, incl. cess and surcharge	~ _____ lakh crores
B	Union's Indirect taxes incl. cess and surcharge. <ul style="list-style-type: none"> - For Union: direct taxes income is >> indirect taxes. - But if we summed all taxes of union, state and local bodies then indirect taxes income >> direct taxes. 	~ _____ lakh crores
C	Union territories without legislature: their direct and indirect taxes: विधानमंडल रहित संघ राज्य क्षेत्र	~6000 crores
D	Gross Tax Revenue (=A+B+C) सकल कर राजस्व	~26 lakh crores
E	Minus the Tax devolution to States (कर हस्तांतरण) as per GST council (for CGST) and Finance Commission (for non-CGST taxes).	(-)~8.5 lakh crores
F	Minus Contributions to National Disaster Response Fund in Home ministry*	(-)~2500 crores
D-E-F	Net Tax Revenue of Union (शुद्ध कर राजस्व)	~ _____ lakh crores

*National Disaster Response Fund (राष्ट्रीय आपदा प्रतिक्रिया कोष) is a statutory fund under Disaster Management Act, 2005. Previously, called National Calamity Contingency Fund (NCCF).

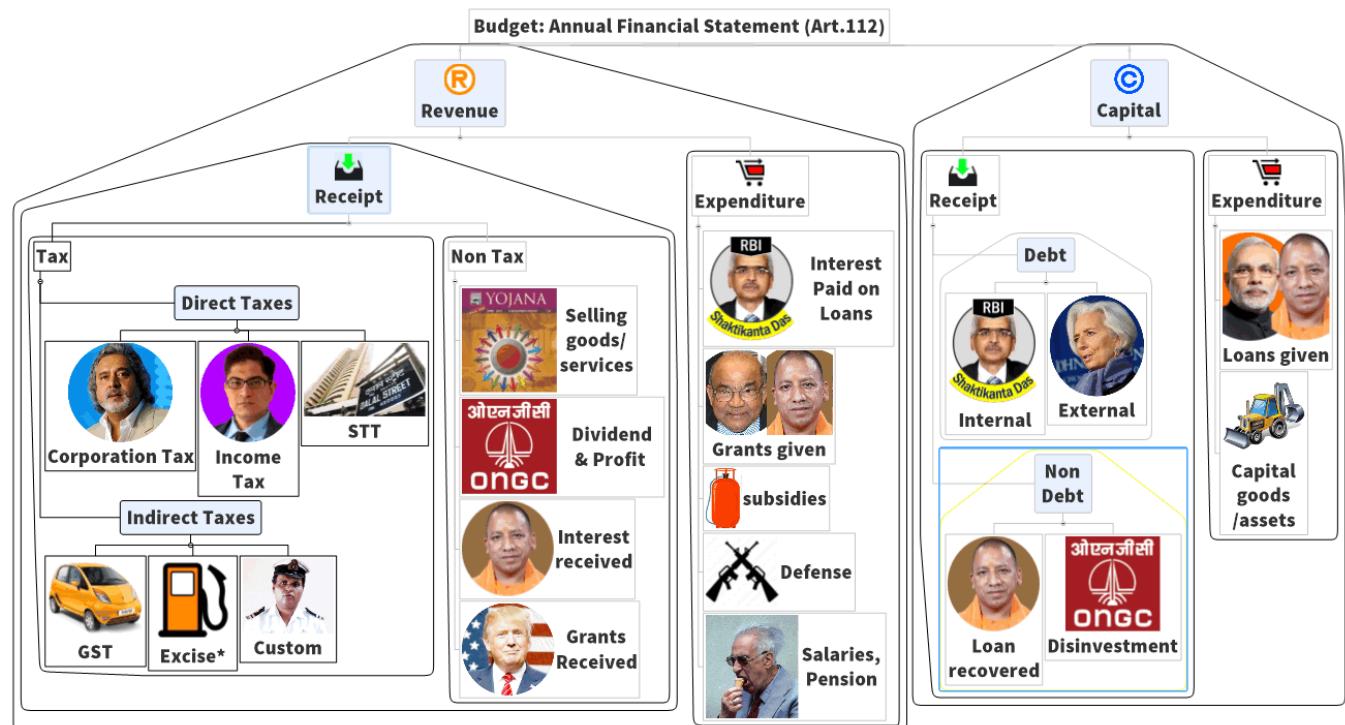


18.6.2 Revenue Shortfall (राजस्व में कमी)

Type of Tax	Tax in ₹ crores	2018-19 Advance Estimates Made in Feb-2018	2018-19 Revised Estimates in Feb-2019	2019-20 Advance Estimates Made in Feb-2019
Direct-Tax	Corporation Tax	621000	671000	760000
Direct-Tax	Income Tax	529000	529000	620000
Direct-Tax	STT	11000	11000	12800
Indirect Tax	Custom Duty	112500	130038	145388
Indirect Tax	Excise on Fuel, Alcohol**	259600	259612.2	259600
Indirect Tax	GST	743900	643900	761200
Gross Tax Revenue →		22.7 lakh crores	22.4 lakh crores	26 lakh crores

- 1/2/2018: Budget 2018 is presented for the next financial year starting from 1st April 2018 to 31st March 2019. So, FinMin could have only made projections /estimations about how much taxes will be collected during 1/4/18 to 31/3/19.
- But throughout the year, based on the advance tax-collection figures & monthly GST collection figures, FinMin will have to re-adjust the estimates.
- 1/2/2019: (Interim) Budget 2019 is presented, along with that, Govt will present revised estimates for previous Financial Year (2018-19).
- From the table we can see that Gross Tax collection is less than expected (22.7 MINUS 22.4) = ~30,000 crores is ‘Revenue Shortfall’, mainly because _____ were less than expected.

18.7 BUDGET → REVENUE PART → RECEIPTS → NON-TAX RECEIPTS





Notable sources of Non-Tax revenue (In descending order)	2019-20
<ul style="list-style-type: none"> ✓ Interest receipts (ब्याज प्राप्तियाँ) received on Union's loans to states, railways, CPSE, foreign countries.) is a revenue receipt. [Had those borrowers repaid loan-principal, then that portion is 'Capital Receipt.] ✓ Dividends and profits received from CPSE, PSBs, RBI. [Had Union sold its shares to a third party (disinvestment / privatization), then that will be 'Capital Receipt']. <p>Union's income from (Dividend & Profits) >> from Interests.</p>	1.5 lakh cr.
Income from selling various goods & services such as railways, postal services, selling of India Yearbook-, Yojana-Kurukshetra magazines, fees that CISF charges for giving protection to Private Airports, auction of spectrum & mining rights, selling of commemorative coins etc.	1.2 lakh cr.
Grant in Aid (अनुदान)/ Donations received by Union. [Had Union received 'loan', it'll be 'Capital Receipt'.]	1000 cr.
Similar Non-tax revenue earned by UT without Legislature	2000 cr.
Sum of Above= Total Non-Tax Revenue Receipts कर-मिल्जन प्राप्तियाँ	~2.7 lakh cr.

Total Revenue Receipts= NET Tax receipts (~17.0 lcr) + Non-Tax receipts (~2.7 lcr)= ~20lcr.

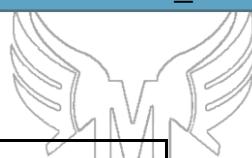
Figures are not important, but the fact that revenue budget: the tax receipts >> non-tax

19 BUDGET → REVENUE PART → REVENUE EXPENDITURE

बजट → राजस्व भाग → राजस्व व्यय: Revenue-expenditure are usually associated with

- Expenditures spent on day to day functioning of the organs of the state = salaries & pensions, stationery, electricity bill, phone bill etc. in Executive, Judiciary, Legislature; Various Constitutional & Statutory bodies.
- Expenditures that do not create income generating assets or permanent assets or financial assets. So, money SPENT on loan-interests, subsidies, scholarships, grants etc. are Revenue Expenditure.

Notable Revenue Expenditures (In descending order)	2019-20
Interest to be paid on previous loans is Revenue Expenditure. [Whereas Union repays loan-principal, its 'Capital Expenditure']	----- lakh cr.
<ul style="list-style-type: none"> - Grant-in-Aid (अनुदान) to States & Local Bodies for Disaster Management, Panchayati Raj Development etc. as per Finance Commission recommendations. Additionally, Govt also gives grants to foreign countries for its soft-diplomacy. 	4.7 lakh cr.



- Grant = Amt doesn't have to be returned with Interest. (Whereas If Govt gave 'loans' to States/CPSE/Foreign Countries then it's an income generating financial asset = counted under Capital Expenditure).	
Subsidies. Within them descending order 1. Food subsidies: ₹ 1.8 lakh cr. 2. Fertilizer (Urea > Others): ₹ 75,000 cr 3. Fuel (LPG > Kerosene): ₹ 37,000 cr 4. Interest Subsidies on loans: Farmers (highest), MSME, Affordable Housing, LIC Vay Vandana Yojana etc.: 25,000 cr. 5. Other Subsidies (Haj Subsidy etc): 12000 cr.	----- lakh cr
Defense related revenue expenditure (e.g. soldier salaries, fuel for tanks)	2 lakh cr
Pension to retired employees (In the last 3 years it has kept rising.)	1.9 lakh cr
> Economic services related revenue expenditure (Agriculture, energy, transport, communication, Science technology) > Social services related revenue expenditure (health, education, social security): > Expenditure on Administrative machinery (Police, Jail, External Affairs etc.), Elections, Parliament, Judiciary: > Revenue expenditures of UT without Legislature:	Fig. not imp.
Total Revenue Expenditure कुल राजस्व व्यय	~25 lakh cr
Total Revenue Receipts (Tax + Non Tax Receipts) कुल राजस्व प्राप्तियां	~20 lakh cr
Revenue Deficit = Revenue Receipt MINUS Expenditure. *If we used precise figures instead of (~)approximation, then its ₹ 4.7lcr.	~5 lakh cr*
Projected GDP for 2019-20 is ₹ 210 lakh crores. So Revenue Deficit as a percentage of GDP = (4.7 lakh crore /210 lakh crore)*100. =	----- %

19.1 REVENUE EXPENDITURE → SUBSIDIES

Tax (₹ ~26 lakh crores in Int-budget-19)	Subsidies (₹ ~ ____ lakh cr in Int-budget-19)
Tax is a compulsory contribution imposed by State. Refusal to pay the tax is punishable.	A subsidy is a benefit given to an individual or firm by the government to reduce some type of burden. A person may refuse to accept the subsidy, He will not be punished for it.
Tax doesn't promise specific and direct goods/services to the taxpayer. (Mukesh Ambani will still be subjected to potholes)	A specific benefit is promised e.g. 6000 to farmers, idlis @₹ 1 rupee in Amma Canteen (Tamilnadu).



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19.1.1 Types of subsidies with selected examples

1. **Given in direct cash (or bank transfer):** PM KISSAN 6k, LPG Pahal ~200 per cylinder.
नगद में दी जाने वाली सब्सिडी
2. **Given in kind:** free school bags, uniform and books to the poor children, free medicines in public hospitals, free insurance. मुफ्त वस्तु या सेवा के रूप में दी जाने वाली सब्सिडी
3. **Indirect (परोक्ष) subsidies:** cheap fees in government colleges, cheap kerosene, cheap urea, cheap crop insurance premium etc. Here govt. is paying some money to an organization so that they may provide goods/services @cheaprate to the beneficiary.
4. **Regulatory (नियामक) subsidies:** e.g. if State Electricity Regulatory Commission directs companies that electricity to farmers must NOT to be beyond ₹ “x” per unit.
5. **Procurement (खरीद) subsidies:** e.g. FCI purchasing at food grains from farmers at minimum support price (MSP).
6. **Interest (ब्याज) subsidies / subvention:** govt pays “x%” interest agriculture, MSME, affordable housing loans.

19.1.2 Impact of Subsidies (सब्सिडी का प्रभाव)

- Merit Goods (लाभदायक वस्तुएँ): Healthcare, education, scientific research, LPG, solar panels, wind mills etc. Here subsidies can increase the positive externalities. (Cheap LPG → poors don't use firewood → more trees & less indoor pollution.)
- But subsidies on diesel, kerosene generate negative externalities on the environment.
- Urea subsidies to industries → cheap urea to farmers → excessive consumption → soil & water pollution, algae-blooms.
- Subsidy leakage (सब्सिडी रिसाव): When ghost beneficiaries (non-existent persons propped up by corrupt officials), and ineligible people are receiving the benefits of subsidy.

19.1.3 Economic Surveys on subsidy delivery

Economic survey 2014-15:

- ✓ We should use _____ (JAM) trinity to reduce the subsidy leakage.

Economic survey 2015-16:

- ✓ Direct benefit transfer (DBT) can't be a panacea in every case, because males of the house may waste DBT-money on liquor & tobacco. So, in some cases, **Biometrically Authenticated Physical Uptake (BAPU)** mechanism will be better i.e. beneficiary goes to a grain / fertilizer shop and uses his Aadhaar & fingerprint to purchase subsidized goods.

Economic survey 2016-17:

- The present subsidy delivery mechanism suffers from two errors:
 - **Inclusion Error:** Non-poor (=affluent people) are receiving ~40% of subsidies
 - **Exclusion Error:** 50% of the real poor are not getting subsidies due to corruption.



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- ✓ So better to abolish all type of subsidies and directly deposit a specific sum of money into beneficiary's bank account to help him buy goods/services from open market =
----- (UBI): More in Pillar#6.

19.2 REVENUE XPDR → SALARIES→ 7TH PAY COMMISSION (वेतन आयोग)

Setup by Finmin → Department of Expenditure. 1st: Srinivasa Varadachariar (1946). 7th: (Retd.) Justice _____ (2014). Its recommendations became effective from 1/1/2016. Major highlights were:

- ✓ New system of "**Pay Matrix**" instead of previous system of pay band and grade pay.
- ✓ In regulatory bodies salaries increased: Chairman ₹ 4.50 lakh per month, members ₹ 4l.
- ✓ Minimum pay in Central service increased to ₹ 18k / per month (Group-D).
- ✓ Maximum pay: ₹ 2.25 lakh per month for Apex scale (e.g. Secretary of a Dept.), and ₹ 2.50l (for Cabinet Secretary)
- ✓ It adopted Dr. _____ formula to computing wages at periodic interval (formula tracks the changes prices of the commodities used by a common man). So, critiques believe there will not be an 8th Pay Commission because salaries will be updated automatically at regular interval, using this formula.
- ✓ It abolished various type of 'interest free allowances' e.g. Purchase of bicycle etc.
- ✓ It continued 'interest-bearing advances' for purchase of computer, house building (upto ₹ 25 lakhs). [= employee can borrow money from department but he will have to return it with interest.]
- ✓ Various reforms for defense and CAPF services.
- ✓ Made stronger rules in **Modified Assured Career Progression (MACP)** system so lazy officials don't get promoted.

19.2.1 Associated terms:

- **Dearness Allowance (DA: महंगाई भत्ता)**: It's given by an employer to protect the employees against rise in inflation. In government services, both working employees and retired pensioners are given dearness allowance.
- **House Rent Allowance (HRA: मकान किराया भत्ता)**: Component of an individual's salary that defines the rent allotted by the employer for employee's accommodation.
- **Gratuity (ग्रेचुटी)**: It's a lump sum amount "x" given by an employer to the employee for rendering services continuously for "y" number of years. Usually given at retirement. Norms governed under Payment of Gratuity Act, 1972
- **one rank one pension (OROP)**: 2015- Modi govt. promised equal pension to military personnel retiring in the same rank with the same length of service, regardless of the date of retirement. Although, Ex-servicemen unhappy about the base year & calculation formula.

19.3 REVENUE DEFICIT (राजस्व घाटा: _____ OF GDP)

When government spends more than its income in revenue account, it incurs ...



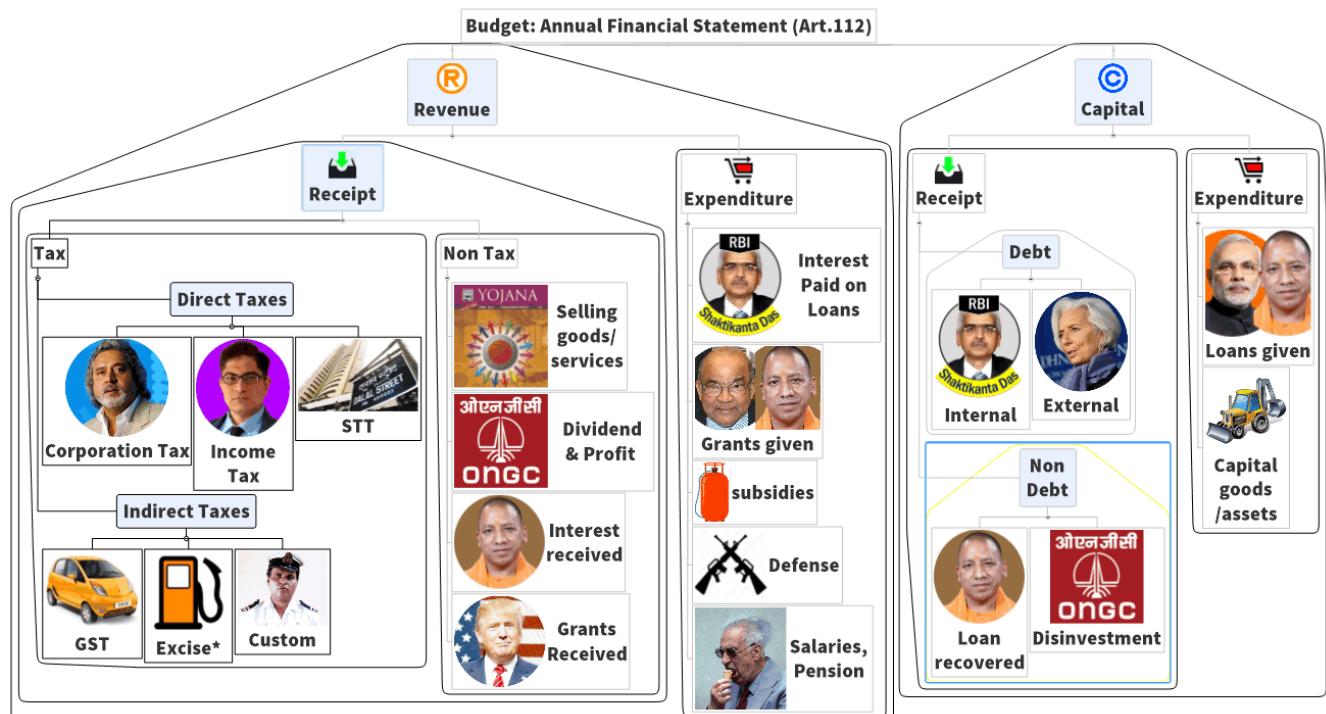
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- Revenue deficit = Revenue expenditure – Revenue receipts.
- Since a major part of revenue expenditure is committed expenditure (like Interest repayment on previous loans, staff-salaries & pensions which Govt can't 'avoid'), so it is quite difficult to reduce the revenue deficit.
- So, when revenue deficit increases government will be forced to borrow more money or cut down the expenditure in the capital part (= less new schools, bridges and hospitals). This will result in lower human development and lower economic growth (less new bridges → less demand of steel/ceements → less growth in those sectors).

19.4 EFFECTIVE REVENUE DEFICIT (प्रभावी राजस्व घाटा: _____ OF GDP)

- We've counted Grant-in-Aid to States / Local Bodies as 'Revenue Expenditure', but some portion of that money may have been used by the States / Local Bodies for building Panchayat-Bhavans, Disaster Management Training Institutes, Cranes & Bulldozers for Disaster rescue operations etc. which are actually "Capital Assets".
- Therefore, Budget 2011 (Chidambaram) introduced a new concept:
- **Effective Revenue Deficit** = Revenue Deficit (~4.7 lakh cr) MINUS Grants to various bodies which were spent for creation of Capital Assets (2 lakh cr)
- ERD= ~2.7 lakh crores (1.3% of GDP) for 2019-20.

20 BUDGET → CAPITAL PART → RECEIPTS (₹ ~68 LAKH CR)



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बजट → पूँजी भाग > प्राप्तियां: Sub-classified into two parts (Figures in Interim-Budget-2019)



Capital Debt Receipts: पूँजीगत क्रृण प्राप्तियाँ	Capital Non-Debt Receipts: गैर-क्रृण पूँजी प्राप्तियाँ
₹ __ lakh cr from Internal Borrowing: <ul style="list-style-type: none"> - From RBI, - From market (Banks, NBFCs) - From small savings (Post-Office Savings Accounts, National Savings Certificates, etc), - From Provident Funds (EPFO, PPF) 	₹ 64,000 cr Loan Principal recovered (i.e. Union government would have given loans to state governments, foreign countries, public sector companies etc.) so when they return Principal amount back that is counted here.
₹ 44,000 cr External borrowing: from foreign countries & international institutions like IMF World Bank, BRICS bank etc.	₹ _____ cr Disinvestment i.e. Union selling its shares from Public Sector Undertakings (PSUs) / Central Public Sector Enterprises (CPSEs).
Bigger portion of Capital Receipts come from this side	Smaller portion

MCQ. Which of following is not a component of 'Capital Receipts'? (IEnggS-2018)

- (a) Market borrowings including special bonds
- (b) External loans raised by the Central Government from abroad
- (c) Receipts from taxes on property and capital transactions
- (d) Provident Funds (State Provident Funds and Public Provident Fund)

20.1 BUDGET → CAPITAL PART → RECEIPTS → DISINVESTMENT: विनिवेश

Public sector enterprise = Any commercial or industrial undertaking owned and managed by the government to maximise social welfare and uphold the public interest. They can be Classified into three parts:

Departmental Undertakings विभागीय उपक्रम	Statutory Corporations वैधानिक निगम	Govt. Companies सरकारी कंपनिया
Directly part of a ministry e.g. Postal, Railways, Ordnance Factories. They can be created easily, no laws required, no registration required	Created by an act of Parliament or state legislature. E.g. RBI Act, SBI Act, LIC Act, FCI Act, EPFO Act. etc, SIDBI, NABARD, NHB, EXIM..	Registered under the Companies Act, Govt's shareholding is 51% or more. Coal India Ltd, GAIL, SAIL, NTPC, IOCL, BHEL & various Public Sector Banks and NBFCs which are not statutory corporations.
High level of ministerial interference	Middle of both sides	More operational flexibility, less interference by Ministers
CAG will audit directly	Some of these Acts provide for internal audit & exclude CAG from auditing the Corporation. E.g. RBI, LIC.	Companies Act requires these companies to produce audited reports. CAG will empanel the (private) auditors

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		for them.
Their earning will go directly in Public Account / CFI	Their earning → profit → dividend goes to shareholders.	
Answerable in RTI Act	Answerable in RTI Act	Answerable in RTI Act
Their employees are considered government employee- subjected to service and discipline rules framed by the government.	Not considered govt employees. Their service / discipline conditions are governed by the respective organizations' internal manuals.	

- **Public sector Undertaking (PSU)** = collective term for Centre's + State's + Local Bodies' Public Sector Enterprises.
- **Significance of corporations and companies:** Development of infrastructure, affordable services, regional balance, prevent concentration of economic power in the hands of Corporates and MNCs.
- **Challenges?** Political interference, lack of innovation & consumer responsiveness, employee unions, loss making enterprises.

20.1.1 Ratna Companies

Norms decided by Ministry of Heavy Industries & Public Enterprises. "Ratna Companies" given for the flexibility in operations like hiring more professionals, acquisition of other companies etc. without requiring government approval for every small decision.

Category	Condition and examples
Miniratna Cat-I and Cat-II	<ul style="list-style-type: none"> ✓ made profits in the last 3 years continuously, further subdivision in Cat-I & Cat-II depending on how much profit is generated. ✓ Examples: National Film Development Corporation Ltd, Mazagaon Dock Ltd, Airports Authority of India, Mishra Dhatu Nigam Ltd, NHPC Ltd, WAPCOS Ltd, ONGC Videsh Ltd, Rail Vikas Nigam Ltd,
Navratna	<ul style="list-style-type: none"> ✓ A Mini Ratna company fulfilling "x" conditions ✓ Other Govt companies fulfilling "y" conditions such as Manpower cost to total cost of production etc. ✓ Examples: Power Grid Corporation of India Ltd, Rashtriya Ispat Nigam Ltd, Rural Electrification Corporation Ltd, Shipping Corporation of India Ltd, Oil India Ltd, National Aluminium Company Ltd, Neyveli Lignite Corporation Ltd, Mahanagar Telephone Nigam Ltd, Hindustan Aeronautics Ltd, Container Corporation of India Ltd, Bharat Electronics Ltd,
Maharatna	<ul style="list-style-type: none"> ✓ Already a Navratna Company, and fulfilling "z" conditions such as min. ₹ 5000 crore profit per year in last 3 years, listed at a Stock exchange, significant global presence etc. ✓ Very few cos here: Bharat Heavy Electricals Ltd, Coal India Ltd, Indian Oil Corporation Ltd, NTPC Ltd, Oil & Natural Gas Corporation Ltd, Steel Authority of India Ltd, Bharat Petroleum Corporation Ltd,



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*Above examples are taken on 1/3/19. Their status is subject to change and updation, but we need not lose sleep over it unless preparing for their specific recruitment exam.

20.1.2 Government policy towards disinvestment

- **Disinvestment:** Reducing the government shareholding upto 51%
- **Privatization:** Reducing the government shareholding below 50%
- **Arguments in favour:** reduced government shareholding → Private investors will enter in the board of directors → more efficiency, innovation and autonomy.
Disinvestment proceeds can be used for welfare schemes, and reducing the fiscal deficit.
- **Argument Against:** MNC monopolies, exploitation of worker, job loss.

Year	Policy
1991's Industrial Policy	Reduce shareholding in all Govt Companies
1998's Vajpayee	<ul style="list-style-type: none"> - In strategic sector (Railways, Defense, Atomic Energy)- we'll not do disinvestment - In Non-strategic = phased disinvestment
UPA-1 (2004-09)	Due to pressure from the left is parties in the coalition: No Disinvestment from any government companies. If a government company is sick, we will try to revive it.
UPA-2 (2009-14)	<ul style="list-style-type: none"> - All Govt Companies can be disinvested upto 49%. Money will goto National Investment Fund (NIF: Public Account) → used for Bank recapitalization, metro rail, nuke energy, EXIM-NABARD-RRB etc. - Also launched CPSE-Exchange Traded fFunds (ETF): <i>Ref SEBI handout</i>

20.1.3 Disinvestment & Privatization in the Modi Raj (2014-19)

- ✓ Tried three methods of Disinvestment, depending on the Company
 - CPSE-ETF, Bharat-22-ETF
 - Institutional placement Programme (IPP): offer shares only to non-retail investors
 - Offer for sale (OFS): offer shares to both retail and non-retail investors
- ✓ Modi govt shut down many sick Govt companies such as HMT watches, Hindustan Photo Film etc.
- ✓ Budget-2016 renamed FinMin's Dept of Disinvestment into Dept. of Investment & Public Asset Management (DIPAM).
- ✓ **Disinvestment targets last 3 budgets:** ₹ 1lcr (2017: Target achieved), ₹ 80k cr (2018: Target achieved), ₹ 90k crore (2019).
- ✓ **Privatisation attempts in 2018:** (1) Tried to sell-off 74% shareholding from AirIndia but no investors found. (2) IDBI sold to LIC.

MCQ. Why is the Government of India disinvesting its equity in the Central Public Sector Enterprises (CPSEs)? (Asked in UPSC-Pre-2011)

1. The Government intends to use the revenue earned from the disinvestment mainly to pay back the external debt.



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2. The Government no longer intends to retain the management control of the CPSEs.

Ans Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

20.2 BUDGET → CAPITAL PART → EXPENDITURE (₹ ~63 LAKH CRORES)

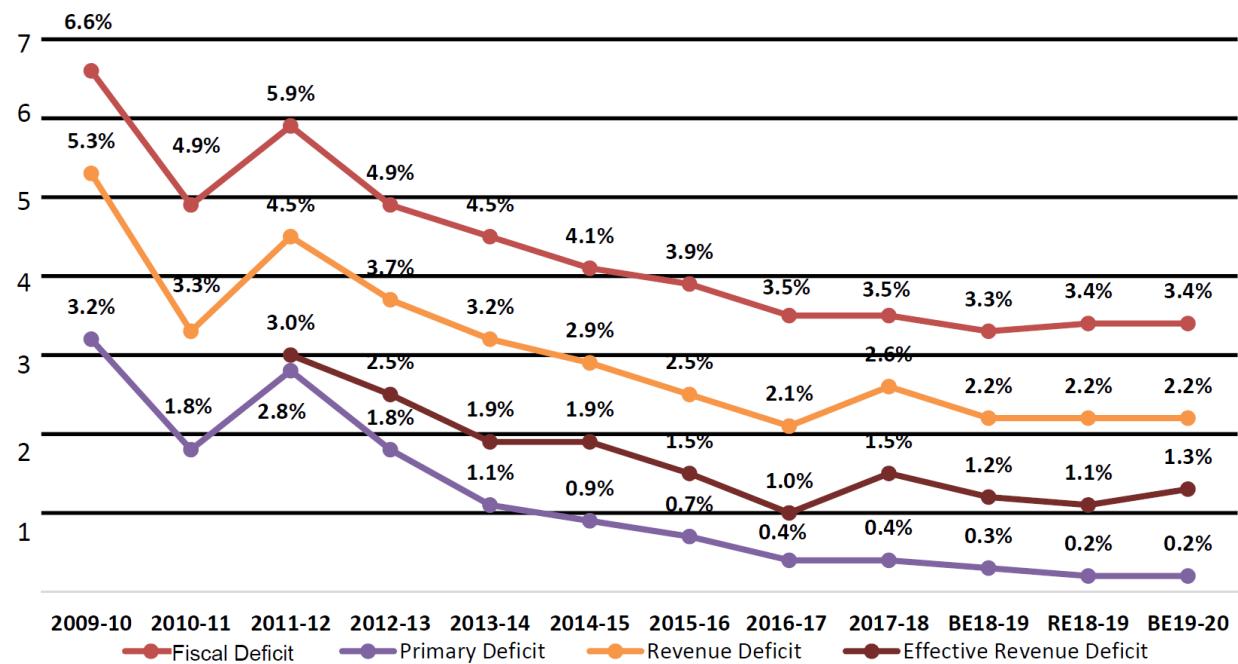
बजट → पूँजीगत भाग → व्यय

Capital Expenditure: पूँजीगत व्यय	Interim-2019 (₹ lakh cr): अन्तरिम-2019
<i>Capital assets for various schemes, ministries, departments (Building, vehicles..)</i>	1.18 lakh crores
<i>Repaying of loan principal for internal debts</i>	60 lakh crores
<i>Repaying of loan principal for external debts</i>	35,000 cr
<i>Giving Loans to CPSEs, State Govt, Foreign Govt etc.</i>	91,000 cr.
<i>Total Capital Expenditure</i>	63 lakh crores

21 TYPES OF DEFICITS: घाटे के प्रकार

- If government's income >> its expenditure it will have a **surplus budget/ अधिशेष बजट**
- If government's expenditure == its income, it will be a **balanced budget/ संतुलित बजट**
- If government's expenditure >> its income, it'll be a **deficit budget/ घाटे का बजट**

Deficit	Formula	Interim-2019 (₹ lakh cr)
Revenue Deficit राजस्व घाटा	Revenue expenditure – Revenue receipts	4.70 lcr. (2.2% of GDP)
Effective Revenue Deficit प्रभावी राजस्व घाटा	Revenue Deficit minus Grants for creation of capital assets	2.70 lcr. (1.3% of GDP)
Budget Deficit बजट घाटा	Budget expenditure minus Budget receipt	00
Fiscal Deficit राजकोषीय घाटा	Budget Deficit	7.00 lcr. (_ _ _ of GDP)
Primary Deficit प्राथमिक घाटा	Fiscal Deficit minus	39000 cr. (0.2% of GDP)



MCQ. Find Correct Statement(s) (Asked in UPSC-Pre-2017)

1. Tax revenue as a percent of GDP of India has steadily increased in the last decade.
 2. Fiscal deficit as a percent of GDP of India has steadily increased in the last decade.
- Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither I nor 2

21.1 FISCAL DEFICIT: राजकोषीय घाटा

- **Fiscal Deficit** = Budget Deficit + Borrowing. *This borrowing includes borrowing at home (such as through Small Savings Scheme, and the G-Secs subscribed by Banks/NBFCs) + Borrowing from RBI + Borrowing from abroad.*
- Alternatively, we can expand formula as $\text{Fiscal Deficit} = \text{Total expenditure} - (\text{Revenue receipts} + \text{Non-debt capital receipts})$.

21.2 PRIMARY DEFICIT: प्राथमिकघाटा

- If the government continues to borrow year after year, it leads to accumulation of debt and the government has to pay more and more interest. These interest payments themselves contribute to borrowing requirements next year.
- So, to get a clearer picture of how much is the government borrowing for new programs, they look at another indicator:
- **Primary Deficit** = Fiscal deficit minus the interest to be paid on the previous loans.

21.3 FINANCING THE DEFICIT AND ITS NEGATIVE CONSEQUENCES ON ECONOMY:

घाटे का वित्तपोषण: अर्थव्यवस्था पे उसके नकारात्मक परिणाम

Deficit can be financed by either taxation, borrowing or printing money.

- Taxes can't be increased beyond a point because it may force people to evade taxes / discourage their motivation to work. (recall Laffer Curve).



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- High deficit → Government borrows more money → @Maturity of G-Sec, it will have to return the principal and interest to the lenders. At that time, Govt may greatly increase taxes on people to arrange that amount. So, Economist David Ricardo argued that during high deficits, people save more, because they become cautious about future hike in taxes. It's called "**Ricardian equivalence: रिकार्डियन तुल्यता**" [& if people begin to spend less and save more, then companies will face unsold inventories, creating new set of problems]
- If government borrows more money from households & financial intermediaries (LIC, EPFO, Banks via SLR), then that much less money will be available for loans to private corporate borrowers. = " _____ : हासकारी प्रभाव" on the private borrowers= harms factory expansion and job creation.
- If Government forces SBI, LIC, EPFO to buy its G-sec using public deposits and thereby depriving households of the optimal return (Had the same money been invested in the corporate sector) = " _____ of the households: घरों/ कुटुम्बों का वित्तीय दमन".
- High level of fiscal deficit → International credit rating Agencies will reduce the sovereign rating → investors will demand more interest from government for buying new G-Sec → G-sec remains unsold → RBI forced to buy it (and print more money to give to Govt) → it's called " _____ : मुद्रीकृत घाटा". It can result in hyperinflation and reduce the purchasing power of currency (if there is not sufficient increase in the supply of onion, tomatoes & goods in the market.) e.g. Germany, after Treaty of Versailles (1919).

21.4 FISCAL CONSOLIDATION / PRUDENCE: राजकोषीय एकत्रीकरण / विवेक

It involves reduction in government expenditure to control its Fiscal Deficit. Such as

1. Reducing the scope of leakages by targeted delivery of schemes and subsidies through direct benefit transfer (DBT) through JanDha- Aadha- Mobile (JAM) trinity.
2. Reducing the quantum of subsidies: e.g.
 - a. Deregulation of Petrol prices (2010), Diesel Prices (2013).
 - b. 2016: Oil Ministry began to block LPG-Pahal subsidies to persons with annual taxable income of ₹ 10 lakh />
 - c. 2017: Oil Ministry asked oil companies to keep raising prices of subsidised kerosene by 25 paise every fortnight until the subsidy is eliminated.
3. Shutting down loss making PSU. E.g. Hindustan Photo Films, HMT Bearings, HMT Chinar Watches, Tungbhadra Steel, Hindustan Cable & HMT Watches (2014).
4. Privatization of loss making PSU/PSBs e.g. 2018- IDBI2LIC, 2018- Tried to sell off Air India, but unable to find any buyer.
5. Austerity Measures: मितव्ययिता के उपाय e.g. 2018- W.Bengal govt issued directives to its departments banning flower bouquets and mementoes in public functions, banning officials meetings at private hotels, frequent installation of AC, car purchases, office renovations etc. & restricting the number of foreign tours by Ministers / IAS etc., More use of video-conferencing instead of personal tours.



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MCQ. There has been a persistent deficit budget year after year. What can be done by by the government to reduce the deficit? (Asked in UPSC-Pre-2015)

- | | |
|---------------------------------|------------------------------------|
| 1) Reducing revenue expenditure | 2) Introducing new welfare schemes |
| 3) Rationalizing subsidies | 4) Expanding industries |
- Answer Codes: (a) 1 and 3 only (b) 2 and 3 only (c) 1 only (d) 1, 2, 3 and 4

MCQ. In India, the price of petroleum products has been deregulated mainly to (UPSC-CDS-2013-II)

- (a) reduce the burden of subsidies given to the oil companies
- (b) discourage the exploration of oil reserves in the country
- (c) discourage the demand for private vehicles
- (d) curb the use of black money in the economy

21.5 FISCAL STIMULUS (राजस्व प्रोत्साहन पेकेज)

- When government reduces taxes and/or increases public procurement (सरकारी खरीद) to boost the demand & growth in economy, it's called "*Fiscal Stimulus*".
- Post-subprime crisis in USA, Manmohan Govt. announced Fiscal Stimulus (2008) such as (1) Cut in the Excise duty & Custom Duty on exports (2) Businessmen where given additional depreciation benefits in Income Tax & Corporation Tax, if they purchased new commercial vehicles. (3) Hiked the MSP procurement prices for farmers.
- However, the economic surveys observed that such Fiscal Stimulus create new set of problems by increasing the fiscal deficit in the subsequent years.

MCQ. Which one of the following statements appropriately describes the "fiscal stimulus"? (Asked in UPSC-Pre-2011)

- (a) It is a massive investment by the Government in manufacturing sector to ensure the supply of goods to meet the demand surge caused by rapid economic growth
- (b) It is an intense affirmative action of the Government to boost economic activity in the country
- (c) It is Government's intensive action on financial institutions to ensure disbursement of loans to agriculture and allied sectors to promote greater food production and contain food inflation
- (d) It is an extreme affirmative action by the Government to pursue its policy of financial, inclusion

21.6 _____, 2003 (FRBM)

राजकोषीय उत्तरदायित्व और बजट प्रबंधन अधिनियम, 2003

Originally it required Union and States to control their deficits with following targets:-

- By 2008: Reduce Fiscal Deficit to 3% of GDP (for Union) and 3% of GSDP (for States).
- By 2008: Eliminate Revenue deficit (=make it 0%) of their respective GDP or GSDP.

While some of the state governments were able to do it, but successive union government struggled to meet these targets so they kept amending the act to extend the deadlines and targets. E.g. Amendment 2012: No need to have 0% Revenue deficit. Instead it required 0%



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Effective Revenue Deficit by 2015. These deadlines were extended even further in subsequent Finance Bills.

21.6.1 FRBM Review Panel under _____ (2016-17); समीक्षा पैनल

- **Budget-2016:** Jaitley felt FRBM Act targets were too rigid and did not allow any room for the government to address any crisis e.g. farm loan waivers during drought period or unemployment allowance during global financial crisis are not possible if government strictly wants to control fiscal deficit at 3% of GDP.
- So, he constituted a panel under NK Singh (former IAS, 15th FC chairman) to review the FRBM act. RBI Governor Urjit R. Patel & CEA Arvind Subramanian were also in the committee.

21.6.2 FRBM Panel's Notable recommendations: उल्लेखनीय सिफारिशें?

- Replace the existing FRBM act with a new act, with an ' _____ ' i.e. During a war, drought or economic crisis, the government should be temporarily allowed to cross breach targets.
- Set Up an independent Fiscal Council for monitoring.
- Adopt following fiscal road map for the union from 2017 to 2023 gradually reduce Union Debt to GDP (to less than 40%), Fiscal Deficit (to 2.5%) and Revenue Deficit (to 0.8%)

So, citing NK Singh report (as an excuse), Budget 2018 amended the FRBM targets →

Indicator as % of GDP	(Actual) 2018-19	(Actual) 2019-20	(TARGET) 2020-21	(TARGET) 2024-25
Fiscal Deficit	3.4%	3.4%	_____ %	3.0%
Primary Deficit	0.2%	0.2%	_____ %	0.0%
Revenue Deficit & ERD	These targets are abandoned in FRBM			
Union Debt: GDP	In 2017, it's ~46.5%, Gradually reduce it to →		_____ %	
General (=Union+State) Debt to GDP:	Gradually reduce to →		_____ %	

FRBM Act requires the union government to present 3 documents along with the budget:

1. **Fiscal Policy Strategy Statement (राजकोषीय नीति कार्यनीति विवरण):** To explain how Govt. is controlling the deficits, and whether there is going to be any deviation from the target.
2. **Macroeconomic Framework Statement (व्यापक आर्थिक ढाँचा विवरण):** to show economic data - GDP, growth rate, import-exports, and government's receipts and expenditure etc.
3. **Medium-term Fiscal Policy Statement (मध्यम अवधि की राजकोषीय नीति विवरण):** for next 3 year projections



		Revised Estimates	Budget Estimates	(Projections)	
		2018-19	2019-20	2020-21	2021-22
1.	Fiscal Deficit	3.4	3.4	3.0	3.0
2.	Revenue Deficit	2.2	2.2	1.7	1.5
3.	Primary Deficit	0.2	0.2	0.0	0.0
4.	Gross Tax Revenue	11.9	12.1	12.1	12.2
5.	Non-tax Revenue	1.3	1.3	1.3	1.3
6.	Central Government debt	48.9	47.3	45.4	43.4

(Concept) Fiscal Slippage: If government has targeted to keep the fiscal deficit within 3.4% percent of GDP, but if it crosses that limit, it's called '**Fiscal Slippage**'.

MCQ. According FRBM Act, the Government is under obligation to present three statements before the parliament along with the Annual Budget. Which one of the following is not one of them? [UPSC-CDS-2008-I]

- (a) Macroeconomic Framework Statement
- (b) Fiscal Policy Strategy Statement
- (c) Medium-term Fiscal Policy Statement
- (d) Statement showing Short term Fiscal Policy

21.6.3 Public Debt Management Agency (PDMA): सार्वजनिक ऋण प्रबंधन एजेंसी

- RBI decides on the repo rate and also undertakes open market operation for buying and selling of G-sec. Most of the G-sec are purchased by public sector banks, insurance and pension funds. As Banking-regulator, the Reserve Bank is able to nudge PSBs to subscribe to G-sec. So, this creates a 'conflict of interest' for RBI in its role as Banking regulator vs Public Debt manager.
- Budget-2015 proposed creating an independence Public Debt Management Agency (PDMA) to takeover these functions of RBI. But later plan was put on a back burner due to RBI's objections.
- 2019: NITI Aayog Vice Chairman Rajiv Kumar again reiterated the need to setup PDMA.

22 TYPES OF BUDGET: बजट के प्रकार

22.1 REVENUE VERSUS CAPITAL BUDGET: राजस्व बनाम पूँजीगत बजट

Revenue budget: राजस्व बजट	Capital Budget पूँजीगत बजट
It is associated with the income and expenditure that are of temporary in nature (1 year or less), and/or do not result into	associated with the income and expenditure that are of long term nature and/or results into creation of permanent / capital /financial



creation of permanent / capital / physical / financial assets.	assets, such as land, buildings, machinery, equipment, shares, bonds, G-sec.
Taxation, revenue from selling goods and services, interest payment on previous loans, salaries, pension, subsidies and other non-developmental expenditure	Borrowings, disinvestment, and expenditure on assets creation.

MCQ. Which of the following is/are included in the capital budget of the Government of India? (Asked in UPSC-Pre-2016)

1. Expenditure on acquisition of assets like roads, buildings, machinery, etc,
2. Loans received from foreign governments
3. Loans and advances granted to the States and Union Territories

Ans Codes: (a) 1 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

22.2 GENERAL BUDGET VERSUS RAILWAY BUDGET (आम बजट बनाम रेलवे बजट)

- 1920-21: _____ Committee recommends separate Railway Budget. This practice continued even after Independence, first the railway minister would present the Railway budget in parliament, and after a few days finance minister will present General Budget.
- NITI Aayog's Bibek Debroy committee recommends its abolition because 1) No constitutional requirement 2) During coalition governments, Rail budget was used for populism, cheap fares which eroded the profitability of Railways. 3) during the British time, railway revenue used to be quite large compared to other sources of revenue, but after independence, Railway revenue is quite small compared to overall General budget- So it does not deserve a special presentation.
- Therefore, Modi govt merged Railway budget merged with General budget from 2017.

22.3 PLAN VS NON PLAN EXPENDITURE BUDGET:

योजना बनाम गैर योजना व्यय बजट: is a method of classifying the expenditure side

Plan (expenditure) budget;	Non-Plan (Expenditure) Budget
<ul style="list-style-type: none"> - Central Plans (the Five-Year Plans) - Central assistance for State Five Year Plans. - It is further subdivided into revenue expenditure (e.g. teachers salary under Sarva Shiksha Abhiyan) and capital expenditure (e.g. new school buildings to be constructed under Sarva Shiksha Abhiyan) 	<ul style="list-style-type: none"> - Expenditure related to general, economic and social services of the government; Interest payments, defence services, subsidies, salaries and pensions. - It is also further subdivided into revenue expenditure (e.g. soldier salaries) and capital expenditure (e.g. Building new aircraft carrier).

Since Budget-2017, Modi govt stopped the practice of displaying the plan and non plan expenditure separately because (1) No such constitutional requirement (2) Government had dissolved the planning commission in 2014-15 (3) 12th Five Year Plan (2012-17) was ending in 2017 anyways.



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22.4 BUDGETING

It is the process / strategy with which the budget is created.

Traditional / Line-item Budgeting पारंपरिक / लाइन-आइटम बजट	पारंपरिक / लाइन-आइटम बजट: Simply calculating the income and expenditure without measuring the underlying benefit or performance <ul style="list-style-type: none"> - Allot ₹ 10,000/- to buy a New bed in government hospital - Allot ₹ 50,000 to buy a new computer in government department
Performance budgeting प्रदर्शन बजट	calculating the income and expenditure tied with underlying benefit or performance <ul style="list-style-type: none"> - Allot ₹ 50,000 to buy a new computer with target that it should result in 30% the faster clearance of RTI-applications compared to pen and paper based office system. <p>Such budgeting helps measuring everything in terms of cost:benefit, efficiency.</p>
Zero based budgeting शून्य आधारित बजट	<ul style="list-style-type: none"> - In a traditional budgeting, the approach is “automatic and incremental, “last year we allotted ₹ 50,000 crore to educational schemes, so this year we should allot 55,000 crores, lest the opposition parties create controversy.”. - Whereas in Zero based Budgeting the budget is viewed as a fresh exercise from zero base. So, each department has to justify its budget demands to finance ministry. E.g. if last year ₹ 50,000 crores given to education schemes but still 60% of class 5 kids cannot read class 2 books, then we'll delete / modify that scheme.
----- Budgeting सूर्योस्त/ समयसीमा का बजट	<ul style="list-style-type: none"> - In a traditional budgeting, once a scheme is launched it runs perpetually, even after regime change e.g. MNREGA, Mid-day Meal. - In a zero based budgeting, schemes are reviewed every year and then they may get discontinued or continued (with or without modifications). - In Sunset Budgeting, scheme are announced with deadline. e.g. MEITY to give MDR subsidy for a period of two years starting from 1/1/2018. Thus, this scheme will self destruct after deadline just like the sun will set after the sunset time.
----- लैंगिक बजट	<p>It is not a separate budget but rather within the general budget, FinMin will put a separate expenditure document showing women specific schemes, targets, and commitments- in two parts:</p> <ul style="list-style-type: none"> ✓ Part A = Women Specific Schemes, i.e. which have 100% allocation meant for women. E.g. Minority Affairs Ministry's "Nai Roshni" scheme for Leadership Development of Minority Women, ✓ Part B = Pro Women Schemes, i.e. where at least 30% allocation is meant for women. E.g. HRD Ministry → Sarva Shiksha Abhiyan. ✓ Practice started from Budget-2005.

22.5 TRIBAL SUB PLAN & SCSP

From 70s, Govt required individual ministries to earmark funds for SC/ST within their overall funds, under the titles:



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- A. “Scheduled Castes Sub-Plan (SCSP: अनुसूचित जाति उप-योजना)” → Social Justice Ministry monitors via e-utthaan.gov.in
- B. “Tribal Sub plan (TSP: आदिवासी उप योजना)” → Tribal Affairs Ministry monitors via stcmis.gov.in which is not a fancy name so we need not memorize unlike e-utthaan.

22.6 OUTPUT OUTCOME FRAMEWORK FOR SCHEMES:

योजनाओं के लिए उत्पादन परिणाम ढाँचा

Started from Budget-2017 onwards, the FinMin uploads a document showing outlay output and outcomes for each ministry and department. These are monitored by NITI Ayog. e.g.

Ministry & Scheme	Outlay	Output (Deliverables)	Outcome
MEITY → Pradhan Mantri Gramin Digital Saksharta Abhiyan (PMGDISHA)	₹ 400 crores	Give computer training to 5 crore persons in rural area	Increased number of digitally literate persons in rural areas

22.7 LAPSABLE FUNDS & MARCH RUSH: व्यपगत निधि और मार्च व्यस्तता

- Appropriation act allows the government to spend funds from consolidated fund of India for a period of one year (ending in 31st March).
- If any allotted funds remain unutilised, then by the ‘ _____ ’, they must be returned (& government will have to again seek Parliament approval for the next financial year using next appropriation bill).
- So, in March, there is rush among the Government organisations to spend money (in a haphazard / reckless manner) lest they've to return it back.
- 2017-18: Finance ministry issued directive that in “In the fourth quarter (Jan to March) and in the March-Month, Govt organizations shall not spend more than “x%” & “y%” of funds”. This helps controlling the March Rush.

22.8 NON LAPSABLE FUNDS & NO RUSH: बिनव्यपगत निधी

- The money in such fund will not lapse on 31st March, so it can be used in future without getting another approval from parliament. e.g. Department of economic affairs → _____ → women safety related projects.
- **Criticism?** because the fund is non lapsable, Departments become very lax in utilising it. Budget 2013 started Nirbhaya fund in the aftermath of Dec-2012 Gangrape @Delhi. The successive budgets kept adding ₹ into it. By 2018: ~3000 crore but not even 50% utilized for any women safety activities.
- 2018: Defence ministry demands “ non lapsable defence modernization fund”, but Finance ministry rejected the proposal for similar same reason. (money will remain unspent.)



22.9 CASH VS ACCRUAL BUDGETING: नगदी बनाम उपचय बजट

If Railways transported cargo of Jindal Steel in January, & raised ₹ 5 lakh invoice but Jindal actually paid money in February. Then, Railways account book can be prepared in 2 ways:

Income	Cash based accounting नकद आधारित लेखा	Accrual-based accounting उपचय आधारित लेखा
January	₹ 0	₹ 5 lakhs (it's deemed as 'earned' even though it's not 'paid' right now)
February	₹ 5 lakhs (i.e. when cash actually received / spent).	₹ 0
So?	Since colonial times, Govt. preparing accounts and budget in this manner.	<ul style="list-style-type: none"> - 12th FC suggest to use this method, for better estimation of income and expenditure. HOW? #BcomNOTIMP. - From 2019 Railways planning to adopt this. So, TheHindu columnists suggesting that all depts shd adopt

22.10 TYPES OF SCHEMES/ योजनाओं के प्रकार

- UPA/Congress Raj: hundreds of centrally sponsored schemes (CSS) with overlapping objectives and duplication of efforts.
- 2015-16: NITI Ayog forms Shivraj Singh Chouhan Panel for rationalization CSS → cabinet approved report → reduced, merged & restructured. Ultimate outcome is →

Central Sector Schemes केंद्रीय क्षेत्र की योजनाएं	Centrally Sponsored Schemes केंद्रीय प्रायोजित योजनाएं
— funded by Union	Not 100% funded by union. States have to bear some cost.
Examples: Urea Subsidy, MDR Subsidy, Jan Aushadhi Scheme, BharatNET, Pradhan Mantri Gramin Digital Saksharta Abhiyan (PMGDISHA) etc.	Further subtypes: <ol style="list-style-type: none"> 1. — (अति महत्वपूर्ण योजनाएँ): <ol style="list-style-type: none"> a. Only 6 schemes: MNREGA, NSoAP, Umbrella schemes for SC,ST,Minorities & other vulnerable groups. For these schemes, UPA-era funding pattern will continue. b. Those schemes deal with social protection and social inclusion are given first priority in the funding for National Development Agenda 2. — Scheme (महत्वपूर्ण योजनाएँ): e.g. PM Gram Sadak, PM Awas, Swachh Bharat, AMRUT & Smart cities etc. Here funding pattern could be 50:50, 60:40, 70:30, 75:25, 80:20 or 90:10 depending on a particular scheme and depending on whether it's a general / special cat. state.
Int-Budget-2019: ₹8.60lcr	Interim Budget 2019 allotted ₹ 3.27 lakh crores here.



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—** In 2016, the third category of Centrally Sponsored Schemes was “Optional Schemes” viz. 1) Border Area Development Programme 2) Shyama Prasad Mukherjee Rural Mission with funding pattern (50:50+80:20), But over the years they are shifted in the schemes.

- For any union territory without legislature: 100% funding by Union for any scheme in any category. We will look at the schemes’ features in the respective pillars.

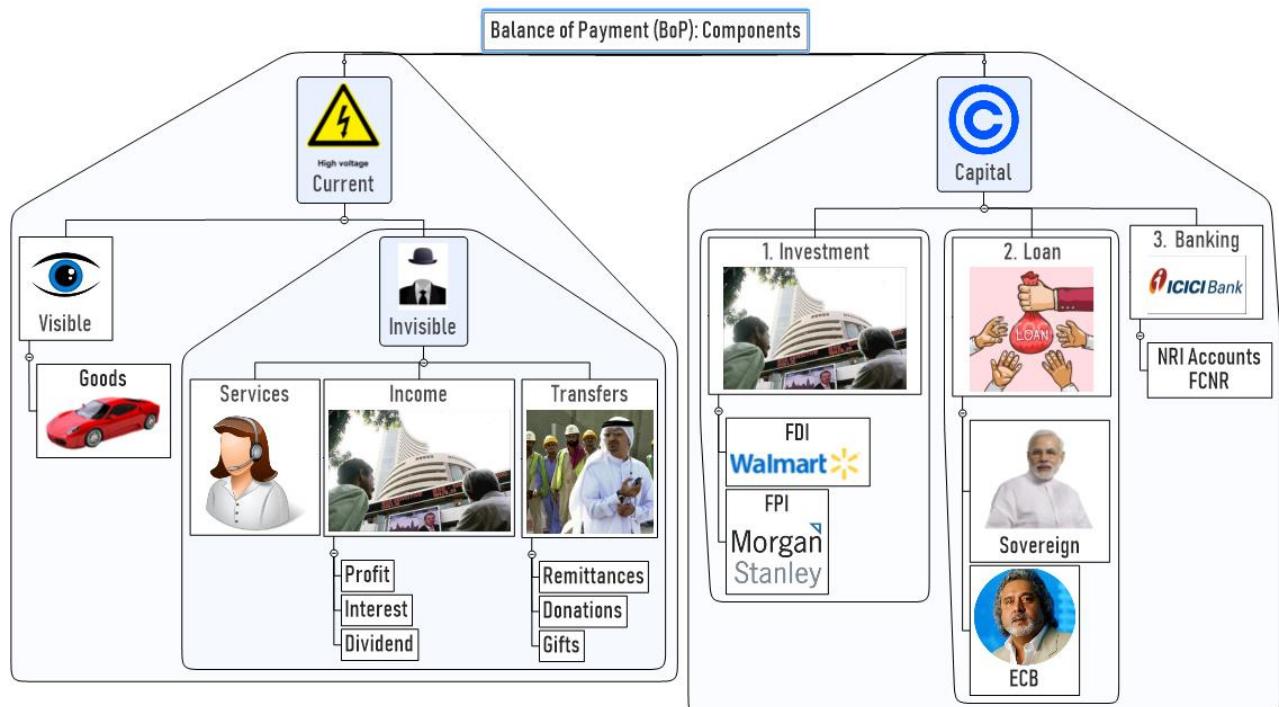
22.10.1 Mock Questions for UPSC Mains GSM3 (250 words each)

1. What are the terms of reference of the 15th finance commission? Why are some state governments apprehensive about them? १५वें वित्तीय आयोग के विचारार्थ विषय क्या है? कुछ राज्य इस विषयमें आशंकावान क्यों है?
2. “The constitution of GST Council has reduced the role of Finance Commission as the balancing wheel of fiscal federalism in India.” Do you agree? Justify your stand. “जीएसटी परिषद के गठन ने वित्त आयोग की भारत में राजकोषीय संघवाद के संतुलन में भूमिका को कम कर दिया है।” क्या आप सहमत हैं? अपने तर्क को उचित ठहराएं।
3. (Asked in GSM3-2018) Comment on the important changes introduced in respect of the Long-term Capital Gains Tax (LCGT) and Dividend Distribution Tax (DDT) in the Union Budget for 2018-2019. केंद्रीय बजट 2018-2019 के दीर्घकालिक पूँजीगत कर (एलसीजीटी) और लाभांश वितरण कर (डीडीटी) के संबंध में पेश किए गए महत्वपूर्ण परिवर्तनों पर टिप्पणी करें।
4. (Asked in GSM3-2016) Discuss the requirements and status of gender budgeting in the Indian context? भारतीय संदर्भ में लिंग बजट की आवश्यकताएं और स्थिति चर्चा कीजिए.
5. (Asked in GSM3-2013) What are the reasons for introduction of Fiscal responsibility and Budget Management (FRBM) act, 2003? Discuss critically its salient features and their effectiveness. राजकोषीय उत्तरदायित्व और बजट प्रबंधन (FRBM) अधिनियम, 2003 को लागू करने का क्या कारण है? इसकी प्रमुख विशेषताओं और उनकी प्रभावशीलता पर गंभीर रूप से चर्चा करें।
6. (Asked in GSM3-2013) Money laundering poses a serious threat to country’s economic sovereignty. What steps are required to be taken to control this menace? मनी लॉन्ड्रिंग देश की आर्थिक संप्रभुता के लिए एक गंभीर खतरा है। इस खतरे को नियंत्रित करने के लिए क्या कदम उठाए जाने की आवश्यकता है?



23 BALANCE OF PAYMENT (BoP: भुगतान संतुलन)

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



23.1 BALANCE OF PAYMENT → CURRENT ACCOUNT →

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



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

23.1.1 Balance of Trade: व्यापार का संतुलन

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

As per Economic Survey 2017-18

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

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

MCQ. The balance of payments of a country is a systematic record of (Asked in UPSC-Pre-2013)

- (a) All import and export transactions of a country during a given period of time, normally a year.
- (b) Goods exported from a country during a year.
- (c) Economic transaction between the government of one country to another.
- (d) Capital movements from one country to another.

MCQ. Which of the following does not form part of current account of Balance of Payments? [UPSC-CDS-2014-II]

- | | |
|----------------------------------|-----------------------------------|
| (a) Export and import of goods | (b) Export and import of services |
| (c) Income receipts and payments | (d) Capital receipts and payments |

MCQ. With reference to Balance of Payments, which of the following constitutes/constitute the Current Account? (Asked in UPSC-Pre-2014)

- | | |
|--|----------------------------|
| 1. Balance of trade. | 2. Foreign assets. |
| 3. Balance of invisibles. | 4. Special Drawing Rights. |
| Answer codes: (a) 1 only (b) 2 and 3 (c) 1 and 3 (d) 1, 2 and 4 | |

23.1.2 _____'s Remittance Report 2018 विश्व बैंक प्रेषण रिपोर्ट

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



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

23.2 BALANCE OF PAYMENT → CURRENT ACCOUNT → IMPORT OF OIL

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

23.2.1 Domestic Oil Exploration Policies?

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

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

NELP's primary limitations were

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

2016: NELP was replaced with _____ (HELP:

हाइड्रोकार्बन अन्वेषण और लाइसेंसिंग नीति). Benefits?

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

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



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

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

23.2.3 Oil prices & OPEC

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

23.3 BALANCE OF PAYMENT → CURRENT ACCOUNT → IMPORT OF GOLD

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



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

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

23.3.2 (2015: स्वर्ण बांड योजना)

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

23.3.3 (2015: स्वर्ण मुद्रीकरण योजना)

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

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

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

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



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MCQ. What is/are the purpose/purposes of Government's 'Sovereign Gold Bond Scheme' and 'Gold Monetization Scheme'?(Asked in UPSC-Pre-2016)

1. To bring the idle gold lying with Indian households into the economy.
 2. To promote FDI in the gold and jewellery sector.
 3. To reduce India's dependence on gold imports.

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

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

23.3.5 Bhartiya Nirdeshak Dravya (2017)

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

23.3.6 BoP → Current → Export → GI Tag

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

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

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

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

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

GI-Controversy?

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

23.3.7 BoP → Current → Exports → SEZ

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

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



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

23.3.8 Baba Kalyani report on SEZ

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

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



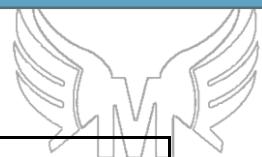
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23.3.9 BoP → Current → Exports → Foreign Trade Policy (2015-2020)

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

FTP-Policy identified region wise opportunities and challenges such as

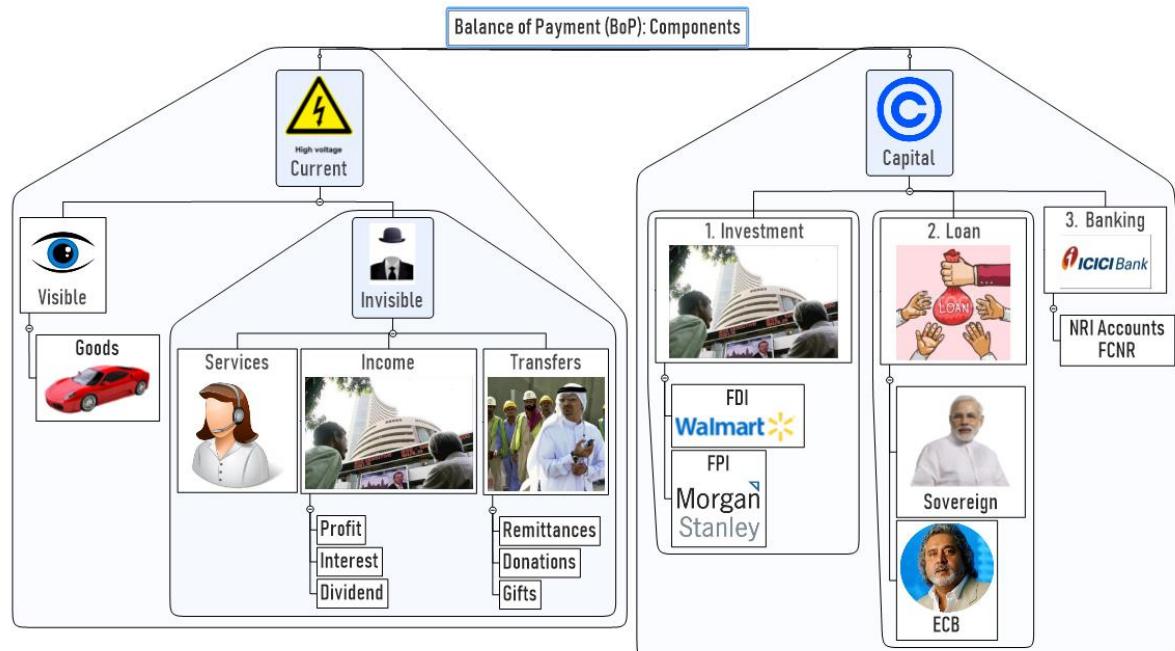
US,EU	Due to variety of tariff and non tariff barriers @USA and EU, we should deepen trade ties the other countries in the respective continents (Mexico, Canada, Georgia, Albania etc) and use their FTAs with US/EU to send our products. Bulk tea cargo to Mexico → further processing → Free trade from Mexico to USA under NAFTA/USMCA.
SAARC	We should integrate SAARC region as a value added chain. E.g. Jute from Bangladesh → make stylish jute bags in India → Export elsewhere.
ASEAN	We have free trade agreements with these countries, but we're importing more than we're exporting here. Need to more focus on skilling, R&D, innovation in our products.
China, Japan	<ul style="list-style-type: none"> - Market access is difficult in China because of the non tariff barriers (e.g. their pharma regulators would delay approving Indian drugs) - Market access is difficult in Japan due to language barrier (they prefer Japanese over English in even product labelling & customer helpdesk support)



CIS	<ul style="list-style-type: none"> - Commonwealth of Independent States (CIS) like Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan etc. - We should create value added chains through them to export towards Russia and EU. e.g. Bulk drug cargo from India → Turkmenistan → repack them into tablets/bottles→send to EU
WANA	West Asia and North Africa region is full of so many countries that instead of pursuing individual free trade agreements with each & every country, better we approach their regional organizations such Gulf Cooperation Council (GCC), COMESA (Africa), ECOWAS (West Africa). and separately we should engage with Israel on one-on-one basis.
LAC	<ul style="list-style-type: none"> - In Latin American countries, we can explore ‘contract farming’ (अनुबंध खेती) e.g. like China has purchased vast track of land for cultivating Maize for biodiesel. - We can also provide LAC nations with project loans for infrastructure / transport development with conditions attached to make'em buy the machinery and engineering services from India. (just like how JICA-Japan gives bullet train loans to India).

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

23.4 BoP → CAPITAL ACCOUNT → INVESTMENT → FDI / FPI



23.4.1 _____ (FPI: विदेशी पोर्टफोलियो निवेशक)

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



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

23.4.2 Foreign Direct Investment (FDI): प्रत्यक्ष विदेशी निवेश

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

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

23.4.3 FDI → 100% Automatic permitted in

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



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

23.4.4 FDI → Others

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

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

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

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

23.4.4.1 India's new FDI rules for E-Commerce

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

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



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

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

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

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

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

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

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

23.4.5 Ministry of Commerce and Industry:

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

Attached offices	<ul style="list-style-type: none"> - Directorate General of Foreign Trade (DGFT: विदेश व्यापार महानिदेशालय) for promotion of foreign trade. - Directorate General of Trade Remedies (DGTR) to impose anti-dumping duty on foreign products.
PSUs	<ul style="list-style-type: none"> - MMTC Ltd. (<i>Gold-coin-walle</i>) - Export Credit Guarantee Corporation of India (ECGC) Ltd (<i>Exporters' Insurance</i>)
Autonomous bodies स्वायत्त निकाय/ संस्थाएं	<ul style="list-style-type: none"> - Agricultural and Processed Food Products Export Development Authority (__ __ : कृषि और संसाधित खाद्य उत्पाद निर्यात विकास प्राधिकरण), under its statutory act. - Indian Institute of Foreign Trade (IIFT)- a “Deemed University” that offers MBA, PHD & other programs. - Statutory Commodity Boards → Coffee, Rubber, Tea, Tobacco, Spices Board



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23.4.6 2017 → FIPB Abolished

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

23.4.7 2019 → DIPP becomes DPIIT

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

23.4.8 _____ (IFSC: अंतर्राष्ट्रीय वित्तीय सेवा केंद्र)

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



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

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

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

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

1. Foreign Loans. 2. Foreign Direct Investment.
 3. Private Remittances. 4. Portfolio Investment.
 Answer codes:(a) 1, 2 and 3 (b) 1, 2 and 4 (c) 2, 3 and 4 (d) 1, 3 and 4

23.5 BoP → SUMMING UP

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

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



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

23.5.1 _____ (स्थिरीकरण)?

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

23.6 INDIA'S BALANCE OF PAYMENT CRISIS (1991)

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

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

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



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

23.6.1 RBI's Forex Reserve: विदेशी मुद्रा रिजर्व

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

MCQ. Which one of the following groups of items is included in India's foreign-exchange reserves? (Asked in UPSC-Pre-2013)

- (a) Foreign-currency assets, Special Drawing Rights (SDRs) and loans from foreign countries.
- (b) Foreign-currency assets, gold holdings of the RBI and SDRs.
- (c) Foreign-currency assets, loans from the World Bank and SDRs.
- (d) Foreign-currency assets, gold holdings of the RBI and loans from the World Bank.

23.7 CURRENCY EXCHANGE RATE: मुद्रा विनिमय दर

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

23.7.1 Exchange Rate Regime: Theory

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



<u>or Flexible (अस्थाई विनिमय दर)</u>	<u>or Pegged (नियत विनिमय दर)</u>
<p>Here the exchange rate is determined by the market forces of demand and supply.</p> <ul style="list-style-type: none"> - So if there are more number of Indian people wanting to import crude oil, gold, iphones; / going to USA for higher studies,... Compared to the number of Americans willing to buy Indian goods, services; / coming to vacation in Kerala - Then, demand for dollars will be more than that of rupees. So, \$1 = 50 → \$1=70 	<p>When the central bank of a country itself decides the exchange rate of local currency to foreign currency e.g. People's Bank of China (PBC) \$1 = 6 Yuan.</p> <ul style="list-style-type: none"> - If excess dollars are entering in their market, the central bank will print more yuan to buy and absorb the excess dollars, to ensure Yuan doesn't strengthen against Dollar (\$1=6 → 5 Yuan). As a result their forex reserve will get large build up of dollars, due to Central bank's purchase. - In future, if less dollars are entering in their market, the central bank will sell the (previously acquired) dollars from its forex reserve to ensure Yuan doesn't weaken (₹ 1= 6 → 7 Yuan)
<p>In this system,</p> <ul style="list-style-type: none"> - if rupees weakens, it's called “ _____ (मूल्यह्रास e.g 50 → 70); Makes the export look cheaper to the foreign buyer - if ₹ strengthens it's called “ _____ : अभिमूल्यन” (e.g. 70 → 50) 	<p>In this system,</p> <ul style="list-style-type: none"> - if yuan is weakened by Central Bank's official notification, it's called 'devaluation' (अवमूल्यन e.g. \$1=6 → 7); usually done when it doesn't have enough dollars in reserve to play the game and / or when it wants to deliberately weaken yuan to encourage exports. - if yuan is strengthened by Central Bank's official notification, it's called "Revaluation: पुनर्मूल्यांकन" (e.g. \$1=7 → 6)
<p>Challenge?</p> <ul style="list-style-type: none"> - Currency Speculation: When a person buys \$ and other foreign currency with the hopes they become more expensive in future so he can sell@ profit to others. (so he'd be hoping for ₹ to depreciate / \$ to appreciate). Such elements distort the exchange rate by hoarding foreign currencies. - Interest Rates: If US repo rate / Treasury Bonds are going @2% whereas in Greece's bonds going@4% Then American investors 	<p>Challenge?</p> <ul style="list-style-type: none"> - If trade deficit widens / speculators are hoarding dollars / FPIs are pulling their money back to USA due to higher interest rates → shortage of \$ in local forex market → PBC will have to sell \$ from its forex reserve to keep the exchange rate stable. - but since PBC will not have infinite amount of dollars in its reserve ultimately it will be forced to be devalue the local currency → imports will become more expensive.



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will convert Dollars to invest in Greece. Later, when US fed increases their repo rate from 2% to 4% American investors might pull back from Greece. (Because America commercial bank loans will become more expensive ~5%, then there will be American companies willing to borrow by issuing Bond/debentures at 4.5%).	<ul style="list-style-type: none">- Therefore, most of the countries have abandoned this system after 70s. China too abandoned it in 2005-06, and shifted to Managed Floating Exchange Rate.
--	--

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

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

23.7.2 ----- / Dirty Float; प्रबंधित चल/ मलिन चल

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

23.7.2.1 Challenges in Managed Float System?

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

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

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

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



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23.8 EXCHANGE RATE REGIME: HISTORIC

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

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

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

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

23.8.3 Currency Exchange in India

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



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Towards Fixed Exchange Rate: निश्चित विनिमय दर की ओर →

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

Towards Managed Floating Exchange Rate →

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

23.9 IMF _____ (SDR: विशेष आहरण अधिकार)

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

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

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

MCQ. Recently, which one of the following currencies has been proposed to be added to the basket of IMF's SDR? (Asked in UPSC-Pre-2016)

23.10 CURRENCY CONVERTIBILITY(मुद्रा परिवर्तनीयता)

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

23.11 RBI RESTRICTION ON CONVERTIBILITY OF RUPEE: रुपये की परिवर्तनीयता

Convertibility on Capital Account Transactions: पंजी खाता लेनदेन पर

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

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

BoP → Capital Account → Investment → FPI

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

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

Convertibility on Current account transactions: चालू खाता लेनदेन पार

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

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

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

23.11.1 ----- :रुपये की पूर्ण परिवर्तनीयता?

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

Anti-Arguments:

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



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

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

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

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

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

23.11.3 ₹ Convertibility → RBI reforms (2004-2019)

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

- 2004 → _____ (LRS: उदारीकृत विप्रेषण योजना) for each financial year, An indian resident (incl. minor) is allowed to take out upto \$2,50,000 (or its equivalents in other currencies) from India. He may use it for either current account or capital account transaction as per his wish. (e.g. paying for college fees abroad, buying shares, bonds, properties, bank accounts abroad.)

Controversy? Panama papers allege certain bollywood celebrities used LRS window to shift money from India in their shell companies in tax havens → later used those shell companies for tax avoidance. [Ref: Black Money Handout for more]

- **2016 onwards:** RBI began relaxing the norms for _____ (ECB: विदेशी वाणिज्यिकर्ज), mainly to soften the NPA problem e.g. Software cos. can bring up to \$200 million in ECB, Microfinance \$500 mill, Infra.cos \$750 mill etc.
- **2018-19:** When ₹ started to depreciate heavily against dollars (\$1 → ₹ 63 → ₹ 74), RBI had to encourage the flow of dollars into Indian economy. So, aforementioned sector-specific limits streamlined → all eligible companies automatically allowed to borrow upto \$750 million via ECB route. (Although prohibited in certain categories e.g. purchase of farm house, tobacco, betting, gambling, lottery etc.)

MCQ. Convertibility of rupee implies: (Asked in UPSC-Pre-2015)

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

23.12 CURRENCY WAR 2018 (मुद्रा युद्ध)

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



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

23.12.1 **Currency War → Fall of Indian ₹ in 2018**

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

To combat this fall, Govt and RBI initiated following steps

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



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

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

23.12.2 Quantitative Easing and Federal Tapering

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

23.12.3 Helicopter Money & Zero interest rate regimes

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

23.12.4 Yuan as global currency?

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



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

23.13 EXCHANGE RATE → MISCELLANEOUS TERMINOLOGIES

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

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

----- दोहरा घाटा	It's the term used when both Current Account Deficit and _____ are high : चालू खाता घाटा और राजकोषीय घाटा
_____ क्रय शक्ति समता (PPP)	<ul style="list-style-type: none"> - Hypothetical concept that tries to compare two currencies' exchange rate through their purchasing power in respective countries. - So, If 1 cup of coffee in India = ₹ 20 whereas 1 cup of coffee costs \$2 in USA then Dollar to Rupee exchange rate (PPP) should be \$1 = ₹ 10. (According to OECD, exact figure is \$1=₹ 17@PPP). - This (hypothetical) exchange rate can happen in real life, if both the countries have Floating exchange rate without any intervention of the respective Central banks; and if the bilateral trade is free of protectionism (= without tariff /non-tariff barriers).
Big Mac Index	The Economist magazine's informal index to measure PPP exchange rate using the price of one McDonald burger in USA vs the respective country.

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

23.13.2 Mock Questions for Mains:

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



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



24 PILLAR #3B: BRETON WOODS ORGANIZATIONS

ब्रेटन वुड्स सम्मेलन was held in Bretton Woods town, New Hampshire in USA after the WW2 (1939-45) to restore the global economy. Total 44 nations participated, incl. India. It proposed 3 international institutions:

1. _____ (IBRD), commonly known as World Bank.
2. International Monetary Fund (IMF).
3. (Proposed) International Trade Organisation (ITO). But could not materialize due to American opposition. Instead, the countries later setup GATT → WTO.

While World bank and IMF are considered “Specialized Agencies of UN (संयुक्त राष्ट्र की विशेष एजेंसियाँ)”, the WTO is considered “Related organization of UN (संबंधित संगठन)” because it doesn't fulfill all requirements of UN charter on specialized agencies.

24.9 BRETON WOODS → 1) WORLD BANK, WASHINGTON, 1944

विश्व बैंक originally focused on reconstructing war-torn European countries. After 50s focusing on poor countries of Asia and Africa. World Bank comprises of 5 institutions, namely

<i>1) International Bank for Reconstruction and Development (IBRD)</i> अंतर्राष्ट्रीय पुनर्निर्माण और विकास बैंक	Commonly known as the world bank. Gives development loans with interest.
<i>2) International Development Association (IDA)</i> अंतर्राष्ट्रीय विकास संघ	Assists the poorest countries through interest-free long-term loans (= “Concessional Loans: रियायती ऋण” or “soft loans”).
<i>3) International Finance Corporation (IFC)</i> अंतर्राष्ट्रीय वित्त निगम	supports private enterprise in developing countries. Known for its _____ Bonds.
<i>4) Multilateral Investment Guarantee Agency (MIGA)</i> बहुपक्षीय निवेश प्रत्याभूति एजेंसी	offers (foreign) investors insurance against non-commercial risk (such as political instability, regime change etc.). This helps 3rd world nations attract foreign investment.
<i>5) International Centre for the Settlement of Investment Disputes (ICSID)</i> निवेश संबंधी विवादों के निपटान का अंतर्राष्ट्रीय केन्द्र	Helps in dispute resolution related to foreign investment / foreign companies in 3rd world countries.

Voting power?

- In the first four organizations, voting power depends on the share capital provided by a country. USA highest, followed by various European giants.
- Fifth is a “dispute settlement” body, so the concept of ‘each country's voting power’ does not apply to it.

World Bank President?

- Since USA and European powers collectively command large shareholding in World Bank & IMF, so their informal arrangement is- USA's favorite will be picked as World Bank chief, while European countries' favorite will be picked as IMF Chief.
- 2017: Jim Yong Kim (USA) given 5 years tenure, but resigned at 2019-Feb. New President: _____ (*Update new name when it's announced*).

World Bank is known for Reports? World Development Report, Ease of doing business Index, Global Economic Prospects report 2019 titled “Darkening Skies”.



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24.10 (NON-BRETON WOODS) → MULTILATERAL DEVELOPMENT BANKS

A multilateral development bank (MDB: बहुपक्षीय विकास बैंक) is an institution, created by a group of countries, that provides financing and professional advising for the purpose of development. Apart from World bank, the other notable examples are →

24.10.1 BRICS Bank and AIIB

	BRICS Bank New Development Bank (NDB) नई विकास बैंक	AIIB: Asian Infrastructure Investment Bank एशियाई अवसरचना निवेश बैंक
Started in	6th BRICS Summit in Fortaleza (2014) members signed treaty	2015-16
Members	Brazil, Russia, India, China South Africa	China, India, UK, Switzerland, ~70 nations as of 2019.
Voting power	Each member is given equal _____ voting power.	Based on share capital provided. China ~27%, India ~7%. Asian countries control about 75% voting.
HQ	-----, China	Beijing, China

- BRICS member have also setup \$100 billion BRICS Contingent Reserve Arrangement: (आकस्मिक रिजर्व व्यवस्था) to help members during BoP crisis- similar to IMF.
 - BRICS nations also planning to setup their BRICS payment system parallel to SWIFT (ref: NPA handout), and BRICS rating agency (ref: SEBI-Share Market handout)

24.10.2 Multilateral Development Banks → Others

BIS: Bank for International Settlements	<ul style="list-style-type: none"> - 1930: setup in BASEL, Switzerland. - Made up of 60 countries' Central Banks. Its committee on banking supervision set norms in 1988 (I), 2004 (II), 2011(III) to ensure global financial stability.
African Development Bank	<ul style="list-style-type: none"> - 1964: setup in Abidjan in Ivory Coast - India is a member, also gets loans.
Asian Development Bank (ADB)	<ul style="list-style-type: none"> - 1966: setup in Manila, Philippines - India is a member, also gets loans.
European Bank for Reconstruction & Development (EBRD) पुनर्निर्माण और विकास के लिए यूरोपीय बैंक	<ul style="list-style-type: none"> - 1991: setup at London. - India became member (shareholder) in 2018. India will not be eligible for loans from EBRD but India can initiate joint investment proposals in Asian, African, European nations for its soft-diplomacy.

MCQ. Consider the following statements:(Asked in UPSC-Pre-2016)

1. New Development Bank has been set up by APEC.
 2. The headquarters of New Development Bank is in Shanghai.

Which of the statements given above is/ are correct?



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24.11 BRETON WOODS → 2) IMF, WASHINGTON, 1945

- International Monetary Fund (IMF: अंतर्राष्ट्रीय मुद्रा कोष) helps in global currency exchange stability, helps against balance of payment crisis.
- Acts as a reservoir of the currencies of all the member countries, from which a borrower nation can borrow the currency of other nations- using the Special Drawing Rights (SDR) mechanism. (Ref: Previous Handout on Currency Exchange.)
- **IMF Chief?** Christine Lagarde (France).
- **IMF' Chief Economist (CE)?** _____, an Indian-American economist, she became the first woman to be the Chief Economist of IMF (2019-Jan). Previously Raghuram Rajan has also served in this position.
- Notable reports? Global Financial Stability Report, _____
- United Nations (UN) has 195 members, whereas IMF has 189 members. But pursuing this type of KBC GK = poor cost:benefit for UPSC

MCQ. 'Global Financial Stability Report' is prepared by the(Asked in UPSC-Pre-2016)

- (a) European Central Bank
- (b) International Monetary Fund
- (c) International Bank for Reconstruction and Development
- (d) Organization for Economic Cooperation and Development

MCQ. Which of the following organizations brings out the publication known as 'World Economic Outlook'?(Asked in UPSC-Pre-2014)

- (a) The International Monetary Fund
- (b) UN Development Programme
- (c) The World Economic Forum
- (d) The World Bank

24.12 BRETON WOODS → 3) GATT → WTO (GENEVA)

- Initially, Bretton Woods conference proposed set up the International Trade Organisation (ITO) But USA opposed → the idea could not materialise → 1948: _____ (GATT: टैरिफ/शुल्क और व्यापार के लिए सामान्य समझौता) was setup.
- Uruguay Round of GATT negotiations decided to set up a permanent institution which can encourage international trade not only in goods, but also in services and Intellectual Property Rights (IPR: बौद्धिक संपदा अधिकार) → Marrakesh treaty (1994) → WTO started functioning from 1/1/1995 at Geneva, Switzerland. India is a founding member.



25 WORLD TRADE ORGANIZATION: विश्व व्यापार संगठन

WTO structure consists of →

Ministerial Conference मंत्री सम्मेलन	<ul style="list-style-type: none"> ✓ Supreme Decision Making body ✓ Meets once every _____ years, deliberates on trade agreements ✓ One country = one vote. (unlike IMF & World Bank, where the money power → shareholding → determines the voting power) ✓ Appoints Director General: महानिर्देशक to look after administrative work. Presently: Roberto Azevêdo (Brazil)
General Council सामान्य परिषद	<ul style="list-style-type: none"> ✓ Day to day decision making body @Geneva. ✓ Implements the decision of ministerial conferences ✓ Has representative from each member country. <i>has two bodies, with separate chairmen</i> <ol style="list-style-type: none"> 1. Dispute settlement body: विवाद निपटान निकाय 2. Trade policy review body: व्यापार नीति समीक्षा निकाय <p>Below general council, there are committees on individual agreements and annexes e.g. Anti dumping, Subsidies & countervailing measures (SCM) etc.</p>

25.9 WTO → FUNCTIONS

From the 16th to 18th century, economists believed in _____ Theory: व्यापारी सिद्धांत i.e. The amount of wealth in the world is static. A nation's wealth and power were best served by increasing exports and receiving payments in gold, silver and precious metals. Therefore any import was seen as loss of nation's wealth in gold payment. So, colonial powers tried to flood their colonies with readymade goods but always prevented entry of goods in their home country.

In 19th century, Economist David Ricardo gave “ _____ Theory”: "तुलनात्मक लाभ सिद्धांत" i.e. countries will engage in trade with one another, exporting the goods that they have a relative advantage in productivity e.g. France should export Champagne & wines to import readymade clothes from England's Manchester (instead of France trying to produce those clothes by itself, which would prove more costly than importing from Manchester.)

But even today, all countries try to protect domestic industries against foreign imports by creating two types of barriers against the international trade:

25.9.1 Tariff Barriers against international trade

Tariff Barriers: शर्करा बाधाएँ: Increasing the taxes, duties, cess, surcharge, on imported goods and services e.g. Trump imposed 25% custom duty on imported steel. Custom Duty is a tax imposed on imports and exports of goods.



CVD	Anti-Dumping Duty: प्रतिपाठन शुल्क
<ul style="list-style-type: none"> - When a foreign country is giving subsidies to their exporters, such product will be sent cheap to India and domestic industry cannot compete with it in terms of price. - Similarly, when Indian government imposes higher amount of taxes, cess or surcharge on the locally manufactured products, then imported items will automatically appear cheaper. - In such scenarios, Indian Govt tries to protect local (domestic) industry by imposing Countervailing Duty: प्रतिकारी शुल्क (CVD), Special Countervailing Duty, Additional Customs Duty. 	<ul style="list-style-type: none"> - If China exports goods to India at a price below their normal price in domestic Chinese market or at a price below their cost of production- then it is termed as “Dumping” - Then, India's commerce ministry → Directorate General of Trade Remedies : व्यापार उपचार महानिर्देशालय (DGTR) investigates → recommends Finance ministry to impose “Anti-Dumping Duty” on such imported items. - E.g. \$185 on every one tonne of imported Chinese Steel, Then its prices will become equivalent to domestically manufactured India Steel, thus Indian steel industry will be protected.
These duties have been removed in India. Now imported items are subjected to Basic Duty + social welfare surcharge.	Not yet abolished in India. They're imposed subjected to WTO norms.

25.9.2 ----- against international trade

गैर टैरिफ बाधाएँ: if Trump does not increase import taxes but plays other tricks like:

1. **Subsidies to domestic industries:** Giving free electricity to Detroit car manufacturers. OR USA govt. giving tax benefits & free car-insurance to American residents for buying American made cars.
2. **Public Procurement:** सार्वजनिक खरीद/प्राप्ति : Making rule that only American companies can fill up tender for supplying stationery, school bags etc. in government schemes.
3. **Technical Barriers to Trade:** व्यापार के लिए तकनीकी बाधाएँ: e.g. imported mango must have 0% pesticides residue.
4. **Quota system:** e.g. not more than 50 metric tonnes of steel can be imported from a single foreign country.

WTO aims to reduce such tariff and non tariff barriers to encourage international trade through its agreements and dispute settlement body. Prominent disputes involving India vs USA are

1. USA argued India's Jawaharlal Nehru Solar Mission gave public procurement preference & subsidy to India-made solar panels thus creating a non-tariff barrier for American solar panels. India lost the case @WTO & forced to withdraw such barriers (2017). However, USA still alleges that India is playing mischief in solar schemes by giving preference to local manufacturers over American-made products (2018)
2. In 2007, India had imposed the ban on American poultry under the Indian Livestock Importation Act, 1898 stating avian influenza / bird flu danger in India. USA claimed



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there was no scientific basis- India merely banning us to protect local poultry-wallas' business interest. WTO ruled in favour of USA (2016). But India has only allowed partial import of poultry from selected states of USA so, USA has demanded \$450 million compensation from Indian Govt. @WTO (2018).

There are total 7 such sectors where India and USA are fighting at WTO.

25.10 WTO → NOTABLE AGREEMENTS

Primary Objective	Agreement(s)
Reduce the tariff barriers	<ol style="list-style-type: none"> General Agreement on Tariffs and Trade (GATT) for goods- शुल्क और व्यापार पर सामान्य समझौता General Agreement on Trade in Services (GATS): सेवाओं के व्यापार पर सामान्य समझौता
Reduce the non tariff barriers	<ol style="list-style-type: none"> For non-food: Agreement on Technical Barriers to Trade (TBT): व्यापार में तकनीकी बाधाएँ) e.g. talcum powder should not have more than x% of asbestos. For food: Agreement on Sanitary and Phytosanitary Measures (SPS: स्वच्छता और पादप उपाय) e.g. food item must not have more than y% pesticides residue.
Reduce non tariff barriers → Subsidies	<ol style="list-style-type: none"> For non-food: Subsidies and Countervailing Measures (SCM: सब्सिडी और काउंटरवेलिंग उपाय) For food: Agreement on Agriculture (AoA: कृषि पर समझौता)- which aims to regulate the subsidies on agriculture through its 'box' mechanism. <ol style="list-style-type: none"> Subsidies that are classified in _____ box category- are allowed (e.g. Research, Cattle-Vaccination). whereas Amber (एम्बर) box category subsidies will be subjected to quantitative limits (e.g. Fertilizer, Electricity, Diesel, MSP.)
Misc. measures to encourage global trade	<ol style="list-style-type: none"> ----- (TRIPS: बौद्धिक संपदा अधिकारों के व्यापार-संबंधित पहलू) Trade-Related Investment Measures on Foreigners. (TRIMs: विदेशियों पर व्यापार से संबंधित निवेश के उपाय) Misc. plurilateral agreements (बहुपक्षीय समझौते): Which are not signed by all the members e.g. Agreements on aircrafts, dairy product, bovine meat, Information Technology Agreement (ITA)

MCQ. In the context of which of the following do you sometimes find the terms 'amber box, blue box and green box' in the news? (Asked in UPSC-Pre-2016)

- (a) WTO affairs (b) SAARC affairs (c) UNFCCC (d) India-EU negotiations



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MCQ. The terms 'Agreement on Agriculture', 'Agreement on the Application of Sanitary and Phyto-sanitary Measures' and 'Peace Clause' appear in the news frequently in the context of affairs of the ___ (Asked in UPSC-Pre-2015)

- (a) Food and Agriculture Organization (b) UN Framework Conference on Climate Change
(c) World Trade Organization (d) United Nations Environment Programme

MCQ. TRIPS Agreement pertains to (Asked in UPSC-CDS-2017-I)

- (a) international tariff regime (b) intellectual property protection
(c) international practices on trade facilitation (d) international taxation of property

25.11 WTO NEGOTIATIONS / SUMMITS / PACKAGES

25.11.1 ----- (MFN)- अत्याधिक वरीयता वाले देश

- Suppose India levies 15% custom duty on imported pen-drives from any country. But, later India-Japan trade agreement is signed wherein Japanese pen-drives are subjected to only 5% custom duty in India. Then implies Japan has become the Most Favoured nation for India (as far as pen-drive trade is concerned).
- WTO agreements require that whatever treatment is being given to the Most Favoured Nation, must also be extended to all other member countries. A member should not discriminate between its trading partners. (So even imported Pakistani pendrives should be subjected to 5% custom duty only, if India is charging that % on Japanese). But in practice, MFN is not implemented in letter and spirit by the members.
- 1996: India granted MFN status to Pakistan but Pakistan didn't reciprocate (mainly) due to their local textile industrialists' lobby who feared competition from Indian textile imports. 2019-Feb: India withdrew MFN status for Pakistan, following Pulwama attack on CRPF personnel. India also hiked the customs duty by 200% on goods originating from Pakistan.

MCQ. The Most Favoured Nation (MFN) Clause under WTO regime is based on the principle of [UPSC-CDS-2017-I]

- (a) non-discrimination between nations (b) discrimination between nations
(c) differential treatment between locals & foreigners (d) uniform tariff across commodities

25.11.2 ----- (LDC)

- सबसे से कम विकसित देश are identified by the UN Economic and Social Council: संयुक्त राष्ट्र आर्थिक और सामाजिक परिषद (ECOSOC).
- Somaliya, Ethiopia, Congo, Central African Republic, Bhutan, Bangladesh etc.
- Least Developed Countries' economic growth can improve if they are able to export more. So, WTO agreements permit other countries to give duty free quota free access to exports from LDC. and that is not considered as a violation of any other agreement.
- e.g. If India levied 0% custom duty on Somalian pendrives, India will not be required to give same treatment to Japanese pen drives under "MFN norm", Because Japan is not an LDC.

Before dwelling into summits, let's keep a few terminologies in mind →

1. First world countries, Advanced Economies (AE), Developed countries= such as USA Canada, France and Germany etc.



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2. Second world countries= USSR and its neighbouring European countries which were under the influence of Communist Socialist ideologies. However the term has become defunct with the collapse of USSR.
3. Third world countries, developing countries, Emerging market economies (EME)= India China, Mexico, Brazil etc.

Some of the burning and contentious issues between 1st world vs. 3rd world at WTO→

25.11.3 Doha Development Round (Qatar)

In WTO's "Doha development agenda" (2001) negotiations, the 3rd world countries want that:

- ✓ 1st world should liberalize their trade regulation further so that 3rd world's goods and services can enter more easily in the first world's domestic markets.
- ✓ 3rd world should be allowed to keep various barriers to slow down the entry of 1st world's agriculture, manufactured goods and service exports in their domestic market.
- ✓ 1st world should give financial and technical assistance to 3rd world.

Obviously, USA and European countries would not like this so Doha round of negotiation continues without conclusion. And in future summits the USA/EU would want WTO officials to begin negotiations on the new matters lucrative to their MNCs (like ICT, E-Commerce) whereas 3rd world nations will continue to insist that Doha round negotiations must be concluded first.

25.11.4 Food subsidies & peace clause: खाद्य रियायतें और शान्ति अनुच्छेद/उपधारा

- Under WTO's Agreement on Agriculture (AoA), 1st world and 3rd world countries are required to limit their food-subsidies to 5% and 10% respectively to the value of their agriculture production in 1986
- But in 1986 Rajiv-Gandhi-era India's agricultural production was far lower than USA so even in absolute quantitative terms USA's 5% will be much bigger than India's 10% → 1st world countries are able to give larger amount of food subsidies to their farmers → export them to 3rd world countries @cheap price, and ruining local farmers. Further, India has a large population of poor farmers who require Government support in the form of subsidies and procurement at Minimum support prices. India also has a large number of malnourished poor families who need subsidized food grains under National Food Security Act.
- 2013: WTO ministerial conference at Bali (Indonesia) → India refused to sign any new agreements until this food subsidy issue was resolved.
- So, WTO Peace Clause → it gave temporary immunity to India and other developing countries, "you may continue to give as much subsidy for your food programs. If USA/any other country challenges your food subsidies@WTO's dispute settlement platforms, we'll not hear their petition." यानि की दे धनाधन सब्सीडी दो और मौज करो.

25.11.5 Bali Package & Trade Facilitation Agreement / TFA (2013)

Bali Package is the trade agreement / outcome resulting from the WTO ministerial conference (मंत्री सम्मेलन) 2013 @Bali, Indonesia. Its two significant components are :

1. **Trade Facilitation Agreement:** व्यापार सुविधा समझौता (TFA): It requires the member countries to reduce their bureaucratic delays, red tapes, inspector raj in import-export of goods. They've setup online portals where traders can seek permissions, pay fees,



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custom duties, self declaration forms (*like e-way bill*) etc. India & others ratified in 2016
→ TFA became effective from 2017. India set up a National Committee on Trade Facilitation (NCTF) under _____ (IAS). Below him, there is a steering committee jointed headed by Revenue secretary (IAS) and Commerce secretary (IAS).

2. Peace Clause on subsidies → explained above.

MCQ. Find correct among the following statements: (Asked in UPSC-Pre-2017)

1. India has ratified the Trade Facilitation Agreement (TFA) of WTO.
2. TFA is a part of WTO's Bali Ministerial Package of 2013.
3. TFA came into force in January 2016.

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

25.11.6 ----- & SSM (2015)

Nairobi Package resulted from the WTO ministerial conference 2015 @Nairobi, Kenya →

1. We'll extend the Peace Clause for another "x" years.
2. Members must stop the subsidy on Agriculture Exports: 1st world countries must comply immediately while 3rd world countries given a relaxed deadline.
3. If there is a surge of cheap agro exports from 1st world to 3rd world, then 3rd world countries will have the right to temporarily increase tariff / taxes on them, to protect their local farmers. This will be called "-----: विशेष सुरक्षा तंत्र (SSM)." →
4. 1996 → Information Technology Agreement (ITA) plurilateral agreement (i.e. not signed by all member nations) → It aims to abolish import export taxes on ~200 IT products.
We'll try to get more members sign this, so global IT-trade can increase.
5. Technical reforms to help the exports from Least Developed Countries (LDC).

25.11.7 Buenos Aires Summit #flop (2017)

The 11th WTO Ministerial conference 2017 @Buenos Aires, Argentina failed to deliver any notable and substantial package because :

1. Food subsidy related reforms remained inconclusive because neither India-China nor USA-EU were willing to compromise. So, in reality 'Peace clause' is extended for infinite period- which is not a good thing because large amount of food subsidies given on (chemical) fertilizers harm the environment.
2. USA-EU were more keen for a new agreement on e-commerce but India-China opposed that such agreements will benefit 1st world countries more (because they've amazon, walmart, facebook etc) than 3rd world. India insisted that first finish negotiations of the original Doha agenda subjects, before proposing such new topics like e-commerce.
3. Members also failed to conclude negotiations related to Special Safeguard Mechanism (SSM), investment facilitation, MSME etc..

As a result, this conference ended without a joint declaration by the members.

The next conference will be held at Kazakhstan's _____ (2020).

MCQ. Consider the following statements relating to WTO: [UPSC-CDS-2014-II]

1. The WTO deals with the global rules of trade between nations.
2. The goal of the WTO is to help producers of goods and services, exporters, and importers conduct their business.
3. The WTO, which is a successor body of the General Agreement on Tariffs and Trade, came into being following the Uruguay Round of Negotiations.



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4. The WTO distances itself in framing of rules on trade in intellectual property rights. Which of the statements given above are correct?
(a) 1, 2 and 3 (b) 2, 3 and 4 (c) 1, 2 and 4 (d) 1 and 3 only

25.12 TRADE AGREEMENTS TYPES: व्यापार समझौते के प्रकार

1. **Partial Scope Agreement** (PSA: आंशिक व्यापकता समझौता): Trade between two countries for a small list of goods @reduced tariffs.
2. **Preferential Trade Agreement** (PTA: अधिमानी व्यापार समझौता) / Free Trade Agreement (FTA: निःशुल्क व्यापार समझौता): Member= lower tariff; non-members: regular tariff.
 - a. All FTAs are not same. Tariff and list of allowed goods/services could vary depending on country to country.
 - b. Depending on number of participants it can be bilateral or multilateral or regional or global (e.g. WTO).
 - c. If countries go further beyond just lower tariffs e.g. relaxed norms for entry of foreign investment and foreign workers, then it becomes CEPA = Comprehensive Economic partnership Agreement or CECA = Comprehensive Economic Cooperation Agreement. CEPA vs CECA Internal difference not important.
3. **Customs Union** (CU: सीमा शुल्क संघ): FTA in which members apply a common external tariff (CET) for non- members. E.g. Caribbean Community (CARICOM)
4. **Common Market** (CM: सामान्य बाजार): Customs union where factors of production (capital, labour) can move freely amongst members e.g. MERCOSUR- S.America.
5. **Economic Union** (EU: आर्थिक संघ): common market where member countries keep common currency & tariff. Allow entry of goods, services, capital and labour among themselves with minimum restrictions. They decide their fiscal policies and diplomatic policies through a common parliament European Parliament, and their monetary policies through a common central bank - European Central Bank.

25.13 FREE TRADE AGREEMENTS → TPP, TATIP, RCEP

25.13.1

(TPP: ट्रांस पैसिफिक साझेदारी) #FAIL

- USA proposed free trade agreement among 12 countries: US, Japan, Malaysia, Vietnam, Singapore, Brunei, Australia, New Zealand, Canada, Mexico, Chile and Peru.
- Aimed to have lower tariffs for participant countries, easier norms for labour, environment and investment.
- 2016: President Trump withdrew from the negotiation claiming TPP will take away jobs from USA (because companies will setup factories in Mexico where labour is cheaper, and then such cheap products will be dumped in USA, yet we'll not be able to impose heavy taxes on them.) So TPP has become defunct.

25.14

(TTIP)

अंतर-एटलांटिक व्यापार एवं निवेश समझौता: Proposed free trade agreement between USA & EU with objectives similar to TPP- reduce tariff, easier entry of foreign investment etc. Negotiations are ongoing but it is not yet signed mainly due to opposition from the European Union side. E.g.

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1. In USA's Farm, Dairy and Meat industry the standards related to pesticide residue, pathogens, antibiotics, growth hormones, genetically modified (GM) crops etc. are slightly lower than EU. So, EU's animal rights & environmental groups worried it will lead to unrestricted flow of those "harmful" products from USA to Europe.
2. EU has strict norms on private companies to cut their emissions and compulsorily invest in renewable energy. In USA such norms are relaxed. EU's environmental groups don't want such 'polluting US companies' to profit via exporting to EU.
3. USA wants EU nations to cut down the subsidies and preferences given to EU's state owned enterprises (SOE) / PSUs. The EU civil rights / labour rights group fear it will lead to privatisation of health, education, and insurance companies which will cause unemployment of PSU-workers, and when pvt.MNCs are providing such essential services it'll become unaffordable for many poor citizens.

USA had been lobbying for TPP and TTIP because USA is disillusioned with the WTO- wherein India, China and other emerging economies have equal voting rights and have become more assertive, so USA and its MNCs are not gaining much benefit out of WTO led agreements. But, If TPP/TTIP materialised, it'd harm Asian economies exports towards US/EU so to compensate that loss, Asian economies came up with their own idea RCEP....

25.14.1 ----- (RCEP)

व्यापक क्षेत्रीय आर्थिक साझेदारी is a proposed agreement between

- 10-ASEAN countries viz. Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam.
- +6 FTA partners of ASEAN viz. Australia, China, India, Japan, South Korea, NZ
- Objective? Reduce tariff on goods and services; encourage investments, economic and technical cooperation, protect Intellectual Property Rights etc.
- Update? 2019-March: The 7th round of RCEP negotiation was held @Siem Reap city in Cambodia → members agreed to finish negotiations and conclude the treaty by the end 2019 itself.

Economic survey 2015-16 observed that

- India has signed 40+ trade agreements with various countries, our global trade has improved but more on import side than export side.
- RCEP, TTIP, TPP are mega regional agreements that will undermine the WTO processes. India must prepare for this changing world. India should shed its "big but poor" dilemma i.e. We've to grow up from the mentality that "Our India is poor nation we must protect farmers & MSME so we have moral right to impose tariff and non-tariff barriers on US/EU goods/services & yet US/EU must allow our goods/services into their countries without any barriers!" It's for this reason, India-European Broad-Based Trade and Investment Agreement (BTIA) is not reaching conclusion. International trade is a give-and-take relationship we've to reduce our trade barriers only then we can expect them to reduce their trade barriers.

MCQ. Consider the following countries:(Asked in UPSC-Pre-2018)

- 1.Australia 2.Canada 3.China 4.India 5.Japan 6.USA

Which of the above are among the 'free-trade partners' of ASEAN?

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



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25.14.2 Trade agreements losing shine → NAFTA & SAFTA

NAFTA 1994	<ul style="list-style-type: none"> - North American Free Trade Agreement; उत्तरी अमेरिका निशुल्क व्यापार समझौता (1994) involves Canada, USA and Mexico. - However, Trump felt NAFTA harms the American interests → 2018: He made a deal with Mexico and Canada to replace NAFTA with a new agreement called United States-Mexico-Canada-Agreement (USMCA).
SAFTA 2004	<ul style="list-style-type: none"> - _____ : दक्षिण एशियाई मुक्त व्यापार क्षेत्र (SAFTA) is a trade agreement of SAARC nations- Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. - 2016: India refused to attend SAARC Annual summit @Pakistan, after Uri-Attack. In 2019 India raised duties on Pakistani goods so SAFTA's is losing its shine.

25.15 BURNING ISSUES IN INTERNATIONAL TRADE

25.15.1 Protectionism, Trade war: संरक्षणवाद, व्यापार युद्ध

- Protectionism means the use of tariff and non tariff barriers to protect the local industry against foreign competition.
- Trade war happens when two / more nations attack each other's exports through tariff and non tariff barriers.
- 2017: USA had \$375 billion trade deficit with China. Cheap import from China → domestic American manufacturers suffer. US companies outsourcing to China → unemployment of American workers.
- 2018: Trump announced 25% tariff on imported steel, semiconductors, chemicals, plastics, motorbikes and electric scooters etc. from China. So, China retaliated by hiking tariff on imported American soybean & other food products, chemicals, medical equipments & vehicles.
- Both also filed complaints against each other at WTO.
- EU also making similar protectionist moves against China and India.

25.15.2 USA's _____ report

- Annual report that lists the countries who are harming the Intellectual Property Rights: बौद्धिक संपदा अधिकार, copyrights, patents and trademarks of American companies.
- These countries are classified into categories such as "Priority Foreign Country" (Most dangerous) > "Priority Watch List" > "Watch List" etc.
- Depending on the classification, USA will complain to WTO and / or spend money on those countries to reduce the piracy (e.g. training and capacity building of Russian police officers & China's cybercrime courts etc.).
- 2018: India, Russia, China etc. are in priority watchlist. Mainly because of their hackers, movie piracy, counterfeit products; India because of its drug patent norms & NPPA which reduce the profitability of US pharma companies' patented drugs.

25.15.3 USA's _____ (GSP) list

यूएसए की प्राथमिकताओं की सामान्यीकृत प्रणालीसूचि

- If a developing country's name is in this list, its exports will be subjected to zero/lower import duties in USA (for selected products only).
- 2019: Trump removed India from GSP list, citing India has imposed heavy import duties on Harley Davidson bikes and other American exports.



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- As such most of the Indian exported goods to USA are not in the GSP list in the first place, so this blacklisting will not harm India much, albeit, Indian textile companies are worried that GSP-removal will make Indian garments more expensive in USA.

Related term: Global System of Trade Preferences among Developing Countries (GSTP: विकासशील देशों के बीच व्यापार व्यवस्था की वैश्विक प्रणाली) is a trade agreement among developing countries and LDC signed under the aegis of United Nations Conference on Trade and Development (UNCTAD: व्यापार और विकास पर संयुक्त राष्ट्र सम्मेलन) in 1988. It aims to reduce the trade barrier among themselves. India is a member.

25.15.4 How does US/EU/China trade war impact India?

Previous economic surveys observed:

- US's protectionism is targeted more towards Chinese goods than towards Indian services (IT/BPO) because of their local political / vote bank perception that Chinese manufacturing industries are more responsible for the loss of American jobs than Indian call-centres. So, India need not worry excessively.
- Besides, Chinese tariffs on USA → opportunities for India to export its soyabean, cars, medical equipments to China.
- Nonetheless, India has also retaliated by hiking the tariffs on imported American and Chinese products.

However, with the rise of nationalistic political groups in the 1st world nations, India will face following challenges →

- 1st world nations' local industrial groups keep pressuring their governments to impose more tariffs on Indian fisheries, textile and pharma sectors.
- 1st world nations tighten their visa / immigration policies = NRIs suffer. (Although positive in the sense it'll result into 'brain gain' for India, instead of 'brain drain' - says Mukesh Ambani!)

25.15.5 BREXIT = BRITAIN EXIT

- 1993: Maastricht Treaty formed European Union, a political and economic union to allow easy movement of goods, services, citizens among themselves.
- 2002: EU introduced its common currency, Euro. Although Britain was an EU member, it continued with its own currency 'Pound Sterling'.
- Later, Britain's political parties campaigned that 1) migrant workers from other EU countries= job loss for local Britishers. 2) EU framework is harming our economic and foreign diplomacy interests.
- 2016: Britain held a referendum & asked its citizens "whether the Britain should EXIT or remain in the European Union?" 52% voted yes, 48% voted no.
- 2017: Britain invokes Article 50 of ____ Treaty, which gives them 2 years timeframe to workout a deal for exit / divorce. e.g. What happens to UK citizens living elsewhere in the EU and EU citizens living in the UK etc. How much money does Britain must pay to EU for leaving?
- So, accordingly Britain is scheduled to leave @+2 years= 29th March 2019. But there is internal political bickering among British parliamentarians on the terms of exit deal.



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25.15.5.1 How does BREXIT affect India?

BREXIT creates both opportunities and challenges for India. We will have to rebuild / update our trade agreements with both parties separately.

- With the rise of ‘nationalism’, ‘protectionism’ in Britain/EU → India’s textile, pharma, automobile exports may get hurt. Although Britain may ease its travel & education visa norms to attract Indian students for their college fees.
 - EU is planning to create a ‘Digital Single Market by 2020’ to cover digital marketing, E-commerce and telecommunications related services. Indian companies can provide backend services.
 - British goods will no longer get easy entry in EU, so they’ll try to export more towards India - because of India’s rising middle class & their growing purchasing power. We can demand reciprocal treatment e.g. “we’ll cutdown tariff for your ‘x’ list of goods, if you do the same for ‘y’ list of Indian goods.”
 - Britain becomes ‘free’ of EU’s foreign policies so it may come up with new initiatives for Palestine, Middle East, Afghanistan etc. and to keep India on board, Britain may give some concessions e.g. “Vote in favour of our “x” resolution @UNGA & we’ll cut down tariff on Indian goods by y% & will give a cheap infra. loan @z%”. And so forth...

MCQ. The term ‘Digital Single Market Strategy’ seen in the news refers to (Asked in UPSC-Pre-2017)

MCQ. ‘Broad-based Trade and Investment Agreement (BTIA)’ is sometimes seen in the news in the context of negotiations between India and ___ (Asked in UPSC-Pre-2017)

- (a) European Union (b) GCC (c) OECD (d) SCO

26 OTHER NOTABLE GROUPINGS RELATED TO ECONOMY

26.9 GROUPINGS: INDIAN SUBCONTINENT

SAARC, 1985	BIMSTEC, 1997
----- ; दक्षिण एशियाई क्षेत्रीय सहयोग संघ	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) बहुक्षेत्रीय तकनीकी और आर्थिक सहयोग के लिए बंगाल की खाड़ी पहल
HQ: _____, Nepal (1985)	Dhaka, Bangladesh (1997)
8: Afghanistan, Bangladesh, Bhutan, India, Nepal, Maldives, Pak & Sri Lanka.	7 members: Bangladesh, India, Myanmar, Sri Lanka, Thailand , Nepal and Bhutan.
<ul style="list-style-type: none"> - 2016: summit @Islamabad cancelled after India and others boycotted due to Uri attack. - Then no annual summits in 2017, 2018. Although 2019 summit is planned @Colombo, Sri Lanka. 	Summits every four years. 2018 summit @Kathmandu, Nepal. Next will be in Colombo, Sri Lanka.

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- SAFTA losing its shine as we learned in earlier section.
- India has setup South Asian University (SAU-2010) @ Delhi (2010) for SAARC students.
- India launched South Asia Communication Satellite (_____) in 2017 to provide tele-medicine, tele-education, banking and television broadcasting facilities to SAARC nations.

26.10 GROUPINGS: ASEAN vs SCO

ASEAN	SCO
-----: दक्षिण पूर्व एशियाई राष्ट्र संघ	Shanghai Cooperation Organization : शंघाई सहयोग संगठन
1969 → Bangkok declaration → HQ: Jakarta, Indonesia	<ul style="list-style-type: none"> - 2001 → HQ: _____, China. - Regional Anti-Terrorist Structure (RATS) @Tashkent, Uzbekistan
10 Members: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.	<ul style="list-style-type: none"> - 6 founding members: Russia, China, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. - +2 new members: India & Pak.
<ul style="list-style-type: none"> - 2018: marked the 25th Anniversary of ASEAN-India Dialogue Relation, their leaders were invited to India-> Delhi declaration with the theme “Shared Values, Common Destiny” - Their 10 leaders also graced our 26th January 2018 Republic Day parade as chief guests. 	<ul style="list-style-type: none"> ✓ 2017: SCO summit at Astana, Kazakhstan → India, Pak formally given membership. ✓ 2018: SCO summit at Qingdao, China resulted Qingdao declaration- a 3-year plan to combat terrorism. India refused to endorse China's One belt one road (OBOR) policy in this summit.

26.11 GROUPINGS: OCEAN-RIM WALLA

Indian Ocean Rim Association (IORA); हिंद महासागर रिम/किनारा एसोसिएशन (IORA)	Asia-Pacific Economic Cooperation (APEC) एशिया-प्रशांत आर्थिक सहयोग
22 Indian Ocean rim nations. India is a member. China-USA are dialogue partners.	21 Pacific Rim ocean economies. India is not a member, China-USA are members.
Setup in 1997, HQ: Ebene, Mauritius	1989, HQ: Singapore
<ul style="list-style-type: none"> - 2018 summit @S.Africa's Durban where they established Mandela Scholarship, added Maldives as a member but blocked membership of Myanmar due to S.Africa's opposition. 	<ul style="list-style-type: none"> - 2018 summit @Port Moresby, Papua New Guinea. India is keen to become member but not yet added.



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26.12 GROUPINGS: BRICS, OECD, OPEC, G20 & JAI

BRICS , 2009	<ul style="list-style-type: none"> - Brazil, Russia, India, China and South Africa. S.Africa joined later in 2011. - 2016 BRICS New Development Bank - 2018 summit @Johannesburg, S.Africa with theme “Collaboration for Inclusive Growth and Shared Prosperity” - 2019 summit @Curitiba, Brazil. - Role of secretariat is played by its pro tempore presidency 2018: S.Africa. 2019: Brazil
OPEC, 1961	<ul style="list-style-type: none"> - Organization of the Petroleum Exporting Countries: पेट्रोलियम निर्यातक देशों का संगठन- 1961 HQ@Vienna, Austria. - a group of oil producing countries Saudi, UAE, Venezuela, Iran, Iraq etc.... total 14 members. Qatar withdrew from 1/1/19. Russia is NOT a member.
OECD , 1961	<ul style="list-style-type: none"> - Organisation for Economic Co-operation and Development: आर्थिक सहयोग तथा विकास संगठन-1961 HQ@Paris, France. - Works for International cooperation in the matters of economy and taxation. Known for Base erosion and profit shifting (BEPS) Norms. India is a member.
G-20 1999	<ul style="list-style-type: none"> - International forum for the governments and central bank governors from 19 countries and the 1 European Union. Setup in 1999. - Annual summits: 2018@Buenos Aires-Argentina, 2019@Osaka-Japan....2022@Delhi.
JAI trilateral 2018	Prime Minister Narendra Modi, US President Donald Trump and Japan Prime Minister Shinzo Abe met in a trilateral format in the sidelines of G-20 Summit in Buenos Aires, Argentina. It was called the first-ever ‘JAI’ meeting. Objective? Economic growth and common prosperity.

26.13 GROUPINGS: GCC vs OIC

Gulf Cooperation Council (GCC); खाड़ी सहयोग परिषद (GCC)	Organisation of Islamic Cooperation (OIC) इस्लामिक सहयोग संगठन (OIC)
1981: HQ-Riyadh, Saudi Arabia	1969: HQ-Jeddah, Saudi Arabia
6 members: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.	~50 Islamic countries from across of the world.
2017: some of these members have cut off diplomatic and business ties with Qatar.	2019-March: While India is not a member but first time invited in OIC meeting as guest of honour. Sushma Swaraj attended @Abu Dhabi,UAE while Pakistan (OIC member) skipped the event in protest.



26.14 MISC GROUPINGS / ORGANIZATIONS

UN specialized agencies related to Economy	<p>List not exhaustive:</p> <ul style="list-style-type: none"> - UNCTAD: United Nations Conference on Trade and Development - UNDP: United Nations Development Programme known for its Human development report (more in pillar#6) - UNIDO: UN Industrial Development Organization - World Intellectual Property Organization (WIPO) - International Labour Organization (ILO) <p>Their establishment years, HQ etc. = KBC GK poor cost:benefit</p>
World Economic Forum, 1971	<ul style="list-style-type: none"> ➢ Not-for-profit think-tank in Cologny (a municipal area in Geneva), Switzerland. ➢ Known for its annual summit at Davos resort in Switzerland where they invite selected world leaders, thinkers, NGOs and industrialists. ➢ Known for its annual reports: Global Competitiveness Report, Global Information Technology Report, Global Gender Gap Report, Global Risks Report, Global Travel and Tourism Report, Financial Development Report, Global Enabling Trade Report.
Andean Community	<p>Free trade area of the the South American countries of Bolivia, Colombia, Ecuador, and Peru.</p>
Mercosur	<p>Southern Common Market of Argentina, Brazil, Paraguay, Uruguay + ANDEAN + other countries. However Venezuela was suspended in 2016.</p>

26.15 EXPORT CONTROL / NON-PROLIFERATION REGIMES;

बहुपक्षीय निर्यात नियंत्रण / अप्रसार व्यवस्था

While not related directly to economy, but they control the 'buying & selling' of bombs!

NSG 1974	<ul style="list-style-type: none"> - Nuclear Suppliers Group (NSG: परमाणु आपूर्तिकर्ता समूह) is a group of countries that control the export of nuke materials, equipment and technology & aim to prevent its use in making nuclear bombs. - China is a member, India not a member yet due to China's objection.
Australia Group 1984	<ul style="list-style-type: none"> - Informal group that encourages members not to export chemical or biological weapons or technology. - China not a member, India became member (2018).
MTCR 1987	<ul style="list-style-type: none"> - Missile Technology Control Regime (मिसाइल प्रौद्योगिकी नियंत्रण व्यवस्था) is an informal group that encourages members not to export missiles equipment, software, technology. - China not a member, India became member (2016)
Wassenaar Arrangement 1996	<ul style="list-style-type: none"> - Wassenaar is an area in Netherland. This arrangement (1996) requires members to be strict and transparent in the export of conventional arms and dual-use goods and technologies. So they don't fall in the hands of terrorists and rogue states like N.Korea. - China not a member, India became member (2017)



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Many other topics related to IR annual summits, treaties etc for prelims self-study from PDF/Mags.

26.16 MOCK QUESTIONS FOR MAINS GSM2

Syllabus Topic: Important International institutions, agencies, for a (structure, mandate); Bilateral, Regional, Global groupings & Agreements (involving and/or affecting India)

1. Discuss the importance of membership to Shanghai Cooperation Organisation (शंघाई सहयोग संगठन) in furthering India's interests in the Central Asian region.
2. In 2018, the 25th Anniversary of ASEAN-India Dialogue Relations was commemorated under the theme of "Shared Values, Common Destiny (साझा मूल्य, समान भाग्य) ". In what areas do India and ASEAN nations share common values and common destiny?
3. "The USA-China and USA-EU trade wars (व्यापार युद्ध) present new sets of threats and opportunities for India." Examine.
4. What are the key areas of reform if the WTO has to survive in the present context of 'Trade War', especially keeping in mind the interest of India? (Asked-in-GSM2-2018)
5. The aim of Information Technology Agreements (ITAs) is to lower all taxes and tariffs on information technology products by signatories to zero. What impact should such agreements have on India's interests? (Asked-in-GSM2-2014)
6. India has recently signed to become founding a New Development Bank (NDB) and also the Asian Infrastructure Investment Bank (AIIB). How will the role of the two Banks be different? Discuss the significance of these two Banks for India. (Asked-in-GSM2-2014)
7. WTO is an important international institution where decisions taken affect countries in profound manner. What is the mandate of WTO and how binding are their decisions? Critically analyse India's stand on the latest round of talks on Food security. (Asked-in-GSM2-2014)
8. The World Bank and the IMF, collectively known as the Bretton Woods Institutions, are the two inter-governmental pillars supporting the structure of the world's economic and financial order. Superficially, the World Bank and the IMF exhibit many common characteristics, yet their role, functions and mandate are distinctly different. Elucidate. (Asked-in-GSM2-2013)



4 PILLAR4A: SECTORS OF ECONOMY → AGRICULTURE

(Definition) Agriculture is a primary economic activity that includes growing crops, fruits, vegetables, flowers and rearing of livestock.

- **Modi-Target:** Doubling farmers' income by 2022-23 compared to _____.
- **UN-SDG#1:** End poverty in all forms.
- **UN-SDG#2:** Eliminate global hunger, protect indigenous seed and crop varieties, doubling agriculture productivity and small farmer incomes by 2030.
- **Sir Arthur Lewis' Dual Economy Model (द्वैत अर्थव्यवस्था):** Economic development results in labourers moving away from agriculture to the more productive industrial sector, & agriculture sector becomes less important part GDP.
- The number of people employed in agriculture is steadily falling down: 55% (2011) to 42% (2018) (*World Bank data*).
- The share of agriculture in the total GDP is falling down, but not steadily. ~15-17%
- The growth rate of agriculture has been zig zag due to El-Nino led drought years. Manmohan target was __ annual growth rate, Modi's 2x income target would require 10% annual growth rate in agriculture.

Agriculture & allied sectors (livestock, forestry, fishing)	2012 -13	2013 -14	2014 -15	2015 -16	2016 -17	2017 -18	2018 -19
Annual Growth Rate (%)	1.5	5.6	-0.2	0.6	6.3	5.0	2.7 (est)

4.1.1 [Yearbook-Info] Agro Ministry

Ministry of Agriculture and Farmers Welfare is made up 3 departments:

Agro-itself	Department of Agriculture, Cooperation and Farmers Welfare <ul style="list-style-type: none"> - Statutory: Coconut Development Board, National Cooperative Development Corporation, Protection of Plant Varieties and Farmers' Rights Authority, Registrar of Multi State Cooperative Societies. - Attached Office: National Rainfed Area Authority. - CPSE: National Seeds Corporation Ltd. (NSC) - Autonomous / Cooperative bodies: NAFED, Small Farmers Agribusiness Consortium (SFAC). Various boards / institutes for horticulture, plant health management, agro marketing etc.
Animals	Department of Animal Husbandry Dairying & Fisheries <ul style="list-style-type: none"> - Statutory: National Dairy Development Board (NDDB)
Agro Research & Extension	Department of Agricultural Research & Education <ul style="list-style-type: none"> - Autonomous body: _____ (ICAR: भारतीय कृषि अनुसंधान परिषद) - Central Agro universities @Imphal (Manipur), Pusa (Bihar), Jhansi (UP)

* Hindi terms not given for most org. because above information is meant for MCQ only. In the mains exam you may attribute all things to 'कृषि और किसान कल्याण मंत्रालय की वैधानिक/ सहकारी/ स्वायत्त संस्था <insert english term/abbreviation>'.



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4.2 AGRI-INPUT → LAND

- While India accounts for more than __ % of world population but we have barely 2.5 % of land of the world.
- Agriculture is a purely land based activity. Size and quality of land has direct bearing on agriculture productivity and farmers' income. Land ownership also serves as a social value & security against credit.
- **Challenges?** Rising population, division of land among heirs → fragmentation of landholdings (भूमिजोत का विखंडन). Small sized-farms are not conducive for farm-machinery → productivity declines.
- **Solution?** Small-marginal farmers should be encouraged to join mfg / service sector jobs, selling their land to rich farmers = **Land _____ (भूमि एकत्रीकरण)**.
- **Land Reform (भूमि सुधार)** is the government led division of agricultural land and its reallocation to landless people. Whereas, **Land _____ (भूमि अधिग्रहण)** means Govt acquiring private land for industrial or infrastructure development.

4.2.1 Land reforms in India after independence

- (1) Zamindari Abolition, Vinoba's Bhudaan movement (2) Ceiling on Landholding i.e. fixing maximum size of land holding that an individual can own. (3) Laws to protection of tenant farmers (जोतदार किसान)
- (4) National Land Records Modernization Programme (NLRMP-2008: राष्ट्रीय भूमि रिकॉर्ड आधुनिकीकरण कार्यक्रम) by Department of Land Resources under _____ Ministry. Because digital land records help reducing court case related to sale / inheritance.
- (5) Forest Rights Act: वन अधिकार अधिनियम 2006 which gives 'patta' (farm land ownership title) to the forest dwellers, if the said family was cultivating that forest land for the last 75 years.
- Land is a state subject, so Union circulated Model Agriculture Land Leasing Act, 2016: which 1) protects land owner from illegal occupation by tenant farmer 2) helps tenant farmer get bank loans using leasing agreement as proof.

Further Self-study? (1) Land reforms is a Mains-GSM3 topic. Do it from mrunal.org/tag/land-reforms (2) Soil pollution & soil erosion is Environment topic do it from Shankar IAS book (3) Soil & Crop distribution: Geography topic from NCERT/ Majid.

MCQ. Which of the following are responsible for the decrease of per capita holding of cultivated land in India? (Asked in UPSC-CDS-2012-II)

1. Low per capita income.
2. Rapid rate of increase of population.
3. Practice of dividing land equally among the heirs.
4. Use of traditional techniques of ploughing.

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



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4.3 AGRI-INPUT → SEEDS: बीज

(Introduction: Origin) Since we can't drastically increase the area under cultivation, so, agriculture yield (amount of crop produced in a given acre of land) depends greatly on seed quality.

- For best yield, hybrid seeds must be replaced every year, and non-hybrid must be replaced every three years. But in India, _____ is less than optimum because of (1) new seeds are not affordable and 2) not available to all farmers. So, government has approved 100% automatic FDI in seed development.
- **Seed village concept:** Group of farmers in a village given training to produce seeds of various crops so they can fulfill seed demand of their own & neighbouring villages.
- **Seed bank / Seed vault** is a depository that stores seeds to 1) preserve genetic diversity 2) supply seeds during natural calamities and unforeseen conditions.
- Agro Ministry gives funding for above two initiatives.

MCQ. Which one of the following best describes the main objective of Seed Village Concept? (Asked in UPSC-Pre-2015)

- (a) Encouraging the farmers to use their own farm seeds and discouraging them to buy the seeds from others.
- (b) Involving the farmers for training in quality seed production and thereby to make available quality seeds to others at appropriate time and affordable cost.
- (c) Earmarking some villages exclusively for the production of certified seeds.
- (d) Identifying the entrepreneurs in villages and providing them technology and finance to set up seed companies.

4.3.1 Agri-Input → Seeds → Green Revolution: हरित क्रांति

- Green revolution refers to the large increase in food production with the help of _____ (HYV: उच्च उपज देने वाली किस्म) of hybrid seeds.
 - **Phase-1:** mid 1960s upto mid 1970s → focus on wheat, rice and more affluent states such as Punjab, Andhra Pradesh and Tamil Nadu.
 - **Phase-2:** mid-1970s to mid-1980s → HYV seeds were spread to a larger number of states and fo variety from just wheat and rice.
- **Biofortification:** is the process by which the nutritional quality of food crops is increased. E.g. ICAR developed CR Dhan 310- a rice variety that has higher protein & zinc content than traditional rice.

4.3.2 Agri-Input → Seeds → Genetically modified (GM) crops

- **Hybrid seeds** (संकर बीज) are developed by cross-breeding / cross-pollination with other plants.
- Whereas, Transgenic / Genetically modified (आनुवंशिक आधार पर आशोधित किस्म) seeds are developed by transferring selected genes from one organism into another. E.g. Bacterium Bacillus thuringiensis genes inserted in cotton → Bt. cotton → if bollworm pests eat it, they'll die due to toxin crystals in the Bt.cotton plant.
- **GM-Regulation?** Environment Protection Act 1986 (EPA: पर्यावरण संरक्षण अधिनियम)
 - _____ (GEAC: जेनेटिक/जननीक इंजीनियरिंग/अभियांत्रिकी मूल्यांकन समिति) conducts studies, and recommends approving a GM crop in India → Environment ministry gives final permission.



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- Over the years, GEAC recommended Bt Cotton, _____ for India. But Environment ministry has allowed only Bt. Cotton (a non-food crop) cultivation in India (2002).

4.3.2.1 Seeds → GM crops → Challenges?

1. **Biosafety concerns (जैव सुरक्षा संबंधी चिंताएं)** GM food crops may be unsafe for human and animal consumption. They may harm the soil bacteria & bees → harm to entire food web and biodiversity. GM crop may eliminate the wild/indigenous species by cross-pollination: परपरागण.
2. American company Monsanto has the patent over Bollgard technology that is used for developing Bt Cotton seeds. So, Indian Bt-cotton seed production companies have to pay a type of royalty to Monsanto, called _____ (विशेषता शुल्क). Govt of India decides the ceiling on Trait fees. Some legal disputes going on. what/how/why NOTIMP.
3. Monsanto also owns patent over _____ technology (समापक जनीन प्रौद्योगिकी) i.e. when such seeds are planted, they'll produce crops only once. Their resultant crop's seeds will be sterile → Farmer forced to buy new seeds from company for every season. Although Terminator gene seeds are not allowed in India.

4.3.2.2 Seeds → GM crops → suggestions by Economic survey 2017?

We've a robust regulatory framework with GEAC. So, mischief is unlikely so we should allow GM crops with following precautions →

1. Allow GM seeds which don't have Terminator Gene or high cost.
2. Allow GM seeds that have following properties: 1) Disease, pest & drought resistant 2) Longer shelf life 3) Shorter crop duration 4) Nonfood / Tree format crops.
3. To prevent MNC monopoly on GM seeds, we've to encourage domestic companies.

4.3.2.3 GM-Crops: Conclusion templates?

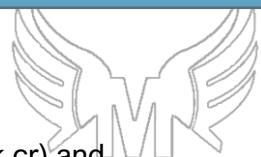
- A. **Conclude in Favor:** India needs self-sufficiency in agriculture because of 1) SDG goal of ZERO HUNGER 2) Economic goal of low food inflation. GM-crop can help in this regard, so a positive consideration should be given GM adoption in India.
- B. **Conclude Against:** India is a signatory to Cartagena protocol to protect biodiversity. SDG Goal (#2.5) also requires all nations to protect the genetic diversity of plants and animals. Given the aforementioned concerns, GM crops should not be introduced in India without due diligence.

Further self study of GM Sci.tech / Biodiversity angles → (i) NCERT Biology class 12 chapter 12 (ii) Ravi Agrahari's Science Tech book: ch. On Biotechnology.

4.4 AGRI-INPUT → WATER (IRRIGATION)

Definition? The supply of water to crops at different intervals is called irrigation.

- While India accounts for more than __ of world population but we have barely **4%** of world's water resources.
- India is a water stressed country. >50% of the agriculture depends on rainfall. Only four months of monsoon & if El-Nino we receive even less rainfall. → 2014 & 2015 drought → food inflation.
- To earn 2x (double) income, a farmer must cultivate multiple crops annually. But majority of farmers face water shortage so they can't do so.



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- Budget-2017: NABARD given funds for long term irrigation infrastructure (20k cr) and Micro Irrigation (5kcr)

4.4.1 Agri-Input → Irrigation → Pradhan Mantri Krishi Sinchai Yojana

Boss? Agro Ministry (2015). _____ Scheme = Not 100% Funded by Union.

Aim? To improve the irrigation coverage, reduce the wastage of water, using 4-pillar strategy:

1. **Accelerated Irrigation Benefit Programme** (AIBP: त्वरित सिंचाई लाभ कार्यक्रम) → Requires Ministry of Water Resources to finish the ongoing national irrigation projects at a faster pace.
2. **Watershed Development** (जलसाव विस्तार विकास) → Setup water harvesting structures like check dams, nala bund, farm ponds, tanks etc. Encourage traditional water storage systems such as Jal Mandir (Gujarat); Khatri & Kuhl (H.P.); Zabo (Nagaland); Eri & Ooranis (T.N.); Dongs (Assam); Katas & Bandhas (Odisha & M.P.).
3. **Har Khet ko Pani** → To distribute water to each and every farm.
4. _____ → Improve the water usage efficiency through Micro-irrigation devices such as drips, sprinklers, pivots, rain-guns. *Related terms* →
 - a. **Fertigation:** Mixing water-soluble fertilizers in drip system → fertilizer delivered into the root system → reduced wastage of fertilizers.
 - b. **Mulching:** It is a simple process of covering the bare soil with straw, wood chips, shredded bark etc. to reduce the water evaporation, soil erosion and weed growth.

Micro-irrigation challenges? High cost of purchase. Trampling by elephant, boar, nilgai etc damages the equipment, but repairman not available locally and repair costs not covered in crop insurance. So less adoption.

4.4.2 Agri-Input → Water (irrigation) → suggestions by Economic Surveys

1. River inter Linking project. Ref: mrunal.org/2018/07/upsc-model-answer-gsm1-river-linking.html
2. Encourage pulses cultivation in the drought prone areas.
3. Canal water usages: cost based water pricing, stop theft of water.
4. **Rain water harvesting** i.e. capture and store rainwater.
5. **Watershed management** i.e. building percolation tanks, recharge wells, etc. with community participation. It helps in conservation of rain, surface and groundwater resources.
6. And finally, a National level dedicated agency to push above things.

4.5 AGRI-INPUT → FERTILIZER (उर्वरक)

(Introduction: Definition) **Manure / Compost** is a natural substance from decomposition of organic waste. Whereas, **Fertilizer** is an artificial chemical prepared in factories to boost nutrients in the soil.

Fertilizers	Notes
Nitrogen (N) Urea	<ul style="list-style-type: none"> - Haber process: natural gas (methane) converted into ammonia (NH₃) → further processing to create Urea. Therefore urea production requires natural gas import. - Ministry of Chemicals and Fertilizers gives Indian companies subsidy to manufacture and sell it at cheap price to farmers.

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	- Urea subsidy is a Central Sector Scheme = _____ paid by Union.
Phosphorus (P)	~80-85% demand is met via import. ISRO using remote Sensing technology to identify the potential mines for rock phosphate.
Potash (K)	_____ demand is met via import.

Ideal NPK ratio in soil: _____, for India it's 8:3:1 because subsidized cheap Urea → illiterate farmers use excessively. As a result →

1. Soil & groundwater pollution.
2. Subsidized urea smuggled to non-agro purpose in chemical industries related to dyeing, inks, coatings, plastics, paints even synthetic milk.
3. Subsidized urea also smuggled to Bangladesh and Nepal.
4. Increased use & smuggling → increased subsidy burden → increased fiscal deficit.

So government done following reforms to control urea misuse/overuse/diversion:

4.5.1 Prevent urea misuse → _____ (2010)

- पोषक तत्व आधारित सब्सिडी. _____ Scheme = 100% Paid by Union.
- **Boss?** Ministry of Chemicals and Fertilizers gives subsidy to company based on weight of the different nutrient in the fertilizer.
- So, fertilizer companies can make new product mixes according to soil requirement in each region.
- **Challenge?** Urea not covered in this scheme. Delay in NBS subsidy payments. Therefore Fertilizer companies focus more on urea more than other fertilizers. Urea overuse continued.

4.5.2 Prevent urea misuse → _____ (2015)

- **Boss?** Agro Ministry. _____ Scheme = not 100% funded by Union.
- मुद्रा स्वास्थ्य कार्ड contains the status of soils with respect to 12 parameters →

Macronutrients	-----
Micro - nutrients	Zn, Fe, Cu, Mn, Bo
Secondary- nutrient	S: Sulfur
Physical parameters	pH, electrical conductivity (EC0, organic carbon (OC))

- A farmer's land is tested & he is given updated soil card once in every 3 years.
- The card also advises on which type of crops, seeds, fertilizer, irrigation method will be suitable for his farm, according to his soil type.

4.5.3 Prevent urea misuse → Neem Coating of Urea (2015)

Boss? Ministry of Chemicals and Fertilizers. From 2015, Government made it mandatory for fertilizer companies to neem coat the urea before selling it. **Benefits?** →

1. Prevents diversion of subsidized urea towards non-agricultural purposes.
2. Neem coating slows down the release of nitrogen from urea → Improves the plant's absorption of Nitrogen from the urea → Yield is improved.
3. Reduction in pest and disease attack → pesticide consumption is also reduced.

4.5.4 Prevent urea misuse → DBT of fertilizer (2018)

Boss? Ministry of Chemicals and Fertilizers.



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- Direct Benefit Transfer (प्रत्यक्ष लाभ अंतरण) in fertilizer: Fertilizer companies are paid subsidy only after the retailer has sold the fertilizer to farmer through Point of Sale (PoS) devices & noting down his Aadhaar Card/ Kisan Credit Card/Voter Identity Card etc. to verify his identity as farmer.
- Then Government transfers the subsidy amount directly into the bank account of the respective fertilizer company.

Benefits? Prevents diversion of subsidized urea towards non-agricultural purposes and towards Bangladesh / Nepal. (Unless बांग्लादेशी घुसपैठिए नकली आधार कार्ड बनवा कर ले जाए)

4.6 AGRI-INPUT → PESTICIDES & WEEDICIDES

(Introduction: Definition) Pesticides and weedicides (कीटनाशक, खरपतवार नाशक) are chemicals which are used for killing / controlling pests and weeds respectively.

- 25% crop loss on account of pests, weed, diseases but India's per hectare pesticide consumption is far less than first world. We should encourage organic pesticides and biocontrol agents.
- We should adopt **Integrated Pest Management** (IPM: एकीकृत कीट प्रबंधन) approach i.e. rather than eradicating pest population to 100%, just try to keep crop damage to economically tolerable level. Because even pests are important for biodiversity protection and food chain balance.
- Spread awareness about proper use of chemical pesticides (esp. Endosulfan) so it doesn't contaminate in food / land / water / human bodies excessively.
- 2019: Monsanto & its parent company Bayer fined in USA for their weedicide / herbicide ' _____ ' (brand name 'Roundup') which was causing cancer. This weedicide is already banned in Punjab, Kerala and selected states of India (2018).
- Under Insecticides Act, 1968, Agro Ministry requires the companies to label the pesticides depending on increasing level of toxicity : green < blue < yellow < red.
- Pesticide Management Bill 2017 aims to replace the Insecticides Act of 1968 with larger penalties & jail time for selling of substandard / fake pesticides, additional powers to state governments etc. But not passed yet, so do not lose sleep.

4.7 AGRI INPUTS → DON'T USE CHEMICALS → PKVY (2015)

(Introduction: Definition) Organic farming-जैविक खेती is a type of agriculture that avoids the use of synthetic fertilizers, pesticides, and other chemical inputs. It relies on crop rotation, crop residues, manures, biofertilizers, biopesticides etc.

- **Ecological benefits?** Less use of chemicals → biodiversity protected, less soil pollution and water pollution. Less air pollution (because farmers will not burn the crop residue).
- **Economic benefits?** 1) organic products command higher prices among the health conscious buyers from developed countries → more exports → less CAD, more farmer's income. 2) less use of chemical fertilizers → governments urea subsidy bill will decline → fiscal deficit can be controlled.
- In 2003, recognizing the aforementioned benefits, _____ stopped entry of chemical fertilizers, and its Vidhan-Sabha declared the intention to become a 100% organic state. The goal achieved in 2015.



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- 2015: To encourage organic farming in India, Union Govt. launched _____ (PKVY).
- **Boss?** Agro Ministry. _____ Scheme = Not 100% paid by Union. (60:40,90:10)
- **Mechanism?** Form a group of 50 farmers in a cluster to start organic farming. Every beneficiary farmer is given ₹ 20,000 per acre for 3 years for doing organic farming.

4.7.1.1 *Organic farming → Limitations?*

1. Organic farming yield (quantity produced per acre) is lower than conventional chemical-based farming. Difficult to produce off-season crops using organic farming. so if entire India became “100% organic farming” → food shortage → inflation.
2. Shelf life, color and texture of organically grown fruits/vegetables are less attractive than chemically grown hybrid / GM varieties. So, unless ordinary consumers are made aware of their health benefits they may not buy.

4.8 AGRI INPUTS → FARM MECHANIZATION (मशीनीकरण)

(Introduction: Definition) It means the higher usage of combine harvesters, land levelers, cultivators, tractors, reapers, threshers, trolleys and mechanical pickers etc.

- **Significance?** (1) ↑ productivity of land and labour by increasing more work output per unit time. (2) ↑ employment opportunities to rural youth in production, operation, and repair-maintenance of machines.
- **Labour augmenting technological progress:** Allows each laborer to be more productive e.g. Industrial revolution → James Hargreaves' Spinning Jenny that allowed each worker to spin eight cotton threads at once (1770).
- **Capital augmenting technological progress:** Allows capital assets / machinery to be more productive. E.g. wooden plough replaced with steel plough → more sturdy, requires less maintenance & repairs, resistant to water-fungal attacks.
- After MNREGA scheme (wherein villagers are guaranteed 100 days of unskilled manual work), the Punjab-Haryana farmers are facing shortage of farm-labourers in peak season, & forced them to offer higher wages → many of the them are opting for machinery to reduce labour requirement.
- **Challenges?** (1) Customized machinery required for India's soil and climatic diversity so R&D, Make in India required. (2) Small-marginal farmers lack financial resources to own machines so renting centres need to be setup.
- **Government Scheme?** 2017: Green Revolution - Krishonati Yojana → Sub-Mission on Agricultural Mechanisation (SMAM): to address above challenges.

MCQ. The substitution of steel for wooden ploughs in agricultural production is an example of _____ technological progress. (Asked in UPSC-Pre-2015)
 (a) labour-augmenting (b) capital-augmenting (c) capital-reducing (d) None of the above.

MCQ. Private investment in Indian agriculture is mostly on labour saving mechanization. This could be a response to (Asked in UPSC-CDS-2015-II)

- | | |
|--|--------------------------------------|
| (a) rising productivity of agricultural sector | (b) rising inequality in agriculture |
| (c) rising wages and tighter labour market | (d) debt write-off by the Government |

4.9 AGRI INPUTS → FINANCE / CREDIT: अर्थव्यवस्था/ साख

(Introduction: Origin) Small and marginal farmers produce little marketable surplus, and often deprived of the remunerative prices even during bumper crops, so without borrowing



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they can never buy inputs for the next cropping cycle. Economic Survey 2016 found an inverse relation between size of landholding vs. Indebtedness (ऋणग्रस्तता) of farmers i.e. small/marginal farmers are more indebted than big farmers.

The notable steps to enhance credit availability to farmers →

RBI's PSL norms: 10% to agriculture + 8% to Marginal Farmer (upto 1ht) & Small farmer (>1 upto 2ht).	<i>Ref: Pill#1: Monetary policy handout</i>
Nationalisation of banks after the Independence. Setting up of differential banks (RRB, LAB, SFB).	<i>Ref: Pill#1: Bank classification handout</i>
Kisan credit card scheme & interest subvention scheme	<i>Ref: Pill#1: Financial inclusion handout</i>

4.9.1 Agri-Finance → Negotiable Warehouse Receipts (NWR)

- Boss? Ministry of Consumer Affairs, Food & Public Distribution → Statutory Body **Warehousing Development and Regulatory Authority (WDRA: भांडागारण विकास एवं विनियामक प्राधिकरण)** - law in 2007.
- Farmer deposits his produce into WDRA registered warehouses and gets negotiable warehouse receipt (NWR; परक्राम्य गोदाम रसीद). He can use it in two ways
 - a. Pledge it in the banks to obtain loans for the next cropping cycle. OR
 - b. Trade it via the commodity exchange markets or electronic National Agriculture Markets (e-NAM).
- **Benefit?** NWR prevents the distress sale of agriculture produce. Farmer can wait and watch for the prices to improve before selling, while his crop is safely stored in the warehouse.
- 2017: Government launched Electronic Negotiable Warehouse Receipt (e-NWR) System. **e-NWRs** prevents tampering, frauds & loss of the receipt. Unscrupulous farmers will not be able to sell same receipt to multiple buyers or get multiple loans from multiple banks.

4.9.2 Agri-Finance → Loan waivers for the farmers

- Budget 2008: Agricultural Debt Waiver and Debt Relief Scheme (ADWDRS). On their outstanding crop-loans upto 29/Feb/2008→
 - o Small and marginal farmers given 100% _____ : कर्ज माफी;
 - o Other farmers were given 25% _____ : ऋण राहत.
- Department of Financial Services → paid the dues to the banks in a phased manner on behalf of farmers.
- 2009: 15th Lok Sabha Election.
- 2016-18: The state governments of Tamilnadu, Maharashtra, Karnataka, Uttar Pradesh, Jammu Kashmir, Punjab, Chhattisgarh Andhra Pradesh Telangana et al. also launched in similar debt waiver and debt relief.
- 2017: Budget gave 60 days interest waivers to farmers on account of the problems farmers suffered during demonetization in 2016.

4.9.3 Agri-Finance → Farm loan waivers: arguments in favour

1. 2002 onwards: BT cotton was approved → boost in agriculture production & income.
2. 2008: Post-subprime crisis and global financial crisis, the demand for textile declined in the international market → cotton prices fell in India → farmers suffered.

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3. 2014: drought, 2015: again drought. Agri growth in zero to negative territory.
4. 2016-17: Demonetization → cash shortage → price of agricultural commodities fell.

Thus farmers are suffering for a decade (2008-18), as evident from the violent agrarian agitations in Madhya Pradesh, Uttar Pradesh and Maharashtra in 2017 and 2018. While corporate borrowers are eligible for loan restructuring, farmers are not given such benefits.

4.9.4 Agri-Finance → Farm loan waivers: arguments against

1. _____ (नैतिक जोखिम): Lack of incentive to be "disciplined", when risky behavior is insured by someone. If the government continue to give loan waivers, farmers will have no discipline to be efficient, cost-savvy and hard working.
2. Loan waivers undermine honest credit culture— Urjit Patel. NPA problem will get aggravated.
3. Loan waivers → Higher fiscal deficit → households and business firms will be hurt.
4. Total farm loans: ~5.5 lakh cr (2013). Out of that ~60% by formal lenders (banks, Microfinance etc.) Rest by informal money lenders (village baniya, shroff etc.) So even if loan waivers are announced, all farmers will not benefit from it.
5. Government's expenditure on healthcare is ~1.2% of GDP. WHO recommends 5%. If all the farm loans are waived it will cost 1.5% of GDP. So, if government has so much spare money to spend, it'll be better to spend in public healthcare which will benefit both farming and non-farming families.

4.9.4.1 Anti-Argument: Loan waiver will not stop farmer suicide

Farmer suicide is a result of:

1. Lack of marketable surplus produce because they've small landholding, lack of irrigation, high yielding seeds and fertilizers.
2. Lack of remunerative prices because of challenges in APMC, MSP and transport-storage infrastructure.
3. Lack of financial inclusion and financial planning. Even after good monsoon and good harvest, they waste money on social events and pilgrimage.

So, loan waiver is a short-term remedy that can't prevent farmer suicide until above three issues are addressed.



4.9.4.2 Anti-Argument: Loan waiver will not improve GDP

The economic survey 2017 observed:

$$\text{Consumption} + \text{investment} + \text{government expenditure} + \text{export} - \text{import} = \text{GDP}.$$

GDP component	What should happen after farm loan waiver?	
	In theory	In reality
+ Consumption (C)	Since farmers' previous loan repayment responsibility is gone, he can use the spare money to buy new tv, fridge, mobile, children education etc. so production will improve in associated sectors due to increased consumption.	World Bank observed that even after 2008's loan waiver scheme, rural consumption was not improved. Because farmers did not have the surplus money to spend anyways.
+ Investment (I)	Similar logic as above, once previous loan is waived, farmers would be investing more in the farm machinery, irrigation pump set, better varieties of seeds, fertilizers, cattle etc.	<ul style="list-style-type: none"> - This didn't happen because farmers did not have surplus money to spend anyways. - Loan waiver → Government borrows money from market → _____ of corporate borrowers' → investment declined in corporate sector.
+ Govt. Expenditure (G)	Government expenditure increased	But it harms economy due to higher fiscal deficit.
NET Exports (= Export minus Imports)	After the loan waiver, farmer would have invested in better machinery seeds fertilizers → more agriculture production in India → exports will improve.	Agriculture exports did not greatly improve because <ol style="list-style-type: none"> 1. Climate change, extreme weather events → production is not greatly improving. 2. Protectionism by USA and EU

Conclusion- Template on Loan Waiver:

From the aforementioned analysis, it's evident that farm debt waiver will have negative macroeconomic consequences for India. Debt waiver is neither feasible nor sustainable solution against agrarian distress, we should work on more efficient and targeted ways to help farmers.

Mock question for Mains: Critically examine the need and feasibility of providing agriculture-debt waiver to small and marginal farmers of India. (250 words)



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4.10 AGRI-INPUT → RISK REDUCTION → INSURANCE

(Introduction: Origin) Though agriculture sector is a minor contributor to India's GDP, but large proportion of our population depends on agriculture. Agriculture itself depends on monsoon, pests, disease and other vagaries of nature. But insurance penetration & insurance density is low in India.

- 2002: Agriculture Insurance Company of India Ltd. (AIC) was setup.
- Agro Ministry launched Pradhan Mantri fasal Bima Yojana (Core scheme) and other crop insurance schemes. *Ref: Pillar #1D handout.*
- **Challenges?** State Governments not paying their share of money in PM Fasal Bima Yojana , private insurance companies rejected / delaying claim settlements. Therefore, Union enacted new norms: State Government / Insurance Company will have to pay additional 12% amount to farmer as interest / penalty for delays caused by them (2018).

4.11 AGRI-OUTPUT → DON'T BURN THE CROP RESIDUE

(Introduction: Origin) Every year during Sept-October, farmers of Punjab and Haryana burn the paddy stubble & residue (फसल अवशेष) which are leftover from previous cropping season. Burning clears the farm land for sowing wheat for next cropping season.

- **Result?** Thick smog & air pollution in Delhi & surrounding region.
- **Solution?** _____ (स्वस्थानी उपजाऊकरन) and the 'Happy Seeder', a mechanical attachment to tractors that enables wheat sowing without having to get rid of paddy straw on the land.
- Budget-2018: Union to give 100% funding to Punjab, Haryana and Delhi to tackle this menace. Further, individual farmers to be given 50% subsidy for such machinery purchase.

4.12 AGRI-SELLING → APMC (कृषिगत उत्पाद विपणन समिति)

(Introduction: Origin) In the post independent India, despite the abolition of zamindari, the farmers were not 'liberated' from exploitation. Because, the goons of local baniyaa or money lender would forcibly take away the farmers' harvest without paying sufficient money. So, state governments enacted APMC laws that "first sale of agriculture produce can occur only at the market yards / Mandis of _____ (APMC)."

4.12.1 APMC Problems?

1. APMC trustees (office bearers) are politically influential persons. They enjoy a cozy relationship with the licensed commission agents. These agents then form cartel, manipulate prices and deprive farmers of remunerative prices; they also engage in hoarding & artificial shortage of food supply in the retail market, thereby driving up the food inflation for profiteering.
2. APMC trustees lack the managerial skill / vision for vertical integration with food processing industries. *[because their only skill is 'Politics']*
3. While these Mandis charge multiple entry, exit and other fees. But money is siphoned off → poor infrastructure, lack of cold-storage and transport facilities → substantial waste of fruits & vegetables despite bumper harvests in good monsoon years.

4.12.2 Model APMC Act?

Since agriculture is a state subject, ultimately state governments have to reform their archaic laws. Union Government already circulated a model APMC Act, 2003



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- It allows the private entrepreneurs and cooperatives to set up their parallel markets, & sell directly to consumers
- It allows the corporate companies to engage farmers in 'contract farming (अनुबंध खेती)' and directly purchase the produce from farmgate.

Further, Union Government released

- Model Agricultural Produce and Livestock Marketing Act 2017 (APLM: मॉडल कृषि उपज और पशुधन विपणन) → it has better features than above model act, covering both agro commodities as well as livestock, fisheries and poultry.
- Model Contract Farming Act, 2018 → (concurrent list) → aims to protect farmers engaged in contract farming with better features than model APMC act 2003.

MCQ. In India, markets in agricultural products are regulated under the (Asked in UPSC-Pre-2015)

- (a) Essential Commodities Act, 1955
- (b) Agricultural Produce Market Committee Act enacted by States
- (c) Agricultural Produce (Grading and Marking) Act, 1937
- (d) Food Products Order, 1956 and Meat and Food Products Order, 1973

4.13 AGRI-SELLING ONLINE → _____ (E-NAM)

- Boss? Agro Ministry (2016). _____ Scheme = 100% paid by Union.
- e-NAM (ई-राष्ट्रीय कृषि बाजार) aims to connect the existing 580+ APMC mandis across India through a web portal, thus enabling interstate and intrastate (within state) trade of agricultural commodities.
- It'll also remove the information asymmetry (सूचना की विषमता) between buyers and sellers, and help in real time price discovery based on actual demand and supply.

e-NAM: Criticism? While the portal was launched for namesake in 2016, but, first inter-state trade started only in 2019. Only 16 states have so far connected their mandis with the web portal. Many APMC mandis lack in quality-check labs for grading of the commodities before online auction- so buyers hesitant to purchase. + Delays in the actual delivery.

4.13.1.1 Agri-Selling Online → e-Rashtriya Kisan Agri Mandi (e-RaKAM) 2017

- This portal is a joint initiative by state-run-auctioneer METAL SCRAP TRADE CORPORATION LIMITED (MSTC- a Government company under the Steel Ministry) and Central Warehousing Corporation (a statutory corporation under Consumer Affairs Ministry).
- It helps farmers to sell agricultural produce. Although faded / obscure topic compared to E-NAM so don't lose sleep over it.

MCQ. What is/are the advantage/advantages of implementing the 'National Agriculture Market' scheme? (Asked in UPSC-Pre-2017)

1. It is a pan-India electronic trading portal for agricultural commodities.
2. It provides the farmers access to nationwide market, with prices commensurate with the quality of their produce.
3. Both 1 and 2
4. Neither 1 nor 2



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4.14 AGRI-SELLING → GRAMIN AGRICULTURAL MARKETS (GRAMs)

- **Boss?** Agro Ministry (2018) → NABARD fund for Agri-Market Infrastructure Fund (AMIF).
- Gramin Haats are owned by Local Bodies (Panchayats/councils), Agricultural/Horticultural Departments of State Govts, Cooperatives, APMCs and Private Sector. Total ~22,000 of them. Whereas APMC mandis are barely 580+.
- Budget-2018: 1) we will upgrade Gramin haat into GRAMs (ग्रामीण कृषि बाजार) 2) We'll link them with e-NAM. So, farmers can directly sell from nearby Gram Haat, instead of transporting the produce to the APMC Mandis at the district level.

4.15 AGRI-SELLING → OUTSIDE INDIA → AGRICULTURE EXPORT POLICY, 2018

- **Boss?** _____ Ministry
- **Target?** To double agricultural exports from present ~US\$ 30+ Billion to ~US\$ 60+ Billion by 2022 and reach US\$ 100 Billion in the next few years thereafter.
- To diversify our export basket e.g. Wild Herbs, Medicinal Plants, Aromatic Oils, Frozen vegetables; Biscuits, Confectionery & Processed Food etc.
- To diversify destinations e.g. Biscuits to Uganda, Nigeria, Kenya. (because Americans are unlikely to be attracted to our Parle-G biscuits.)
- To boost value added agricultural exports e.g cashew apple jams, flavoured / roasted cashew, etc. instead of exporting raw cashew.
- To help exporters with sanitary and phyto-sanitary (SPS) issues via APEDA, FSSAI and other bodies. So their products are not banned by US/EU on the allegations of pesticide residue / pathogen / fruit fly contamination.
- To focus on branding, packaging & marketing of Indian ethnic products e.g. canned Indian cuisine like sarson da saag, Makhana from Bihar, Agra petha, Hyderabadi biryani in overseas markets.
- To focus on R&D for gluten free, fibre rich products to cater health conscious consumer overseas.
- Encourage private investments through Ease of doing biz. in export oriented activities: cold storage, packaging, air cargo; Creation of Agri-start-up fund.

Conclusion? Thus, this policy will help integrating Indian agricultural products with the global value chains and help doubling farmers' income by 2022.

4.16 AGRI-SELLING → INCOME SUPPORT FOR FARMERS

2018: NABARD released All India Rural Financial Inclusion Survey.

- Total ~21 crore rural household. Out of them ~10 crore engaged in agriculture.
- These agricultural households' average monthly income is ₹ 8900/-
 - Out of that agriculture cultivation brings barely ₹ 3100.
 - Rest of the income comes from livestock, wage labour, MNREGA etc.
- Thus farming is not a very profitable enterprise in India.

Economic survey 2018 noted: Climate change's negative impact is twice on unirrigated farms than irrigated. With higher temperature and shorter rainfall: income fall will be 15-18% (for irrigated farm), 20-25% (for unirrigated farm).

Modi-govt has target of doubling the farmers income (from base year 2015-16) in 2022-23. But for that agricultural sector must grow at 10% annually whereas it's struggling to grow even @5%. Therefore, Govt. intervention is necessary in the form of subsidies, procurement, MSP and minimum income support (PM-KISAN@6k/pa).



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4.17 AGRI-SELLING → MINIMUM SUPPORT PRICES (MSP)

Under the State APMC Acts, the first sale of agriculture commodity can occur at Agricultural Produce Market Committee (APMC) Mandis only. However, a farmer may not get remunerative prices at the Mandi due to following reasons:

1. Bumper production /supply which brings down the market prices AND / OR
 2. Cartelization / price-fixing by the mandi-merchants.

So, to protect the farmers, Government of India announces MSP (न्यूनतम समर्थन मूल्य) before each crop sowing season.

4.17.1 MSP covers which crops?

For 22 crops (MSP) + 1 sugarcane (FRP) = 23 viz.

14 kharif crops	<ul style="list-style-type: none"> - Kharif: grown in summer / monsoon season. - paddy, jowar, bajra, maize, ragi, arhar, moong, urad, groundnut-in-shell, soyabean, sunflower, sesamum, nigerseed and cotton;
6 rabi crops	<ul style="list-style-type: none"> - Rabi: grown in winter season. - wheat, barley, gram, masur(lentil), rapeseed/mustard and safflower
3 commercial /cash crops	<ul style="list-style-type: none"> - Jute, copra and Sugarcane. - For Sugarcane, mechanism is different: It requires the sugar mill companies to pay the minimum Fair and Remunerative Price (FRP) fixed by Govt. (Whereas for other 22, Govt itself procures @MSP)

MCQ. Consider the following:(Asked in UPSC-Pre-2018)

1. Areca nut 2.Barley 3.Coffee 4.Finger millet 5.Groundnut 6.Sesamum 7.Turmeric
The Cabinet Committee on Economic Affairs announces MSP for which of the above?

4.17.2 MSP computation, Swaminathan Committee?

Agro Ministry's Commission for Agricultural Costs and Prices (CACP: कृषि लागत और मूल्य आयोग) recommends MSP (& FRP for sugar) → Cabinet Committee on _____ (CCEA: आर्थिक मामलों की कैबिनेट समिति) chaired by PM approves & announces MSP.

CACP's computation method is →

A2	Actual costs directly incurred by the farmer on seeds, fertilisers, pesticides, hired labour, depreciation on farm buildings & machinery, interest on working capital, diesel/electricity for tractor/pump sets etc.
FL	Imputed cost of (unpaid) family labour.
----- times	This will be the official MSP. (from Budget-2018 onwards). So farmer sees 50% profit on this cost of production.

The National commission on farmers (2006) headed by Scientist MS Swaminathan had suggested 50% profit but using a different '**C2 formula**', BUT

- C2 formula computed lot of costs, including imputed rent on his own land and imputed interest on his own capital etc. (i.e. what if farmer had leased the farmland or

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gave his savings as loan to someone else, instead of farming by himself, then how much rent / interest would he have earned?)

- If govt. used C2 formula, MSP will become very high due to aforementioned (hypothetical) imputed costs → higher budgetary allocation, fiscal deficit will increase. So, Govt is using A2+FL formula only.

MCQ. The Fair and Remunerative Price (FRP) of sugarcane is approved by the (Asked in UPSC-Pre-2015)

- (a) Cabinet Committee on Economic Affairs.
- (b) Commission for Agricultural Costs and Prices.
- (c) Directorate of Marketing and Inspection, Ministry of Agriculture.
- (d) Agricultural Produce Marketing Committee.

4.17.3 Agri-Selling → MSP → Procurement (अधिप्रापण / खरीद)?

- Central agencies namely, Food Corporation of India (**FCI**), Cotton Corporation of India (**CCI**), Jute Corporation of India (**JCI**), Central Warehousing Corporation (**CWC**), National Agricultural Cooperative Marketing Federation of India Ltd. (**NAFED**), National Consumer Cooperative Federation of India Ltd. (**NCCF**), and Small Farmers Agro Consortium (**SFAC**) will purchase the entire quantity offered by the farmers at MSP.
- So, it's also called 'Open Ended Procurement' i.e. whether farmer brings 20/200/2000/xyz kilo, Govt agencies will buy it, without any 'quota' for every farmer.
- Collectively, this entire mechanism is called **Market Intervention Scheme and Price Support Scheme** (MIS-PSS: बाजार हस्तक्षेप योजना और मूल्य समर्थन योजना).
- **Boss?** Agro Ministry. Central Sector Scheme = 100% paid by Union. (Int-Budget-2019: ₹ 3000 crore)

4.17.4 MSP Benefits?

- ✓ Farmer always has the option to sell produce to government, if he can't get remunerative prices from private merchants. It prevents distress-sale of produce at throwaway prices to private merchants.
- ✓ Government announces MSP before the sowing season for 23 crops including cereals, pulses, oilseeds & certain cash crops. This advance information helps the farmer to make an informed decision about which crop to sow for maximum economic benefit within the limitations of his farm size, climate and irrigation facilities.
- ✓ MSP sends a price-signal to market that if merchants don't offer higher than MSP prices the farmer may not sell them his produce. Thus MSP serves as an anchor or benchmark for agro-commodity market. While MSP doesn't guarantee that market prices will always be higher than MSP, but at least it ensures the market prices will not be drastically lower than MSP.

4.17.5 MSP Limitations?

- ✗ FCI/NAFED procurement (अधिप्रापण) is usually confined to big towns and district centres. Farmers in remote & tribal area unable to bring their produce to the procurement agencies due to high cost of transportation. 1997: Government launched Decentralized Procurement (DCP: विकेंद्रीकृत अधिप्रापण योजना) wherein State Government themselves procure wheat and rice from farmers, & Union will bear the costs. But not much success in increasing the penetration yet.



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- ✗ Procurement is usually confined to rice and wheat (cereal grains). Not done for pulses, oilseeds and other crops. So, aforementioned benefits of MSP remain 'only on paper', they are not implemented in reality.
- ✗ MSP not even announced for vegetables and fruits.

4.18 AGRI-SELLING: PM-AASHA TO FIX MSP LIMITATIONS

Pradhan Mantri _____.

Boss? Agro Ministry (2018-Sept). Central Sector Scheme = _____ funded by Union.

The scheme has three components:

1. **Price Support Scheme (PSS: मूल्य समर्थन योजना)**: Central Agencies will henceforth also do physical procurement of pulses, oilseeds and Copra.
2. **Price Deficiency Payment Scheme (PDPS: मूल्य में कमी भुगतान योजना)**: If Farmers sells oilseed crops to private merchants in APMC-mandis who are paying them less than MSP price, then govt will directly transfer the difference money in farmer's bank account.
3. **Private Procurement Stockist Scheme (PPSS: गैर-सरकारी प्राप्ति थोक-व्यापारी योजना)**: Private agencies will be hired for procuring the commodities at MSP on behalf of Govt.

4.19 AGRI-SELLING: DIRECT INCOME W/O SELLING → PM-KISAN@6K/PA

----- - Income Support Scheme

- **Boss?** Agro Ministry. Central Sector Scheme = _____ paid by Union.
- **Beneficiary?** A small / marginal farmer family comprising of husband, wife and minor children -who collectively own cultivable land upto 2 hectare as per the land records of the concerned State/UT. (2 hectare = ~5 acres).
- There are total 12 crore such families.
- **Entitlement?** Direct Benefit Transfer (DBT) of ₹ _____ per year in three equal installments (₹ 2000 x 3) in the beneficiary's bank account. Thus, eliminating middlemen and corruption.

Timeline?

- **1/2/2019:** PM-KISAN scheme announced for the first time in interim budget 2019 & allotted annual ₹ 75,000 crores for Financial Year 2019-20.
- **24/2/2019:** Modi formally launched from Gorakhpur, UP.
- The benefits are given with retrospective effect from 1/12/2018 (so, addl. ₹ 20k crores are allotted for this previous-installment in revised estimates of 2018-19).

Documents required?

- Farmer may show Aadhar card, driving Licence, Voters' ID Card, MNREGA Job Card etc. State authorities will cross check it against their land ownership database.
- Aadhar card is kept optional for the 1st and 2nd installment. But, in subsequent installments, Aadhar to be compulsory for farmers for verifying their identity.
- Mobile number is optional but State Govt are encouraged to capture it.
- Compulsory to give Bank account number and its IFSC code (This code is written on bank's passbook, helps identify the name of the bank and address of the branch.)
- **Mechanism?** Union ₹ → State govt's bank account → beneficiary's account. States send data to <http://pmkisan.nic.in> portal.
- **Complaint?** District Level Grievance Redressal Committees.



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4.19.1 PM-KISAN: Criticism / Challenges?

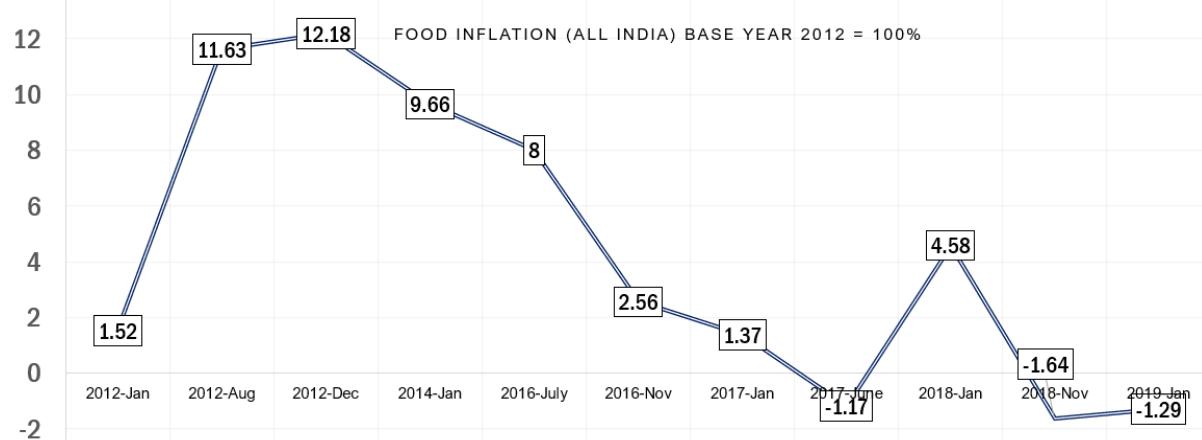
1. If a farmer's name is not in the land records of State/UT then he's not eligible. This excludes
 - a. landless / tenant farmers - who cultivate someone else's land on contract.
 - b. Tribal farmers who may not have land ownership documents.
2. It excludes farmers with land above 2 ht. But in drought prone / rain-fed areas, even they require income support because their income is low.
3. ₹ 6000 rupees per year is too little amount to cover the cost of seeds, fertilizers, wages of farm labourers. For a 2 ht land, minimum input cost is ~₹ 50k in reality.
4. Some state governments are running better schemes on their own e.g.
 - a. Telangana's Rythu Bandhu scheme gives upto ₹ 40,000 per year.
 - b. Odisha's KALIA scheme gives ₹ 10,000 per year to families without any conditions about their land holding area.

Counter-argument? Union government has launched a scheme within the constraints of fiscal deficit target. 14th finance commission has provided 42% tax devolution to the states so they may run parallel schemes with their own funds for the farmers' welfare. PM-Kisan is a better alternative than one time loan-waivers.

Conclusion template?

Successive economic surveys have noted that farming is not a profitable enterprise in India. <insert UN-SDG Goal#1, 2, Modi-Target 2x income>. However, an Indian farmer is often at the mercy of the monsoon & the APMC-merchants. PM KISAN income support scheme is a notable initiative to empower him.

4.20 AGRI-SELLING: FOOD INFLATION FOR CONSUMERS



(Introduction-Origin) With green revolution, we became self-reliant in cereal production. But perishable fruits and vegetables have remained our Achilles' heel. Seasonal spikes in onion, tomatoes & pulses is a recurring nightmare for middle class families of India. The underlying causes as following:

1. **Demand Side:** Growth of middle class & their disposable incomes → more demand of fruits/veggies than before.
2. **Supply Side:** shortage of commodities on account of 1) poor monsoon & pests 2) post-harvest losses due to unavailability of cold-storage & warehousing 3) hoarding.

4.20.1 Food Inflation due to shortage of Vegetable supply

1. Every year, Global Warming: April-May heat waves destroy nascent flowers / buds of vegetable plants.



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2. Pests & Diseases: Maharashtra and Southern Indian farmers have been growing tomatoes & onions since last 3 decades. But, overuse of general pesticides → whiteflies, red mites, gram pod borers and other pests have gained immunity. → crop-loss has increased. Farmers had started using Swiss-MNC developed seeds but later they were found to be vulnerable to certain viral diseases.
3. UPA-Congress Govt (2004-14) had rapidly hiked MSP for wheat & rice so many farmers shifted from veggies / pulses to cereal production.
4. After demonetization (2016), cash based retail vegetable industry suffered → lower prices to farmers in the last season. So they shifted away from vegetables towards sugarcane, maize, soya etc. cash & cereal crops → veggies production has declined.
5. Heavy rains, floods and cyclones disrupt the supply chains. Farmer strike in Maharashtra, UP & MP, wherein they destroyed truckload of tomatoes, milk, potatoes etc. to vent their grievances.
6. Shortage of cold storage infrastructure. Big traders utilize them for hoarding onions and potatoes, → less space for other vegetables' storage even during bumper crops.

4.20.2 Food Inflation due to shortage of Pulses supply

1. Finest irrigated land used for cereal and cash crops like sugarcane because of better MSP. So pulses' area under cultivation is declining. Govt should tweak the MSP for pulses cultivation, especially in rain-fed areas because pulses require less water than sugarcane.
2. Pulses make the soil nitrogen rich, it encourages weed growth- which harms the pulses yield. Pulses are themselves protein rich, so they're more susceptible to (1) pests attack and (2) When stored in open godowns, humid conditions = fungal growth. 25% of the produce is lost by this. **Solution?** New seed varieties required but Indian scientists are always focused on 'cereals' rather than 'pulses'.

4.21 AGRI-SELLING: FOOD-INFLATION: GOVT INITIATIVES?

- **Minimum Export Price (MEP: न्यूनतम निर्यात मूल्य)** It is the price below which of commodity cannot be exported from India. During inflation in a particular agricultural commodity, commerce ministry will raise MEP to discourage its export from India and increase its availability in the local market. **Limitation?** Frequent revisions in MEP creates uncertainty for exporter-oriented farmers for the next cropping season.
- Hoarding by big traders to create artificial shortage & food inflation. _____ (1955: आवश्यक वस्तु अधिनियम) If the Union finds that a certain commodity is in short supply and its price is spiking (agro, fertilizer, edible oil etc.) then it can notify stock-holding limits for a specified period.
- **Limitation?** The state govt. have to enforce it. But not done in letter and spirit due to nexus between politicians & big traders who provide them election funding.

4.21.1 Food Inflation → Govt initiatives → OMSS

- 1964-65: A statutory corporation Food Corporation of India (FCI: भारतीय खाद्य निगम) was set up under Ministry of Consumer Affairs, Food and Public Distribution (उपभोक्ता मामले, खाद्य और सार्वजनिक वितरण).



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- By default, FCI procures cereals/foodgrains @MSP & sells them to poor-families via the **Public Distribution System** (PDS: सार्वजनिक वितरण प्रणाली) outlets.
- However, during food inflation, FCI would also sell the grains in open market to increase supply and curb price rise. This is called _____ Scheme [खुला बाजार बिक्री स्कीम].
- **Limitation?** While OMSS can help during shortage / inflation of cereal grains (rice, wheat). But, not much useful in veggies because they're out of FCI-MSP ambit.

4.21.2 Food Inflation → Govt initiatives → _____ Fund (2014)

- मूल्य स्थिरीकरण कोष is a Central Sector Scheme = 100% funded by Union.
- **Boss?** Agro Ministry gives Interest free loans given to FCI, NAFED & other central/state agencies to procure pulses and perishable vegetables from local and foreign farmers and sell it to *aam-aadmi* at reasonable prices.

4.21.3 Food Inflation → Govt initiatives → _____ for T-O-P (2018)

- **Boss?** Food Processing Ministry → NAFED given ₹ 500 crore.
- NAFED pays money / subsidy to the farmer self help groups, food processing companies etc. for processing, transportation & cold storage of Tomato, Onion and Potato (TOP), to ensure their round the year availability in market at a reasonable price.

Conclusion-Template? Vegetables and pulses are rich source of vitamins and nutrients. They're part of large varieties of Indian and international cuisines. Therefore, food Inflation is a matter of concern for (1) nutritional security in India and (2) India's export competitiveness. Hence aforementioned factors need to be addressed on priority basis.

MCQ. India has experienced persistent and high food inflation in the recent past. What could be the reasons? (Asked in UPSC-Pre-2011)

1. Due to a gradual switchover to the cultivation of commercial crops, the area under the cultivation of food grains has steadily decreased in the last five years by about 30%.
2. As a consequence of increasing incomes, the consumption patterns of the people have undergone a significant change.
3. The food supply chain has structural constraints.

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

4.22 AGRO-SELLING→ DEFLATION (2017 ONWARDS)

While agri. Inflation was a recurring nightmare during UPA-Congress raj (2004-14), the Modi-raj has resulted in food-deflation (fall in the prices) for 3 reasons:

1. Demonetisation, limits on cash transactions and fear of being tracked by IT/GST authorities → Traders are less inclined to hoarding → more supply available at market.
2. Protectionism by US/EU & fall of International commodity prices → India's agro exports are down → More supply available in domestic market.
3. Urjit Patel's hawkish policy helped curbing inflation.



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4.23 AGRO-SELLING → DEFLATION → SUGAR MILLS' PROBLEM

- Bumper production of sugarcane in India and Brazil → fall in global sugar prices but to keep Indian farmers happy Govt did not reduce FRP → Mill-owners' arrears to farmers (i.e. previous payment not cleared yet.) → Ministry of Consumer Affairs, Food & Public Distribution gave mill-owners soft loans. It also raised the Minimum Selling Price (MSP) of sugar from factory gate to wholesalers from ₹ 29 → ₹ 31/kg.
- Finance Ministry imposed 100% custom duty on import of sugar & 0% custom duty on export of sugar to help Indian sugar mills.
- 2019-March: Brazil and Australia filed official complaint in WTO that Indian Govt's subsidies/soft-loans/tariff to sugar sector led to excess supply & "depressed" global prices so their local industry is hurt.

4.24 AGRICULTURE PRODUCTION & PROCESSING → OTHER SCHEMES

4.24.1 Agro Production & Processing → Farmer Producer Company (FPC)

- Western economists had predicted that small farms will eventually cease to exist as big farmers will buy their land, but that hasn't happened in India. So, Government decided better to enable small farmers to setup company & combine their landholdings.
- 2003: Companies Act, 1956 was amended to allow new type of company- FPC.
- FPC is a hybrid between a private limited company (=professional management) and a cooperative society (mutual benefits without excessive weightage to who contributed how much land / share capital.)
- FPC can be setup by minimum 10 farmers (no upper limit). However, FPC is not allowed to become a Public Ltd. company i.e. they can't invite public at large to invest in their shares/bonds.
- Agro ministry gives them upto ₹ 10 lakh equity support, & additional credit guarantee for bank loans.

4.24.2 Agro Production & Processing → RKVY & RAFTAAR (2017)

- Boss? Agro Ministry. Core Scheme = not 100% funded by Union.
- _____ (RKVY) started during UPA/Congress (2007).
- 2017: Modi renamed and rebranded it to RKVY-RAFTAAR i.e. Remunerative Approaches for Agriculture and Allied sector Rejuvenation.
- It's a _____ scheme- will expire in 3 years (2017-2020).
- It provides funding for Infrastructure creation (warehouse, cold storage, market facility etc.); training & skill development (Mushroom cultivation, beekeeping, aromatic plant cultivation, floriculture) and financial support to farmers to start agri-enterprise after getting the training.

4.24.3 Agro Production & Processing → Green Revolution - Krishonati Yojana

- Boss? Agro Ministry. Core scheme= not 100% paid by Union.
- It's a SUNSET scheme 2017 to 2020. (Unless renewed and continued further)
- 2017: Modi made this umbrella scheme (छतरी योजना) by combining previous 11 Congressi Schemes viz.

1. Mission for Integrated Development of Horticulture (MIDH:बागबानी एकीकृत विकास): Bee keeping also promoted in it. One of MIDH sub-mission is 'Coordinated Programme on

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Horticulture Assessment and Management using 'geo-informatics' (Project CHAMAN) to use space technology / remote sensing data to assess the horticulture production & diseases in India. 2018: Phase-II of Chaman launched.

2. National **Food Security** Mission (NFSM) to increase production of rice, wheat, pulses, millets (coarse cereals) and commercial crops & restore soil fertility.
 - a. 2018 declared as "**National Year of Millets**". Further, UN & FAO accepted India's proposal to celebrate _____ as **International Year of Millets** (अंतर्राष्ट्रीय बाजरा वर्ष). Because, millets are tolerant to drought, climate change, photo insensitive; need less water, provide nutritious elements in poor families' diet. So, Govt create two sub-missions.
 - i. NFSM on Makka and Jau.
 - ii. NFSM on Nutri-Cereals (पौष्टिक अनाज) - Jowar, Bajra, Ragi and little millets like Kutki, Kodo, Sawa, Kangni and Cheena.
 - b. NFSM has another sub-mission: National Mission on Oilseeds and Oil Palm (NMOOP: तिलहन और तेल पाम) to augment the availability of vegetable oils and to reduce the import of edible oils. Associated term: Yellow Revolution.
3. National Mission for **Sustainable Agriculture** (NMSA: स्थायी / सतत कृषि के लिए राष्ट्रीय मिशन) to encourage organic manures, bio fertilizers, cropping practices for soil and moisture conservation measures; Rainfed Area Development (RAD) programme.
 - a. Subscheme: National Bamboo Mission (NBM) to augment the income of farmers. Further, Indian Forest Act, 1927 was amended to exclude bamboo from the definition of 'trees'. This will encourage bamboo grown outside forest area without interference from Forest Department.
4. Sub-mission on **Agriculture Extension** (SMAE: कृषि विस्तार पर उप मिशन): farmers training & skill development with more use of electronic / print media, mobile apps and ICT tools, etc.
5. National **e-Governance** Plan on Agriculture (NeGP-A: राष्ट्रीय ई-गवर्नेंस): to enhance reach of extension services- about cropping methods, market prices etc. to the farmers.
6. Sub-Mission on **Seeds and Planting Material** (SMSP: बीज तथा पौध रोपण सामग्री): to promote new technologies in seed production, processing, storage, certification and quality etc.
7. Sub-Mission on Agricultural **Mechanisation** (SMAM: कृषि मशीनीकरण पर उपमिशन): To increase the availability of farm machines to small and marginal farmers. e.g. 'Custom Hiring Centres' where they can rent the machines without spending money on individual ownership. encourage R&D for small-sized machineries for small landholdings, hill-areas etc.
8. Sub Mission on **Plant Protection** and Plan Quarantine (SMPPQ: पौध संरक्षण और पौधों के अलगाव पर उपमिशन): To minimize the damage by insect pests, diseases, weeds, rodents, etc. and to shield our agricultural biosecurity from alien species.



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9. Integrated Scheme on Agriculture **Census, Economics** and Statistics (ISACES: कृषि गणना, अर्थव्यवस्थाएं तथा सांख्यिकी पर एकीकृत योजना): For data collection which can be used for R&D and policy making.
10. Integrated Scheme on **Agricultural Cooperation** (ISAC: कृषि सहयोग): Give financial assistance for farmers' cooperatives for agricultural marketing, processing, storage etc.
11. Integrated Scheme on **Agricultural Marketing** (ISAM: कृषि विपणन): To develop online and offline agricultural marketing infrastructure.

<Homework? After Prelims, self-study their features in a more comprehensive manner, because UPSC is in habit of asking about random obscure agro. schemes in the mains exam. E.g. horticulture mission.>

4.24.4 Agro Production & Processing → PM _____ Yojana

- Boss? Food Processing Ministry. Core Scheme = _____ funded by Union.
- Modi's PMKSY (प्रधान मंत्री किसान सम्पदा योजना) is an umbrella scheme incorporating previous Congressi schemes like Mega Food Parks, Integrated Cold Chain, modernization of reefer vans etc. Basically, funding is given to setup food processing infrastructure / parks / collection centres. E.g. Patanjali Food and Herbal Park at Haridwar, Uttarakhand.
- **Budget-2018** launched a new sub-scheme under PM Kisan Sampada Yojana called Operation Greens for T-O-P: Tomato, Onion and Potato.

Self-Study-for

- **Mains-GSM1:** Industrial location factors at mrunal.org/tag/gsm1-geo-location
- **Main-GSM3:** Food Processing Industry at mrunal.org/tag/food-processing

4.25 SECTORS → AGRO ALLIED: → ANIMAL HUSBANDRY (पशुपालन)

- **DPSP-Article ___:** requires the State to organise animal husbandry on modern and scientific lines, preserving and improving breeds, and prohibiting the slaughter of cows and other cattle.
- India has the world's largest livestock population (Cattle > Goat > Buffalo > Sheep > Pig > Horses & Ponies > Camels > Donkeys).
- 1970-1996: Operation Flood in 3 phases, to setup dairy farmers' cooperatives → increase milk production in India.
- **Challenge?** Post-2017, there is crash in milk prices in global market due to excess supply. So, Indian private dairy owners also cut down their procurement prices, resulting in dairy farmers' distress & agitations where they spill milk on highways in protest.

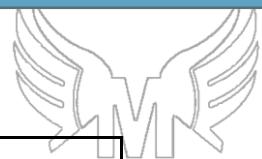
4.26 AGRO ALLIED: ANIMAL HUSBANDRY → WHILE REVOLUTION

- **Boss?** Agro Ministry → Department of Animal Husbandry, Dairying & Fisheries.
- Core Scheme = _____. Funded by Union.
- It is an Umbrella scheme covering many Congressi schemes like Dairy Entrepreneurship Development, Livestock Census, National Livestock Mission, Schemes for fodder & vaccination etc.
- Notable parts of White revolution are →

**Pashudhan
Sanjivani**

- Animal Wellness Programme with emergency helpline
- Farmers given **Nakul Swasthya Patra**: An Animal Health card

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	with UID identification number of each animal registered in a National Database.
e-Pashudhan Haat portal	Online portal for connecting farmers with breeders of indigenous bovine breeds so they can connect with each other for bulls, artificial insemination etc.
Rashtriya Gokul mission	<ul style="list-style-type: none"> - Indigenous bovine breeds (स्वदेशी गोजातीय नस्ल)- conserve them & increase their population. E.g. Gir, Sahiwal, Rathi, Deoni, Tharparkar, Red Sindhi. - State govt are given money for establishing Gokul Gram breeding & disease treatment centres.
National Kamdhenu breeding centre	For development and conservation of indigenous breeds in a scientific manner. Two centres: 1) Itarsi near Hoshangabad in M.P. 2) Chintaladevi near Nellore in Andhra GK-NOTIMP.
----- ----- 2019	<p>Int-Budget-2019 has setup this executive body in Agro Ministry with prominent social workers & scientists in cow-welfare field. Goals?</p> <ul style="list-style-type: none"> - Genetic up-gradation of cow resources - Enhance cow productivity through research in organic manure, biogas etc; Cow welfare, cow protection laws.

4.27 AGRO ALLIED: FISHERIES → BLUE REVOLUTION (मत्स्य → नीली क्रांति)

- **Boss** is same as White Revolution, This is also a core scheme.
- Government gives money for modernization of boats, marketing & cold storage infrastructure. National scheme for welfare of fishermen which gives money for construction of houses, tube wells for drinking water etc.
- Promote Inland fisheries, aquaculture & pisciculture i.e. raising fish in artificial tanks/ ponds.
- **Mariculture** = cultivation of marine organisms in their natural environment in sea upto 12 nautical miles from coast. Just like Agriculture, this is also a State-list subject. 2018: Agro Ministry announced Draft National Policy on Mariculture which encourages State Govts to lease the sea area to private entities & even farming of genetically modified species in enclosed / caged marine spaces.

Related?

- “**Pink Revolution**” for meat and poultry industry, under Ministry of food processing however not much in LimeLight under the Modi-government.
- Similarly, Yellow revolution in oilseed also not much limelight.

4.28 AGRICULTURE → RESEARCH DEVELOPMENT & EDUCATION

Indian Council of Agricultural Research (1929) is the apex body of agricultural research, education and extension under the ministry of agriculture. ICAR operates through 690 + Krishi Vigyan Kendra which provide last Mile connectivity to farmers and help them adopt the latest cropping technologies.

Challenges in Agro R&D? (Challenges in Agro)

1. ICAR scientists’ **salary structures and promotion rules** are time-bound and seniority based. So highly intelligent scientists opt for private companies / foreign countries.
2. Presently agriculture research funding is <1% of GDP. We need to increase it.



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3. Government scientists mainly focus on improving quantitative yields. If they also focused on aroma, taste, appearance, calorie, nutrient, antioxidants etc. from wealthy health-conscious urban/foreign consumers' point of view, then premium varieties can be created to help farmer earn more money. Because our goal is 2x farmer income, which doesn't necessitate 2x production.
4. Indian agriculture research has become '**cereal centric**'. We need to focus on pulses, oilseeds, horticulture and animal husbandry as well.
5. Even if research doesn't drastically improve the quantitative yield, but improves the shelf life of onions, potatoes, tomatoes etc. then also food inflation can be controlled by reducing seasonal variation in the supply.

Past Economic Survey & NITI reports observed: There is proliferation of self-financed private agri colleges without sufficient faculties, proper labs or infrastructure.

- Instead of creating more institutions, we should focus on quality of research and infrastructure in existing bodies.
- ICAR should have UGC like powers to regulate these private agro. Colleges.
- At least two agricultural universities should be given large grants so they can achieve global status.

4.29 AGRICULTURE → EXTENSION SERVICE (विस्तार-सेवा)

<for Mains GSM3>

- **Definition:** Extension service is an informal education process to offer advice, information and training, usually meant for farmers, villagers and women to change their outlook towards their agricultural / economic / health problems.
- **Challenge?** According to NSSO survey, ~60% of Indian farmers do not get much agricultural technical assistance from government-institutes. So they rely on progressive farmers, media, and private sellers of seeds, fertilizers, and pesticides- who may not give them unbiased advisory because of their own vested commercial interests.

Usually 5 delivery channels for agri-extension services:

Channel →	Challenges
Individual counseling via personal meeting, toll-free Helpline & Letters	Geographical each, manpower availability. Barely 1 extension worker available per 800-1000 farmers.
Group counseling via seminar, workshop, group discussion, field visit.	Farmers fear loss of workday, lack of motivation to spend time / travel.
Kurukshetra and other govt magazines / periodicals.	Illiteracy and poverty. then we've to use audio-visual methods such as....
Mass Media via Kisan TV (2014) and Public Radio broadcast.	Marginal farmers may not have instruments to watch them. Customized / tailor made advisory / information difficult to deliver.
E-Technology via E-Krishi (Webportal) ; mKisan (SMS/USSD), Kisan Suvidha App etc	Mass reach possible because more mobiles and jio4G effect. Tailor-made advisory can be given.

4.29.1 Agri-extension services → Timeline of schemes / events

- 1974: Kisan Vikas Kendras under ICAR started.
- 1998: Agriculture Technology Management Agencies (ATMAs) supported by ICAR.



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- 2002: Agriclinics by private individuals -usually, agri. graduates. They receive funding from Agriculture Ministry.
- 2014 onwards: Modi launches Kisan TV, Kisan Suvidha App, mKisan portal etc. while ICAR launched
 - I. _____ → Attracting And Retaining Youth In Agriculture- For entrepreneurship in food processing chains.
 - II. _____ → Student Rural Entrepreneurship Awareness Development Yojana
 - III. Krishi Unnati Mela → Jointly by ICAR & Agro Ministry's other departments. 3rd edition @New Delhi in 2018.

4.30 AGRICULTURE-CONCLUSION

- ✓ Agriculture is the largest sector of Indian economy in terms of number of people employed. For their income security, as well as entire India's food & nutritional security, we've to focus on improving soil, irrigation, seed, fertilizers, market reforms etc. <insert name of x y z> scheme is important in that regard.
- ✓ And / or to double the farmers income, we've to focus on horticulture / floriculture / fisheries / animal husbandry / poultry / food processing / extension services and therefore addressing aforementioned <insert name of > challenges is need of the hour.

4.31 MAINS QUESTIONS FROM AGRICULTURE IN PREVIOUS UPSC EXAMS

Suggested reading?

- 1) Web-resources mentioned in this handout for Food processing and land reforms.
- 2) Introduction conclusions of past 3 years' economic surveys (usually their vol2 ch.7 deals with Agro).
- 3) Chief Editor's Desk (Preface) of last 2 years' Yojana & Kurukshestra magazines from http://yojana.gov.in/Recent_archive_2018.asp (change year number for getting previous Archives). **If a particular month's magazine issue is devoted to Agro → further go through index & refer to article inside it depending on exam requirement.**
- 4) NITI PDF Document: Strategy for New India @75 ch. 5, 6 and 7.

4.31.1 Mains Questions: Agro → Cropping & irrigation & Land Reforms

GSM3 Syllabus Topic: Major crops cropping patterns in various parts of the country, different types of irrigation and Land reforms in India.

Sikkim is the first 'Organic State' in India. What are the ecological and economical benefits of Organic State?	2018
Assess the role of National Horticulture Mission (NHM) in boosting the production, productivity and income of horticulture farms. How far has it succeeded in increasing the income of farmers?	2018
How has the emphasis on certain crops brought about changes in cropping patterns in recent past? Elaborate the emphasis on millets production and consumption.	2018
What are the major reasons for declining rice and wheat yield in the cropping system? How crop diversification is helpful to stabilize the yield of the crop in the system?	2017



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What is water-use efficiency? Describe the role of micro-irrigation in increasing the water-use efficiency.	2016
What is allelopathy? Discuss its role in major cropping systems of irrigated agriculture.	2016
Given the vulnerability of Indian agriculture to vagaries of nature, discuss the need for crop insurance and bring out the salient features of the Pradhan Mantri Fasal Bima Yojana (PMFBY)	2016
Discuss the role of land reforms in agricultural development. Identify the factors that were responsible for the success of land reforms in India.	2016
Establish the relationship between land reform, agriculture productivity and elimination of poverty in Indian Economy. Discussion the difficulty in designing and implementation of the agriculture friendly land reforms in India.	2013

4.31.2 Mains Questions: Agro →E-Tech. in aid of farmers

GSM3 Syllabus Topic: e-technology to aid farmers, Technology missions;

Explain various types of revolutions, took place in Agriculture after Independence in India. How these revolutions have helped in poverty alleviation and food security in India?	2017
How can the 'Digital India' programme help farmers to improve farm productivity and income? What steps has the Government taken in this regards?	2015

4.31.3 Mains Questions: Agro →Food processing industry

GSM3 Syllabus Topic: Food processing and related industries in India (scope & significance, location, upstream-downstream requirements, supply chain management); storage, transport & marketing of agro-produce and related issues & constraints; Economics of animal-rearing

Examine the role of supermarkets in supply chain management of fruits, vegetables and food items. How do they eliminate number of intermediaries?	2018
What are the reasons for poor acceptance of cost effective small processing unit? How the food processing unit will be helpful to uplift the socio-economic status of poor farmers?	2017
Livestock rearing has a big potential for providing non-farm employment and income in rural areas. Discuss suggesting suitable measures to promote this sectors in India	2015
In view of the declining average size of land holdings in India which has made agriculture non-viable for a majority of farmers, should contract farming and land leasing be promoted in agriculture? Critically evaluate the pros and cons.	2015
What are the impediments in marketing and supply chain management in industry in India? Can e-commerce help in overcoming these bottlenecks?	2015



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There is also a point of view that agriculture produce market committees (APMCs) set up under the state acts have not only impeded the development of agriculture but also have been the cause of food inflation in India. Critically examine.	2014
India needs to strengthen measures to promote the pink revolution in food industry for better nutrition and health. Critically elucidate the statement.	2013

4.31.4 Mains Questions: Agro → MSP

GSM3 Syllabus Topic: Farm subsidies and MSP and issues therein (direct and indirect); PDS (objectives, functioning, limitations, revamping, issues of buffer stocks & food security)

What do you mean by Minimum Support Price (MSP)? How will MSP rescue the farmers from the low income trap?	2018
How do subsidies affect the cropping pattern, crop diversity and economy of farmers? What is the significance of crop insurance, minimum support price and food processing for small and marginal farmers?	2017
“In the villages itself no form of credit organisation will be suitable except the cooperative society.” – All Indian rural credit survey. Discuss this statement in the background of agriculture finance in India. What constraints and challenges do financial institutions supplying agricultural finances? How can technology be used to better reach and serve rural clients?	2014
Food security bill is expected to eliminate hunger and malnutrition in India. Critically discuss various apprehensions in its effective implementation along with the concerns it has generated in WTO.	2013
What are the different types of agriculture subsidies given to farmers at the national and state levels? Critically analyze the agriculture subsidy regime with the reference to the distortions created by it.	2013



41 INDUSTRIAL POLICY AND LPG REFORMS

1948	1 st industrial policy by India's Minister for industries _____.
1956	<ul style="list-style-type: none"> - Industrial Policy Resolution (औद्योगिक नीति संकल्प). It focused on public sector led heavy industries (Oil, mining, shipbuilding, steel, chemicals, machinery manufacturing etc). - PM Nehru presumed this will help in 1) employment generation 2) self reliance 3) provide Raw material, intermediate goods and machinery to help other industries to produce consumer goods.
1991	BoP crisis forces PM _____ to launch New Industrial Policy (नई औद्योगिक नीति) with LPG reforms
Post-LPG	<ul style="list-style-type: none"> - Service sector's share increased in GDP (to ~ __ %) & employment (to ~34%) -though not steadily. - Mfg. sector's share increased in GDP (to ~ __ %) & employment (to ~24%) -though not steadily.

41.1 LIBERALIZATION, PRIVATIZATION AND GLOBALIZATION?

41.1.1 Liberalization :उदारीकरण

Means the withdrawal of controls and regulations by the government on the industries.

Till 1991	After LPG-reforms
Ministerial interference in the functioning of CPSEs → fall in professionalism and inefficiency.	Govt. signed memorandum of understanding (MoUs:समझौता जापन) with CPSEs granting them operational freedom through 'Ratna' status.
<ul style="list-style-type: none"> - Mandatory for any private individual to obtain license to start to start any industrial activity. - Even on licensed industries, govt. would impose 'production quota' (e.g. not more than 'x' number of telephones or 'y' number of scooters be produced.) Government would appoint inspectors to check the compliance. <p>Result? Delays, corruption, No ease of doing business.</p>	<p>Production quota & Inspector was abolished. Licences required only for a selected number of industries. Namely,</p> <ol style="list-style-type: none"> 1. Alcoholic drinks 2. Tobacco products 3. Electronic aerospace and Defence equipment 4. Industrial explosives, gun powder, nitrocellulose and matches; 5. Hazardous chemicals: Hydrocyanic acid, Phosgene, Isocyanates & their derivatives. <p>For remaining sectors, a private entrepreneur can start the business by simplifying an Industrial Entrepreneur Memorandum (IEM:उद्यमी जापन) with</p>



	Commerce Ministry (except for the industries reserved for public sector). The purpose of IEM is merely to collect data about investment, employment and industrial activities.
The big corporates were not allowed to enter in the sectors reserved for the Small Scale Industries (SSI) / MSME. e.g. pickles & chutneys, mustard oil, groundnut oil, exercise books and registers, wax candles, glass bangles, steel almirah etc.	Govt gradually shrunk this list. By 2015, no item was reserved for SSI/MSME industries.

41.1.2 Privatization: निजीकरण

- Allowing private sector to enter into the sectors which were previously reserved for public sector companies only,
- Converting public sector companies to private sector companies by reducing Government shareholding to below 50%

Till 1991	After LPG-reforms
Most of the industrial sectors were reserved for the public sector Industries only → no competition, lack of innovation.	Only following industries are reserved for public sector undertakings 1. Atomic Energy 2. Railway Transport
Government would nationalise private sector industries in the national interest such as banking, insurance, aviation.	- Stopped the practice of nationalisation. - Private sector companies were allowed in Banking, Insurance, aviation, telecom and other sectors.

41.1.3 Globalization: वैश्वीकरण

Globalization is a process in which nations allow free flow of goods, services, labour, capital investment, technology, ideas and innovations.

Till 1991	After LPG-reforms
Inward looking economy, Import substitution policy, variety of tariff and non tariff barriers on the imported goods and services → problem of smuggling.	India joined the WTO-regime, we gradually relaxed the tariff and non tariff barriers on the imported goods and services.
Very strict controls on currency convertibility, foreign companies, and foreign investment.	Norms where relaxed (Ref: Pillar#3)

Further self study on the LPG reforms from NCERT class 11 ch.2 and 3. Mains Answer writing about LPG reforms: youtube.com/user/TheMrunalPatel/search?query=rao



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41.2 BEYOND LPG → TOWARDS 4TH INDUSTRIAL REVOLUTION

Timelines (Approx)	Industrial revolutions & their major components
1.0 (1800 onwards)	powered by coal, iron machines and factories, railways, steamships and telegraph.
2.0 (1900 onwards)	powered by electricity, oil, motor-vehicles, planes, telephone, TV, cinema and radio
3.0 (1980 onwards)	electric and hydrogen powered vehicles, drones, flexible robots, 3D printers and nanotechnology
4.0 (latest buzzword from 2016's WEF-Davos summit onwards)	It further optimizes the computerization of Industrial revolution 3.0 using cloud computing, Artificial Intelligence (कृत्रिम बुद्धिमत्ता) and Internet of Things (IoT: e.g. using smartphone app to turn on AC before you arrive at home.)

- The Fourth Industrial Revolution will result in automation of manufacturing processes through "smart factories" where cyber-physical systems will make decisions, minimising wastages, optimising the use of energy and raw material.
 - Germany, France, China, USA etc. have already launched government funded programs for this.
 - 2017: Commerce ministry set up a task force on AI for India's economic transformation under **Dr. V. KAmakoti** of IIT Madras.
 - 2018: Defence ministry set up a task force on AI for national security under _____ of Tata Sons.
 - 2018-Budget gave ₹100 crore to Department of Science & Technology for a mission on cyber physical systems. NITI Ayog working on National Artificial Intelligence Mission.
 - 2019-Interim-Budget announced a National Programme & Centre & webportal on 'Artificial Intelligence'.

41.2.1 Beyond LPG → 4th Industrial Revolution → New Industrial Policy

1991: Our last industrial policy was made. 2017: _____ ministry began formulating a New industrial policy for India focusing on the Fourth Industrial Revolution (चौथी औद्योगिक क्रांति) with six thematic areas viz.

- 1) Technology & Innovation: Govt to provide incentives for artificial intelligence, internet of things, and robotics.
 - 2) Manufacturing & MSME, 3) Ease of Doing Business
 - 4) Infrastructure & Investment 5) Trade & Fiscal Policy
 - 6) Skills & Employability for Future

2019-Jan: This policy is awaiting cabinet approval.

41.2.2 4th Industrial Revolution →

- **Boss?** Ministry of Heavy Industries & Public Enterprises → Department of heavy industries
 - It aims to propagate technological solutions to Indian manufacturing units to make them ready for Industry 4.0 by 2025.

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- **How?** Awareness generation, demo centres, training , networking between industry and academia, international Corporation.
- **Related?** This department is also responsible for the National Capital Goods Policy 2016, that aims to increase domestic production of textile machinery, Earth moving and mining machinery, printing machinery etc.
- Textile Ministry also has a SAMARTH scheme- but it's for Skill development in textile sector.

41.3 MFG POLICY → NATIONAL MFG POLICY 2011: राष्ट्रीय उत्पादन नीति

- **Boss?** Commerce ministry → DIPP / DPIIT.
- **Target?** To increase manufacturing's share in GDP to __ by 2022, & create __ million jobs.
- For this target, Govt will pursue ease of doing business, skill upgradation for young workforce, funding for innovation & green Technologies
- Creating National Manufacturing & Investment Zones (NMIZ).

41.3.1 Mfg Infrastructure → NMIZ, राष्ट्रीय उत्पादन और निवेश क्षेत्र

- NMIZ is an 'industrial township' containing Special Economic Zones, Industrial Parks & Warehousing Zones, Export Oriented Units etc.
- NMIZ are given additional support by government e.g.
 - Tax incentives, Relaxed norms for FDI approval
 - Providing Rail, Road, energy, communication connectivity, schools-hospitals & other social infrastructure for the workers, etc. in a time bound manner.
 - relaxations in the labour laws e.g. women allowed to work in night shift, easier hiring-firing norms: आसान काम पर रखने के - निकालने के मानदंड.
- NIMZ will be treated as self governing bodies under Article 243(Q-c) of the Constitution. So the traditional norms related to Municipality, its functions, election of ward members etc. will not apply for the township area.
- We have more than 15 NMIZ such as Ahmedabad-Dholera Investment Region@Gujarat, Dadri-Noida-Ghaziabad investment Region@Uttar Pradesh, Manesar-Bawal Investment Region@Haryana etc.
- Previously, Delhi Mumbai Industrial Corridor had setup Special Investment Regions (SIR) in its region. They're converted into NMIZ.
- 2017: Commerce ministry launched **Industrial Information System** (IIS), a GIS-enabled database of industrial areas and clusters across the country. This helps the entrepreneurs to find out availability of raw material, distance from key transport hubs, layers of terrain and urban infrastructure.

41.3.2 Mfg Infrastructure → Industrial Corridors (औद्योगिक गलियारे)

- **Boss?** _____ Ministry → National Industrial Corridor Development and Implementation Trust (NICDIT).
- They provide funding for industrial and commercial areas, townships, Warehousing and container depots, Rental Factories, Social infrastructure like- schools, technical institutions, hospitals etc, Housing and Residential Complexes; Connectivity for roads, railways, airports, Oil and gas pipeline etc.

Notable ongoing/ proposed industrial corridors of India:

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- **Delhi Mumbai Industrial Corridor:** (DMIC-2006 onwards) passing through Uttar Pradesh, Haryana, Rajasthan, Madhya Pradesh, Gujarat and Maharashtra. It's implemented by a Special purpose vehicle (SPV: company) with ownership: 49% NICDIT, 26% Japanese Bank for International Cooperation (JICA) and remainder with India's Public Sector Financial Intermediaries.
- Other notable corridors: Amritsar Kolkata Industrial Corridor, Chennai Bengaluru Industrial Corridor, Bengaluru Mumbai Economic Corridor, Vizag –Chennai Industrial Corridor, East Coast Economic Corridor from Kolkata to Chennai.
- 2017: Commerce Ministry approved **Defence Park** at Pallakad, Kerala. **2018:** Budget announced two Defence Industrial Production Corridors: 1) Tamil Nadu 2) Uttar Pradesh.

Related? infrastructure, National Investment and Infrastructure Fund (NIIF) etc. in Pillar#5

42 MFG & SERVICES → MAKE IN INDIA: WHY? (2014)

Previous economic surveys observed that nations improve their GDP using three ways

1. **Geology:** Energy & Minerals resources e.g. W.Asia, Botswana, Chile, Australia, Canada. **India's challenges?** Not sufficient crude oil resources, we still lack cost-effective technologies for large-scale exploration of Shell gas and nuclear minerals.
2. **Geography:** Tourism e.g. Barbados, Mauritius, Caribbean. **India's challenges?** While India has great tourism potential due to its geographical, climatic and cultural diversity. But, tourism income alone cannot sustain a large nation like India.
3. **Jeans to Jets:** As agrarian economy evolves, it'll begin producing low-skill items like jeans → further growth & technological advancements to produce jets, softwares & other high-skilled goods and services → then country will outsource the jean mfg. to other third world nations. USA grew like this. China, Thailand, Indonesia, Malaysia and other East Asian economies pursuing this model.

India's case is unique because post LPG-reforms we directly jumped from Agriculture to IT/service sector. Our growth in (low skill) manufacturing sector has been sub-optimal due to 1) Electricity, road and other infrastructural bottlenecks 2) Outdated factory and labour laws that prevent ease of doing business.

Demographic dividend and the need to shift agricultural labour

- In the advanced economies, not more than 25% of the population is engaged in agriculture (USA 4%, UK 5%, France 14%, Australia 16%).
- Whereas in India >40%, because the non-agricultural sector has not been adequately developed to absorb the labourers from the growing population.
- Demographic dividend = economic growth potential when share of the working-age population becomes larger than the non-working-age population. India 65% population is below the age of 35 age.
- Industries use raw materials from agriculture and agriculture sector needs industrial equipment and machinery such as pump set, tractor, electricity etc. So both are complementary to each other. But, industrial activities provide higher wages / remuneration than agricultural labour.
- So, industrialization is the only answer to reap India's demographic dividend. Further, to double farmers' income, some of the small-marginal farmers should opt for

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industrial / service sector jobs so that land consolidation-mechanization can help doubling the incomes for rest of the farmers.

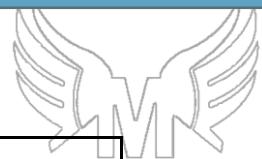
Keeping these angles in mind, PM Modi launched ‘Make in India (मेक इन इंडिया)’ in 2014.

42.1 MAKE IN INDIA: How?

- **Nodal?** _____ ministry.
- **Objective?** Promote India as global hub for manufacturing goods & services, design and innovation in 25 sectors.
- **How?** (i) Updating the Policies, relaxing the FDI norms (ii) Fiscal incentives (Tax breaks, subsidies, procurement) (iii) Infrastructure Creation (iv) Ease of Doing Business by relaxing the factory-labour-tax laws & administrative procedures (v) Innovation and R&D (vi) Skill Development.

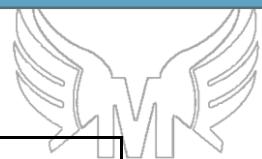
25 Sectors under	Make in India Initiatives to boost production and demand of India-made products? <list is not exhaustive>
1. Auto Components	<ul style="list-style-type: none"> - National Automotive Testing and R&D Infrastructure Project (NATRIP) project for encouraging R&D - FAME-India [Faster Adoption and Manufacturing of (Hybrid &) Electric Vehicles in India]. - Electric, Ethanol and Methanol Vehicles exempted from Permit.
2. Automobiles	
3. Aviation	<ul style="list-style-type: none"> - National Civil Aviation Policy (NCAP) & UDAAN scheme to boost regional air connectivity. Faster approval to the Greenfield airports in the North East areas - 2016: FDI policy relaxed for Aviation.
4. Biotechnology	New biotechnology parks launched, FDI policy relaxed.
5. Chemicals	New plastic parks launched.
6. Construction	Real Estate (Regulation and Development) Act, 2016- for granting quick permissions to the builders at the same time protecting the home buyers.
7. Defence Manufacturing	<ul style="list-style-type: none"> - Defence Procurement Procedure (DPP-2016: रक्षा अधिप्राप्ति प्रक्रिया) : Government will give first priority to the indigenously designed developed and manufactured (IDDM) defence equipments. - Updated Defense Offset Norms (रक्षा ऑफसेट मानदंड) i.e. when government buys defence equipments from a foreign company, that foreign company will have to reinvest “x%” of the income back into Indian industries.

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8. Electrical Machinery	<ul style="list-style-type: none"> - New electronic parks approved, subsidy to entrepreneurs for purchasing machinery.
9. Electronic System Design	<ul style="list-style-type: none"> - National Electronics Policy 2019 <<i>its salient features given under the Standup India portion of this handout</i>>
10. Food Processing	New Mega Food parks, cold storages, abattoirs approved.
11. IT and BPM	<ul style="list-style-type: none"> - 2016: 100% automatic FDI in market-place E-commerce. - Post demonetisation various initiatives to encourage the digital payment systems. - Pradhan Mantri Digital Saksharta Abhiyan (PMGDISHA), Digital India Mission- All of them directly and indirectly increase the demand of computer hardware and software. - Public Procurement (Preference to Make in India) Order 2017 which requires govt departments to buy India-made desktops and computer parts.
12. Leather	New leather parks and clusters approved
13. Media and Entertainment	<ul style="list-style-type: none"> - Single window clearances for film shootings for foreign film makers in India. Relaxed the norms to start new private FM radio stations. - Interim-Budget-2019: Previously Single Window clearance to foreigner film makers for shooting movies. This facility made open to Indian as well. Cinematography Amendment bill: unauthorized camcording / duplication of movie → upto 3 years jail + 10 lakh fine.
14. Mining	Mines and Minerals (Development and Regulation) Act (MMDR) amended in 2015-16 for ease of mining exploration.
15. Oil and Gas	Gas based Thermal Power Projects approved. Gas grid projects to deliver gas through pipeline. Strategic oil reserves created. _____ ----- (HELP) 2016 To facilitate the exploration of all type of hydrocarbons. PM-Ujjwalla yojana to encourage poor families adopt LPG (which indirectly boosts the demand & manufacturing of gas stoves, lighters etc.).
16. Pharma	Additional NIPER institutes approved → increased the availability of trained manpower. FDI norms relaxed. Compulsory licensing of expensive MNC-patented drugs to encourage generic drugs' production in India. <Ref: IPR portion of this handout.>
17. Ports	----- Project to improve port infrastructure.<More in Pill#5>



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18. Railways	New Metro Rail Policy 2017 with public private partnership. Mumbai-Ahmedabad high speed rail project with help of Japan.
19. Roads and Highways	<ul style="list-style-type: none"> - Expressways between Vadodara Mumbai, Delhi-Mumbai, Bangalore-Chennai etc. - NHAI approved new investment models. - Bharatmala project for highway construction.
20. Renewable Energy	Preference given to domestic manufacturers for purchasing equipments for Jawaharlal Nehru National Solar Mission and similar projects. Although later USA complaint to WTO that it is a 'non-tariff' barrier.
21. Space	ISRO's commercial arm _____ Corporation Ltd. getting other countries to launch their satellites using ISRO's expertise.
22. Textiles	India Handloom Brand launched. Special Textile Package to increase jobs and machinery upgradation. Apparel and garment manufacturing parks setup in North East.
23. Thermal Power	New thermal power plants with green supercritical technology. UDAY scheme to cover the losses of distribution companies. Deendayal _____ scheme to increase the electricity penetration in rural households. Unnat Jyoti by Affordable LED for All (UJALA) scheme to increase consumption of LED bulbs.
24. Tourism and Hospitality	<ul style="list-style-type: none"> - e-Visa scheme, Swadesh Darshan scheme, PRASAD scheme etc. to increase tourism
25. Wellness	<ul style="list-style-type: none"> - Yoga day, AYUSH Ministry to attract foreigners for medical tourism in India. etc.

Challenge? Most of the jobs in above 25 sectors are skill intensive while India is burdened with vast pool of unskilled labour. So, government has to pay more attention to education and skill development schemes incl. Skill India (2015) → *more in Pillar#6*.

42.2 MFG & SERVICES → STARTUP INDIA (2016)

Nodal? _____ Ministry.

- Startup company is defined as a company which is:
 - Not older than ____ years. (10 years if Biotech Company).
 - Doesn't have annual turnover above ₹ 25 crore
 - Works towards innovation & development of goods / services.
- Under Startup India (स्टार्टअप इंडिया) initiative such startup companies are given _____ exemption from Income Tax / Corporation Tax.
- Self-certification permitted wrt EPFO act, ESIC Act and various Labour Laws.
- Relaxed norms in public procurement. E.g. if Govt tender says 'we are hiring a web development company to make a site for Govt department, but it must have x years



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experience and y crores of turnover.."- These "x" and "y" requirement would be kept relaxed for a startup company.

- Relaxed norms for exit i.e. winding up the companies.
- Govt established "Fund of Funds for Startups" (FFS) in Commerce Ministry. This fund will provide money to other startup related schemes.
- Industry-academia partnership, incubation and hand holding, Mobile app and Portal, Legal and Technical Support for filing the patent, lower / zero fees for patent applications etc.
- Foreign venture capital investors (FVCI) given certain technical relaxations by Income Tax Dept (for TDS/ tax withholding) and Reserve Bank of India (for currency convertibility).

Related Term: Unicorn club → A startup company whose valuation is \$1 billion >. Swiggy, Paytm, Byjus etc. Indian startups are in this list.

42.3 MFG POLICY → NATIONAL POLICY ON ELECTRONICS 2019

- इलेक्ट्रॉनिक्स पर राष्ट्रीय नीति 2019 replaces the previous policy of 2012.
- **Boss?** Ministry of Electronics and Information Technology (MeitY).
- To make India as a global hub for Electronics System Design and Manufacturing – (ESDM: इलेक्ट्रॉनिक्स प्रणाली रचना/सिस्टम डिजाइन और विनिर्माण), Government will do following: →
 - Tax benefit, subsidies and other incentive for R&D, innovation, Training and skill development for 5G, Internet of Things (IoT), Artificial Intelligence (AI: कृत्रिम बुद्धिमत्ता), Machine Learning, Virtual Reality (VR), Drones, Robotics, Nano-based devices, Medical Electronic Devices, Automotive Electronics Industry, Strategic electronics for the defence sector etc.
- ----- (SPF: सार्वभौम पेटेंट निधि): Govt will buy Patents / Intellectual Property Rights (IPR) from the innovators / Corporate Companies → allow MSME industries to use those IPR for electronics manufacturing, without having to pay hefty royalties to original patent holder..
- **Targets for 2025?** Turnover of \$400 billion. Produce 100 crore units of mobile handsets & export 60 crores units out of that. Create 1 crore jobs.

42.3.1 Mfg → Electronics Development Fund (EDF: इलेक्ट्रॉनिकी विकास निधि)

- **Boss?** MeitY gave money to Canara bank's CANBANK Venture Capital Funds Ltd.
- 2015: EDF was set up as a "Fund of Funds" (वृहद निधि) → money is given to "Daughter Funds" (उप-निधिया) e.g. SEBI registered venture capital funds who are investing in electronics related startup companies.

Conclusion Template:

- **Electronics / IT Technology** permeates all sectors of economy. It plays vital role in economic growth, employment generation and strategic security of nation. R&D, IPR and Training are the critical components for the success of an Electronics / IT Technology company. Aforementioned policy, initiative, scheme will play a significant role in this regard.



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42.4 STARTUP CRITICISM / CHALLENGES

- “**Valuation game**”: Startup try to increase subscribers with cashback /discounts → show the data to investors about company’s projected sales/growth/valuation to get more funding → eventually convert the private limited company into public limited company & launch IPO to get even more capital → people subscribe in IPO hoping large amount of dividend while the promoter leaves with money & company sees fall in revenue once the cashbacks and discounts are stopped.
- **Past Economic Surveys**: Most of the startups are focused on e-commerce aggregation i.e. Connecting the buyers with sellers (uber, zomato, flipkart, pepperfry etc.) due to ‘valuation game’, whereas India needs more startups in Agriculture, Manufacturing, Healthcare and Education.
- 2019: Raghuram Rajan noted: There is no ‘free lunch’ in economy so when ‘superstar’ companies are giving free products / cashback to consumer - who is paying for it? is it company itself or the government (through tax-holidays & subsidies given to that company!)
- While startup entrepreneurs have to be encouraged but at the same time, (fake) Angel investors’ tax evasion and avoidance has to be discouraged. So we also have angel tax norms (ref: Black Money handout).

42.5 STARTUP → (SHUTDOWN) “EXIT” OF SICK INDUSTRIES

Sick industries: बीमार उद्योग in an entity that has accumulated more losses than its entire capital. Industrial sickness can be a result of

- Internal factors like mismanagement, workers low morale & strikes etc.
- External factors like rising cost of energy & raw material, fall in product demand etc.

1985: PM Rajiv Gandhi enacted **Sick Industrial Companies Act** → Statutory body in Finance Ministry → **Board for Industrial and Financial Reconstruction (BIFR)**.

- BIFR would A) help the SICK industry with new funds or B) shut down the SICK industry on case to case basis. Higher appeal? Authority for Industrial and Financial Reconstruction (AIFR).
- Ideally, a sick industry should be liquidated so its labour and capital can be shifted to healthy companies.
- But, above bodies’ decision making was very slow so sick companies will not quickly shut down, and continue to receive Government funding/support, as if Abhimanyu entered the “Chakravyuh” but never exits. So previous economic surveys used the term ‘Chakravyuh challenge’.

2016: PM Modi repealed this act & its bodies. Their pending cases referred to NCLT. So now if a firm becomes sick then:

- IF wilful defaulter or incapable defaulter → liquidation under the Sarfaesi Act
- ELSE I&B Code: IP will make a resolution plan within 180-270 days → if IP’s resolution plan is not agreeable to the landers → liquidation.
 - If a startup company wants to (voluntarily) shut down, it can make application under I&B Code → IP will liquidate it within 90 days. This helps the entrepreneur to pull out his portion of capital (to start another startup = Ease of doing business).



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Conclusion Template: Startups have always been the engine of progress. The Mega corporations of today were startups of yesterday. Startups can be effective instruments for reaping India's demographic dividend, catalyze employment generation and augment its economic growth. The aforementioned policies/ schemes are significant in this regard.

43 MFG & SERVICES → INTELLECTUAL PROPERTY RIGHTS

- WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS-1995) protects following types of IPR (बौद्धिक संपदा अधिकार) : Copyright, Trademarks, Geographical Indications, Industrial Designs, Patents, Integrated Circuits & Trade Secret.
- **World Boss?** UN specialized agency World Intellectual Property Organization (WIPO: HQ Geneva, Switzerland, विश्व बौद्धिक संपदा संगठन).
- WIPO is known for
 - (1) Global _____ Index
 - (2) _____ Treaty 2013 which requires nations to increasing accessibility of copyrighted books to Visually Challenged. India was first to ratify.
 - Further, Social Justice Ministry → Divyangjan Dept → launched '_____ e-library' for VH, in collaboration with Daisy Forum of India (an NGO) and Tata Consultancy Service (TCS).

43.1.1 IPR → Indian Laws

Year	Act	Nodal?
1952	Cinematograph Act	Ministry of Information and Broadcasting. Budget-2019 promised to amend it with anti-camcording provisions.
1957	Copyright Act	Previously HRD ministry, now _____ Ministry.
1970	Patents Act	Commerce Ministry's Controller General of Patents, Designs and Trademarks. (CGPDTM)
1999	Trademarks Act	
1999	Geographical Indications of Goods (Registration and Protection) Act	Commerce Ministry's Geographical Indications Registry at Chennai
2000	Designs Act	CGPDTM
2000	Semiconductor Integrated Circuits Layout-Design Act	MEITY: Ministry of Electronics and Information Technology
2001	Protection of Plant Varieties and Farmers' Rights Act	_____ Ministry
2002	_____ Act	Environment Ministry

43.2 IPR → PATENTS → COMPULSORY LICENSING (अनिवार्य लाइसेंसिंग)

- If public interest is involved → Government can use, manufacture, import or sell a patented invention without the patent-owner's consent. Permitted under WTO's TRIPS agreement.
- 2012: Shortage of an anticancer drug Nexavar in Indian market. Bayer Pharma (Germany) held the patent and production rights & sold it price of ₹ 2.50 lakhs per 120 tablets.



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- So, Indian Govt used powers of Indian Patent Act to ‘Compulsory Licence’ to an Indian company NATCO to produce this drug, sell it at ₹ 8880 per 120 tablets & pay 6% royalty to Bayer.
- US & EU are apprehensive of Indian Govt issuing CL, because their MNCs will suffer, if such low prices and royalty % are forced.

43.3 IPR → EVERGREENING OF PATENTS (पेटेंट को सदाबहार करना / रखना)

- Patent is a statutory right given for an invention for a limited period of time.
- Patent protection is a territorial right and therefore it is effective only within a country.
- Suppose a pharma company is given 20 years patent for xyz drug in India, others cannot manufacture it during that period.
- But when the patent is about to expire, the company just slightly modifies the original drug formula to create a new drug and seeks patent for that new drug. This unethical practice is called “Evergreening”.
- Indian Patent Act prohibits Evergreening. (under Section 3(d)).
- (2013) A Swiss pharma company Novartis’s blood cancer drug Glivec’s patent was about to expire, they had sought patent for similar new anti-cancer drug but lost the case in Supreme Court India. SC allowed Indian companies can produce generic version of this anti cancer drug → patient will get it at cheaper price.

43.4 IPR → UTILITY PATENTS: उपयोगिता पेटेंट

- Utility patents / ‘petty patents’ recognize the minor (mechanical) improvements of existing products e.g. adding speaker in a microwave oven to announce when food is prepared.
- Commerce ministry is not in favour of amending the Patent Act to allow Utility Patent because otherwise it could aggravate the problem of ‘Evergreening of Patents’.

43.5 IPR → NATIONAL IPR POLICY 2016

- Nodal? _____ ministry. Motto? Creative India; Innovative India.
- This policy shifted the Copyright Office and its statutory body Intellectual Property Appellate Board (IPAB) from HRD ministry to commerce ministry.
- Conduct IPR awareness programs for industry, police, customs and judiciary so they can combat counterfeiting and piracy in a more efficient manner.
- +Filler points like Launching new courses in the higher education to increase the availability of patent experts in India, reducing the patent application fees for the startup companies and grassroot innovators etc.

MCQ. With reference to the ‘National Intellectual Property Rights Policy’, consider the following statements: (Asked in UPSC-Pre-2017)

1. It reiterates India’s commitment to the Doha Development Agenda and the TRIPS Agreement.
2. Department of Industrial Policy and Promotion is the nodal agency for regulating intellectual property rights in India.



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3. Both 1 and 2
4. Neither 1 nor 2

43.6 IPR → NOTABLE SCHEMES

SIPP	<ul style="list-style-type: none"> - Commerce Ministry's Startups Intellectual Property Protection (SIPP: स्टार्टअप्स बौद्धिक संपदा संरक्षण) scheme valid from 2016 to 2020. - Startup entrepreneurs are given free training on how to file the patents. No patent fees for them.
AIM & SETU In NITI in 2015	<ul style="list-style-type: none"> - Atal Innovation Mission in NITI Ayog to help the innovators. E.g. launch challenges / competitions and award prize money. - Self Employment and Talent Utilisation (SETU) in NITI ayog to setup incubators for innovation. Incubators are centers that help aspiring entrepreneurs to develop /experiment with products without investing in all the machineries beforehand.
Smart India Hackathon	<ul style="list-style-type: none"> - Organized by the _____ Ministry in 2017, 18, 19. - 2019: College students asked to give innovative ideas to solve the challenges faced by public sector organisations, industries and even NGOs. 36 hrs software development competition, 5 days hardware development competition etc.
Misc.	<p>Dept of Science Technology launched</p> <ol style="list-style-type: none"> 1. INSPIRE (Innovation in Science Pursuit for Inspired Research) 2. MANAK (Million Minds Augmenting National Aspiration and Knowledge) 3. NIDHI (National Initiative for Developing and Harnessing Innovation) 4. NIDHI-PRAYAS (PRomoting and Accelerating Young and ASpiring technology entrepreneurs) <p>HRD Ministry launched Uchhattar Avishkar Yojana (UAY) for IITs</p> <p>All these schemes provide some type of grant, funding, scholarship, award the innovator. By default they're 100% Union fund. Internal difference & exact features= poor cost benefit.</p>

Conclusion template? Innovations / Startup can turn Indian youths from job seekers into job creators. They encourage entrepreneurship, innovation and creation of revolutionary new products that can be used by people around the world. Hence startups are important / protecting their IPR is important. Aforementioned initiatives / schemes are important in that regard.

43.7 INDEX → GLOBAL _____ INDEX (GII)

(वैश्विक नवीनीकरण सूचकांक) by _____, Cornell University (USA), Insead Business School (France).

- ✓ Its 80 indicators capture innovation enabling factors such as political environment, education, infrastructure and business sophistication.
- ✓ **2018 ranking:** 1) Switzerland: kept first rank since 2011 2) Netherlands 3) Sweden 17) China.... 57) India and 126) Yemen the last. India's rank has improved over the years.



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43.8 INDEX → GLOBAL INDEX (GCI)

(वैश्विक प्रतिस्पर्धात्मकता सूचकांक-विश्व आर्थिक मंच) by _____ ranks nations on GCI 4.0 framework with 12 drivers of productivity: Institutions, Infrastructure; Technological readiness; Macroeconomic context; Health; Education and skills; Product market; Labour market; Financial system; Market size; Business dynamism; and Innovation.

- ✓ **2018 ranking:** 1) USA, 2) Singapore, 3) Germany.... 28) China, 58) India.... 140)
Chad the last. India's rank has improved over the years.

44 INDEX → EASE OF DOING BUSINESS REPORT

व्यापार करने में सुगमता का रिपोर्ट is an index by the _____ to measure how easy or difficult it is to run a business organisation in a given country, based on simple average (equally weighted) of 10 parameters..

2018-Oct: 'Annual Doing Business 2019' report →

- Top 3 were NZ, Singapore, Denmark.
- USA@8, China@46, India@100, Pak@136. Somalia@190 (lowest)

	India's Ranking →			
	2016	2017	2018	Improvement: 2018 vs 2017
Number of documents, procedures, time & cost involved in...				
<i>Overall</i>	130	100	--	--
<i>Starting a Business</i>	155	156	137	19
<i>Construction Permits</i>	185	181	52	129 (highest jump)
<i>Getting Electricity</i>	26	29	24	5
<i>Registering Property</i>	138	154	166	-12
<i>Getting Credit</i>	44	29	22	7
<i>Protecting Minority Investors</i>	13	4	7	-3
<i>Paying Taxes</i>	172	119	121	-2 (despite apps & portals!)
<i>Trading across Borders</i>	143	146	80	66
<i>Enforcing Contracts</i>	172	164	163	1
<i>Resolving Insolvency</i>	136	103	108	-5 (despite I&B Code)

MCQ. According to the World Bank's Doing Business Report, 2019, India's ranking has improved in which of the following areas compared to previous year?

(UPSC's-CDS-II-2018):

1) Paying taxes 2) Resolving insolvency 3) Starting a business 4) Construction Permits

Answer Codes: A) 1 only B) 1 and 2 only C) only 3 and 4 D) All four areas.

We've already learned some of the measures for Ease of Doing Biz in the handouts of GST, Foreign Trade policy, WTO: TFA agreement etc. Apart from that...



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44.1 EASE OF DOING BIZ → LABOUR REFORMS : श्रम सुधार

There are multiple Central laws related to labour e.g. Minimum Wages Act, 1948; the Payment of Wages Act, 1936; the Payment of Bonus Act, 1965; and the Equal Remuneration Act, 1976.

- Entrepreneur has to fill up multiple forms to prove his compliance, and he's subjected to multiple annual inspections by the govt officials = No ease of doing biz.
- Therefore, Second National Labour Commission (2002) recommended govt to simplify & consolidate these laws. 2017-18: Govt announced to replace existing ~44 central laws with just four laws namely
 1. Labour Code on Wages (Bill 2017): मजदूरी पर श्रम संहिता (विधेयक 2017)
 2. Labour Code on Social Security & Welfare (Bill 2018): सामाजिक सुरक्षा और कल्याण पर श्रम संहिता
 3. Labour Code on Industrial Relations (Bill 2018): औद्योगिक संबंधों पर श्रम संहिता
 4. Labour Code on Occupational Safety, Health and Working Conditions (Bill 2018): व्यावसायिक सुरक्षा, स्वास्थ्य और कामकाजी परिस्थितियों पर श्रम संहिता

Until above labour code bills are passed, Labour Ministry keeps amending the existing laws for ease of doing business and for workers welfare such as

Passed	Provisions
Maternity Benefit (Amendment) Act, 2017: मातृत्व लाभ (संशोधन) अधिनियम, 2017	<ul style="list-style-type: none"> - Applies to factory, mines, plantations, shops and other establishments. - Increased paid maternity leave from 12 weeks to 26 weeks (for the first two children only) - If woman worker adopts a baby <3 years (or gets a baby through surrogacy)= 12 weeks paid leave for her as well. - If factory has 50 workers/> then boss must install creche facility. - After maternity leave is over, boss may even allow the woman worker to work from home. - Boss must inform every woman worker of her rights in writing.
Payment of Wages (Amendment) Act, 2017	Previously the employer was legally required to pay salary in 'physical cash only'- in certain industries. Act reformed to allow salary payment in cheque/NEFT to encourage less cash economy.
Child Labour (Prohibition) Amendment Act, 2016: बाल श्रम (निषेध) संशोधन अधिनियम, 2016	<p>It amends the 1986's act to provide that → Children below _____ can't be employed anywhere, EXCEPT:</p> <ul style="list-style-type: none"> - TV/ Cinema /Sports (but not circus) - Non hazardous family enterprise work after the school hours. <p>Adolescents between _____ age can be employed but only in non-hazardous work. Any violations = Jail + penalty. District Magistrate given additional powers. Criticism? Chemical mixing, battery acid recycling etc. occupations removed from the 'hazardous list' so Ease of doing biz for their owners, but</p>



	exploitation of adolescent workers.
Apprentices (Amendment) Act, 2014	<ul style="list-style-type: none"> - The original 1961 Act regulated the training of apprentices in the industry. But rules were draconian e.g. Govt shall decide the apprentice youth's stipend, holiday, overtime. If factory owner is violating any norm → jail. - So, the 2014's amendment relaxed the norms, Factory owner will decide stipend, holiday etc. and if any violations then only penalty, no jail for him.

44.2 EASE OF DOING BIZ → FIXED TERM EMPLOYMENT 2018

- Fixed-term employee (निश्चयत-अवधि कामदार) is a contractual worker hired for a fixed period. If his contract is not renewed on expiry then he's deemed automatically terminated.
- Just like a permanent worker, a fixed-term worker is entitled to all benefits such as wages, hours of work, allowances, EPFO-ESIC and other statutory benefits (But only for the duration of contract).
- 2016: Labour Ministry allowed Fixed term employment only to the textile sector using the powers under Industrial Employment (Standing Orders) Act.
- Budget-2018: Jaitley permitted in all manufacturing sectors.
- **Good?** When factory owner has large production order to fulfill, he can hire more people for short duration without the compulsion of giving them 'permanent jobs'. → → Ease of doing business.
- **Bad?** Trade Unions fear the industrialist will convert all the permanent jobs into 'fixed term contract jobs' → boss may simply refuse to renew contract without giving reasons & replace them with cheaper younger labourers= job security is diminished. Although Govt clarified that industrialist can't convert existing permanent jobs into fixed-term contract jobs.

44.3 EASE OF DOING BIZ → FACTORIES ACT REFORMS

- Factories Act 1948 (कारखाना अधिनियम) regulates the safety, health and welfare of factory workers.
- If an establishment is classified as 'factory', then the entrepreneur is required to install washroom, drinking water facility, spittoons, creche and other amenities depending on how many workers are employed.
- He cannot engage women workers in night shift or near dangerous machineries.
- His premises will be subjected to government inspection, If any violation he can be arrested and jailed. (=more opportunity for the factory inspector to demand bribes)
- The original act defines a factory as a premise where manufacturing is done using power and minimum 10/> workers are employed during last 12 months. (20 workers, if no power used).

44.3.1 Factories (Amendment) Bill, 2014

- Aims to relax definition of factory (20/> workers...) This will create ease of doing business for the small entrepreneurs because they will not have to comply with the



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factory act.

- Allows the entrepreneur to engage women worker in night shift & near dangerous machineries subjected to various safety conditions (= women equality & empowerment)
- For smaller violations, the entrepreneur can pay specified penalty. No arrest/ jail.

The bill is still pending in the parliament, but Rajasthan and other state governments have amended their state laws to implement this reforms, because Labour is in concurrent list.

44.3.2 Factories (Amendment) Bill, 2016

- Bill aims to increases the overtime limit of workers if 1) Entrepreneur has excessive workload / production order to fulfil OR 2) if government notifies in public interest.

44.4 EASE OF DOING BIZ → INDUSTRIAL DISPUTE ACT 1947, 2010

- If a factory has 100/ workers, and industrialist want to retrench (fire a group of workers to reduce salary bill) then State Govt's approval is necessary.
- Employer must give Advance notice to workers before changing office hrs, holiday norms etc. If workers are unhappy they can file complaint to labour ministry officials.
- Result? NOT EASE of doing Biz because what if entrepreneur wants to adopt new labour saving Machine/technology or what if he has to increase work hours during emergency foreign contract.
- To address these issues, Union amended the act in 2010 with certain technical reforms. Further, Rajasthan, Madhya Pradesh and other states also relaxed norms because labour=concurrent list, to attract more investment in their states.

44.5 EASE OF DOING BIZ → _____ PORTAL (2014)

Labour Ministry's webportal to facilitates ease of doing business in following manner:

1. Labour inspector has to upload reports within 48 hrs of inspecting the factory. This reduces the scope of bribery, corruption & tempering of records.
2. Entrepreneur can do online registration & payment of ESIC and EPFO for his workers.
3. Entrepreneur can upload compliance documents under various factory / labour acts.

44.6 EASE OF DOING BIZ → MODEL SHOPS AND ESTABLISHMENTS BILL, 2016

- State list subject. Each state has separate Shops and Establishment Act to govern the working conditions, wage payments, leaves and holidays, work hours, etc.
- Union govt has circulated Model Shops and Establishments Bill, 2016 (आदर्श दुकानें और प्रतिष्ठान विधेयक) to the States & UT with legislatures to adopt / customize it as per their wish.
- This bill allows the shopkeeper / malls the freedom to operate an for 24/7 and 365 days in a year without any restriction on opening/closing time and enables employment of women during night shifts with safety provisions. E.g. 2019-Feb Gujarat adopted this bill with certain modifications.

Benefits? 1) ease of doing biz 2) overtime benefit to worker 3) separate workers may be employed in day shift and night shift = more jobs.



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44.7 EASE OF DOING BIZ → REAL ESTATE REGULATION & DEVELOPMENT ACT

Boss? Ministry of Housing and Urban Poverty Alleviation: आवास और शहरी गरीबी उपशमन

- While “land” is in the State List of the Constitution, but purchase of home / property / real estate = ‘Contract’ in the Concurrent List.
- So, Parliament enacted रियल एस्टेट (विनियमन और विकास) अधिनियम, 2016 to regulate transactions between home/commercial property buyers and builders of the real estate projects, by setting up state level regulatory authorities called _____ : रियल एस्टेट विनियामक प्राधिकरण (RERAs) → higher appeal to Real Estate Appellate Tribunals (अपीलीय न्यायाधिकरण).
- First, the builder must get his project registered @RERA’s website. including the facilities like fire fighting systems, sewage treatment plants, functional lifts etc. He can’t make advertisements or accept money from the buyers otherwise.
- Real estate agents dealing in these projects also need to register with RERAs.
- After RERA registration, project details will be published on RERA website where buyer can cross check / file complaints if any.
- Then builder can accept money from buyers, but in a separate bank account. If the project is not completed in time → builder will have to pay the home/shop/office-buyer’s monthly interest on bank loans (if any). RERA can order further relief / refund / arrange another builder to finish the project.
- If defects found in building upto 5 years → builder must repair free of cost.
- **Punishment?** Penalty + jail upto 3 years.

RERA-Good?	RERA-Challenges?
<ul style="list-style-type: none"> - RERA registration system is online & time bound → ease of doing business for the Builder as he will not have to make repeated trips / bribes to govt. officials. - Consumer protection. - Since building has to be registered at RERA, money has to be deposited in separate bank account → reduces the opportunities for tax evasion and avoidance; malpractice like selling same home to two buyers etc. 	<ul style="list-style-type: none"> - Since cost of compliance increases, builders may raise home prices (e.g. considering the additional business cost of doing ‘free repairs’ upto 5 years). - The building projects which were started before RERA act but still building construction is pending → difficult to get justice due to legal loopholes. - Some (non-BJP) state governments have not yet appointed RERA chairman or setup RERA websites. - Unlike GST, RERA doesn’t apply to J&K.

Conclusion-Template: World bank research indicates that countries that improve 10 points on the Ease of Doing business score create an additional 60 new businesses per 1 lakh population. Those new businesses create further job opportunities, which help reduce poverty & inequality in a country. Thus, ease of doing business for ‘corporates’ results into



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the ease of living for poor people. The aforementioned scheme / policies / act / initiatives / challenges will play pivotal role in that regard / must be addressed on priority basis.

45 MFG → TEXTILE / MSME / SCHEMES / YEARBOOK/ MISC.

45.1 TEXTILES MINISTRY

List not exhaustive

PSU	Cotton Corporation of India, Jute Corporation of India, National Textile Corporation Ltd. and others.
Attached offices	Development Commissioners for handloom / handicrafts
Statutory Bodies	National Jute Board, Central Silk Board, National Institute of Fashion Technology (NIFT)

+ various autonomous bodies, export promotion councils, research associations and advisory boards for apparel, textile, wool, silk, carpet etc.

45.1.1 Textile Ministry → Notable schemes / initiatives

1. Jute Packaging Material (JPM) Act, 1987: requires the foodgrains and sugar companies to pack “x%” of their produce in jute bags only. This ensures that jute bag industry can survive against the competition of cheap plastic bags.
2. Technical textiles = Fishing nets, bullet proof jackets, shoe laces, surgical gowns, parachute etc. items. Textile ministry helps such industries with schemes and subsidies.
3. **Project _____**: Presently the makers of shoe / shirt / pants etc. refer to size charts developed by UK / US standards e.g. Size 44 shirt, XL t-shirt etc. Textile ministry's project aims to develop size charts specific to Indian consumers' measurements.
4. _____ logo (2015): It certifies that given handloom product - sari, dress material, bedsheets etc. is 1) Indeed handmade 2) has zero defect 3) has zero negative impact on the environment 4) has authentic Indian traditional design. Such brand logo increases the appeal of Indian handicrafts to (mainly foreign) buyers. To obtain this logo, the weaver/entrepreneur applies online to Textile Ministry → Development Commissioners for handloom, and pays fees after his product is registered.
5. Previously, UPA/Congress had Mahatma Gandhi Bunkar Bima Yojana (MGBBY)- although gradually Modi switched those beneficiaries to Pradhan Mantri Suraksha Bima Yojana. ~~So we need not worry about this obscure scheme.~~
6. 2016: '**Pehchan**' cards given to handicraft artisans- linked with their Aadhaar numbers and bank accounts to help them avail various scheme benefits.

Textile Ministry's Central sector schemes = 100% funded by the union →

7. National Handloom Development Programme → **Weavers Mudra scheme**: Textile ministry gives interest subvention and credit guarantee for the weavers' bank loans upto prescribed limits.



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8. Amended Technology Upgradation Funds Scheme (**ATUFS**): Provides funding to the textile industries to upgrade their machineries. Similarly **Power Tex** scheme for powerlooms.
9. Ambedkar Hastshilp Vikas Yojana, Handloom Weaver Comprehensive Welfare Scheme (HWCWS) etc. schemes to provide training / skill development / marketing support etc. to the artisans.
10. 2017: _____ Scheme for Capacity Building in Textile Sector. Ministry of Skill Development & Entrepreneurship (MSDE) hires public & private sector institutes for giving training to youth for textile sector → Textile ministry pays 'coaching fees' to those institutes.

45.1.2 Textile Ministry → Pradhan Mantri _____ Yojna

When an apparel manufacturing unit hires new employees who are eligible for EPFO scheme (i.e. monthly salary ₹ 15,000 or less)

Employee	Employer (boss') contribution is paid by Govt for first 3 years i.e. →
12% cut from salary for EPF (provident fund)	<ul style="list-style-type: none"> - 3.67% EPF (provident fund) + 8.33% EPS (Pension) = 12% paid by Textile Ministry under Pradhan Mantri Paridhan Rojgar Protsahan Yojna 2016. - It's Central Sector Scheme =100% paid by Union.

Past economic surveys have suggested / observed:

- India is well positioned to get ahead of China in textile sector because wage costs in most Indian states are significantly lower than in China's wages.
- Textile leather industries should be encouraged to move to smaller towns so they can absorb the Indian women workers available there.
- To increase export earning, we should go beyond textile → readymade garments. But that requires R&D in foreigners' fashion, style & size preferences.
- India primarily exports leather-based shoes, but nowadays foreigners prefer non-leather shoes for they are 1) cheaper 2) more comfortable 3) more fashionable. So, we've to do R&D for non-leather shoes targeted for them.
- **Challenges?** (1) Getting quality cattle hides becoming difficult due to present socio-political atmosphere so leather industry facing problems (2) Bangladesh & Ethiopia emerging as textile/leather hubs and they get duty free access to USA/EU for being L.D.C. so India textile industry facing steep competition.

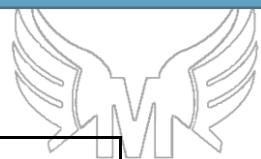
Conclusion-Template? Textile / Leather industry has great potential to generate new jobs especially for Indian women, & augment our income from exports. These industries can greatly help achieving SDG Goal #1: End poverty, Goal #5: Gender Empowerment, Goal #8: Promote sustained, inclusive and sustainable economic growth, Goal #10: Reduce inequality within India. Aforementioned policy / scheme / initiative / challenges are crucial in that regard / must be addressed on priority basis.

45.2 MFG & SERVICES → [YEARBOOK] MSME MINISTRY

Micro, Small & Medium Enterprises, सूक्ष्म , लघु और मध्यम उद्यम मंत्रालय : List not exhaustive →

PSU	National Small Industries Corporation Limited (NSIC)
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Attached offices	Development Commissioner (MSME)
Statutory Bodies	----- (KVIC), Coir Board

45.2.1 MSME Ministry → (Pending) MSME Amendment Bill 2018

सूक्ष्म, लघु और मध्यम उद्यम विकास (संशोधन) विधेयक, 2018 aims to update old definitions:

Type	2006 Act → Investment in		2018 Bill
	Mfg Unit:	Services:	All enterprises
	Plant and Machinery	in Equipment	Annual Turnover
Micro	25 lakh	10 lakh	5 crore
Small	25 lakh to 5 crore	10 lakh to 2 crore	5 to 75 crore
Medium	5 to 10 crore	2 to 5 crore	75 to 250 crore

Further, the bill empowers Union Govt to change these annual turnover limits through a notification up to three times the limits given above. (*This saves the time in not having to introduce another bill in future to get permission of Parliament*)

Trade Unions (Amendment) Bill, 2019; Payment of gratuity amendment Act 2017 etc. are not so MCQ/Mains worthy so we need not bother.

45.2.2 MSME Ministry → PM's _____ (PMEGP)

2008 ManMohan started प्रधान मंत्री रोजगार सृजन कार्यक्रम → Modi continued it till 31/3/2020.

- **Boss?** MSME Ministry → KVIC. Central Sector Scheme = _____ funded by the union.
- **Beneficiary?** Min. std.8 pass person / Self-help-group wanting to setup a NEW micro-enterprises in the non-farm sector.
- Suppose the cost to start a business is 100% then entrepreneurs himself has to contribute 5-10% from his pocket, KVIC gives him 15-35%, rest is given as bank loans. Thus it's a 'Credit linked Subsidy' program.
- These percentages depend on whether the business is to be started in rural area or urban area, and whether the Entrepreneur is General/SC/ST/Women/PH/Minorities/Ex-Servicemen/North East.

45.2.3 MSME Ministry → _____ (2015)

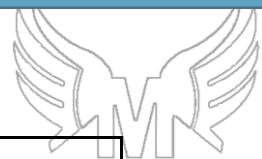
- A Scheme for Promoting Innovation, Rural Industry and Entrepreneurship.
- **Boss?** MSME Ministry. Central Sector Scheme = _____ funded by the union.
- To encourage Innovation & Rural Entrepreneurship, this scheme will set up Business Incubators and Startup fund for agro-based industry.

45.2.4 MSME Ministry → _____ Mission (2018)

- **Boss?** MSME Ministry → KVIC. Central Sector Scheme = ____% funded by the union.
- KVIC to setup solar charkha clusters in rural areas.
- KVIC will provide training, subsidy for purchasing Solar Charkha, and interest subvention on the loans taken by the weavers / entrepreneurs.
- **Target?** Generating 1 new lakh jobs.

45.2.5 MSME Ministry → Misc. Initiatives

UAM	- To register an enterprise as MSME, its entrepreneur has to
-----	--



2015 onwards	fill up an Udyog Aadhaar Memorandum(UAM)-free online form to MSME ministry. (Previously it was cumbersome form called ‘Entrepreneurs’ Memorandum’.) <ul style="list-style-type: none"> - He’ll be allotted a unique Udyog Aadhar id linked with his personal aadhar number. - Udyog Aadhar id helps applying for various Govt. schemes for MSME.
Udyami Mitra Yojana	Toll-free helpline mainly to help the first generation entrepreneurs.
India _____ Fund	For promoting grassroot innovations
SFURTI	Scheme of Fund for Regeneration of Traditional Industries → to setup clusters of Khadi, Coir, Handicraft; & help the entrepreneurs inside them.
CHTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises (CHTMSE) funded by MSME Ministry and _____ to help the MSE Entrepreneurs get loans without collateral from the banks. (<i>Ref:Pill1: Financial Inclusion handout for more</i>)
MSME Samadhaan	<ul style="list-style-type: none"> - MSME Act, 2006 requires State Governments to establish Micro and Small Enterprise Facilitation Council (MSEFC). - If a buyer is not paying money to MSME supplier within specified time limit, then MSEFC can order him to pay money with interest rate. - MSME Ministry’s ‘MSME SAMADHAAN’ webportal helps filing online complaint for delayed payments.
MSME- _____	MSME Ministry’s webportal to connect jobseekers (passed out trainees / students of MSME Technology Centres) to recruiters (various companies).
Udyam Sangam, Udyam Samvad	MSME ministry organizes such Workshops, Conventions, Mela usually at Delhi.

45.2.6 MSME Ministry → Public Procurement Order

MSME Ministry’s Public Procurement Order 2012 (सार्वजनिक खरीद/अधिप्राप्ति आदेश) requires every Central Ministry/Department/PSU to procure annually,

- At least **25%** of their goods & services requirement from Micro and Small Enterprises (MSE). Further,
 - ____ of that 25% must be procured from MSE owned by **Women** Entrepreneurs: महिला उद्यमियों के स्वामित्व वाले MSE
 - ____ of that 25% from **SC/ST** entrepreneurs.
- Give first purchase preference to local suppliers. Try to ensure that procured goods/services have minimum 50% local content (to encourage Make in India).
- MSME Ministry → ‘**MSME- _____**’ webportal monitors the progress.



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MSME Ministry gets power to issue such order / quota under MSME development Act 2006.

45.2.7 Public Procurement → GeM Portal

- Government e-Marketplace (GeM) is an online portal that helps Govt organizations at union, state, PRI/ULB and PSUs to buy common use goods & services in transparent and efficient manner e.g. pen, pencil, stationery.
- Verified sellers list products in this portal→ Govt organizations buy it online from here. Ensures transparency, efficiency, cost saving (compared to individual organization giving newspaper ads inviting tenders).
- **Boss?** _____ Ministry's not-for-profit company named 'GeM Special purpose vehicle (SPV)'.

45.2.8 MSME → PM's Initiatives for MSMEs (2018, Nov)

- ✓ Loans upto 1 crore within 59 minutes through an online portal. (*Ref: Pillar#1 handout, also revise Mudra & Standup India while you're there!*)
- ✓ Interest subvention of 2% for all GST registered MSMEs on fresh or incremental (=additional) loans. (*Same again announced in Interim-Budget-2019*)
- ✓ MSME / Corporates can borrow money from banks/NBFCs under Bill of exchange / Factoring / Trade Receivables Discounting System (TReDS). Technical norms are further tweaked to help them. (~~how does it work? NOTIMP~~)
- ✓ All govt organizations to compulsorily procure 25 percent from MSMEs, out of that 25% → 3% from women owned MSME. (*previously it was 20% & women didnot have internal quota*)
- ✓ All CPSUs to compulsorily procure through GeM portal.
- ✓ Simplified forms under labour laws. Factory / labour Inspector will inspect MSME unit via computerised random allotment- to prevent any nepotism / collusion.
- ✓ Self-declaration for air and water pollution laws. Only 10% MSME units to be inspected to checked.
- ✓ For minor violations under the Companies Act, entrepreneurs no longer have to approach NCLT, but file penalties online using simple forms.
- ✓ 100 Technology Centres will be established. Govt. will bear 70% cost for establishing Pharma clusters.

Conclusion-Template? MSMEs produce over 30% of India's GDP, contribute to over 45% India's total exports and provide employment & entrepreneurship opportunities to weaker sections of the society. Thus they play a pivotal role for both industrial development and human development of India. <+ the SDG goals in Textile Template> Aforementioned Policy / Scheme / Act / Bill is important to catalyse that role played by MSMEs.

45.3 MFG → ELECTRIC VEHICLES

- 2015: Ministry of Heavy Industries & Public Enterprises launched National Electric Mobility Mission Plan (NEMMP).
- One of its sub component is FAME (Faster Adoption & Manufacturing of Hybrid and Electric Vehicles) India. They give subsidy, training, awareness for such vehicles.
- It's Central Sector Scheme = 100% funded by Union.
- **Target-2020?** 60 to 70 lakh e-vehicles sold. ~25 lakh tonnes of Fossil fuels saved. Carbon Dioxide emissions decreased by 1.5% by 2020.



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Beyond this, pursuing individual industry specific policies / schemes in mfg / service sector = poor cost : benefit.

45.4 MFG → BODIES FOR QUALITY STANDARDS

45.4.1 _____ Ministry → Statutory → BIS (1986)

- Bureau of Indian Standards (भारतीय मानकों का कार्यालय /ब्यूरो) is the apex regulator of standardization and quality certification of goods.
- It allows the manufacturer to use _____ (ISI) mark on their goods (e.g. helmet, cooker etc.) if they meet BIS's standards.
- BIS also has separate hallmark license system for gold and silver jewellery.
- BIS is India's nodal for International organisation for standardization (ISO-standards), WTO's _____ (TBT) agreement.

45.4.2 Commerce Ministry → Not-Statutory → QCI (1997)

- Quality Council of India is a non-profit society registered under Societies Registration Act with the funding from Commerce ministry, Confederation of Indian Industry (CII), Federation of Indian Chambers of Commerce and Industry (FICCI) & Associated Chambers of Commerce and Industry (ASSOCHAM).
- QCI helps the industries to adopt quality standards like ISI, ISO, OHSAS, KAIZEN etc.
~~हिंदी शब्दावली यहां जरूरत नहीं क्योंकि मुख्य परीक्षा में इसका काम नहीं.~~

45.4.3 _____ Ministry → Statutory → BEE (2001-02)

- _____ (ऊर्जा दक्षता ब्यूरो) setup under Energy Conservation Act, 2001.
- Its Energy '_____ labeling' logos help consumers decide which electronic appliance is more energy efficient than other brands.
 - This labelling compulsory for Air Conditioners, Refrigerators, Tubelight, Color TV, Electric Geysers, Inverter, LED Lamps etc.
 - This labelling is voluntary for other appliances like Computers, LPG stoves, ceiling fans- But this list is subject to change **so update this portion of handout as and when new development take place.**

45.4.4 Health ministry → Statutory → FSSAI (2006)

- _____ (भारतीय खाद्य सुरक्षा और मानक प्राधिकरण) lays down scientific standards for food manufacture, storage, distribution, sale and import in India.
- FSSAI chairman may be a non-bureaucrat, food-scientist etc. While FSSAI functions under the Administrative control of Health ministry, FSSAI Chairperson enjoys rank of an independent Secretary to Government of India. He's not 'under' any department of Health Ministry.
- FSSAI act repealed previous central Acts like Prevention of Food Adulteration Act 1954, & other laws / orders related to Fruits, Meat Edible Oils, Edible Flour, Milk Products etc.
- FSSAI labelling rules 2011: Every package containing vegetarian food item must contain a square symbol with a **Green Colour** filled circle inside. If egg / non-vegetarian item then _____ Color.



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- FSSAI packaging rules banned the use of recycled plastic and newspaper for packing / wrapping food articles.
- FSSAI rules ban the use of **calcium carbide** or **acetylene gas** for artificial ripening of fruits, however _____ is permitted upto certain limits.
- Monosodium Glutamate (MSG) is a flavor enhancer in Chinese food, but leads to obesity and liver inflation. Earlier FSSAI had banned sale of Nestle's Maggi noodles because it contained lead and MSG, although later HC lifted the ban.

Related? _____ is given by Agro Ministry→Directorate of Marketing & Inspection → under the Agricultural Produce(Grading and Marking) Act, 1986. It covers Agriculture commodities, wool, cotton, meat etc.

MCQ. Find correct statement(s): (UPSC-Prelims-2018)

1. The Food Safety and Standards Act, 2006 replaced the Prevention of Food Adulteration Act, 1954.
2. The Food Safety and Standards Authority of India (FSSAI) is under the charge of Director General of Health Services in the Union Ministry of Health and Family Welfare.
3. Both 1 and 2
4. Neither 1 nor 2

45.4.5 Consumer Protection Bill, 2018 (उपभोक्ता संरक्षण विधेयक)

Boss? Ministry of Consumer Affairs, Food and Public Distribution

This bill aims to replace the original act of 1986. Lok Sabha passed in 2018-Dec.

Consumer Protection Bill, 2018 → New provisions?

1. **Product Liability:** If a consumer suffers an injury, property damage or death due to defective goods / services → company will be liable to pay for damages.
2. **Unfair Contract** e.g. asking excessive security deposits for broadband / DTH connection, company unilaterally terminating the service without cause → Company liable to compensate the consumer.
3. Complaints can be filed electronically, cases can be heard through video conferencing.

Consumer Protection Bill, 2018 → Statutory Bodies?

1. **Consumer Disputes Redressal Commissions** (known as **Consumer Courts**) at the district, state and national levels. Their powers and jurisdictions are upgraded. E.g. District consumer court can hear matters upto ₹ 1 crore. Appeal structure District → State → National → SC.
2. **Consumer Protection Councils** (उपभोक्ता संरक्षण परिषद) These advisory bodies will work for awareness generation.
3. (new) **Central Consumer Protection Authority** (केंद्रीय उपभोक्ता संरक्षण प्राधिकरण): It can intervene to protect consumers from unfair trade practices. It can also launch class action against a company, order recall or refund of products. The agency is designed on the lines of highly effective US Federal Trade Commission.

Punishment	<ul style="list-style-type: none"> - Fines upto ₹ 50 lakhs + upto 5 years jail. - ₹50k fine on Consumer if filing frivolous complaints.
Celebrity Ads?	If an endorser (समर्थनकार) is found giving a misleading advertisement then he can be banned from advertising any product upto 3 years & fine.

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45.5 MAINS QUESTIONS IN PREVIOUS GSM2 & GSM3

How are the principles followed by the NITI Aayog different from those followed by the erstwhile Planning Commission in India?	2018
Account for the failure of manufacturing sector in achieving the goal of labour-intensive exports rather than capital-intensive exports. Suggest measures for more labour-intensive rather than capital-intensive exports.	2017
Capitalism has guided the world economy to unprecedented prosperity. However, it often encourages shortsightedness and contributes to wide disparities between the rich and the poor. In this light, would it be correct to believe and adopt capitalism driving inclusive growth in India? Discuss.	2014
"Success of 'Make in India' programme depends on the success of 'Skill India' programme and radical labour reforms." Discuss with logical arguments.	2015
While we found India's demographic dividend, we ignore the dropping rates of employability. What are we missing while doing so? Where will the jobs that India desperately needs come from? Explain.	2014
Normally countries shift from agriculture to industry and then later to services, but India shifted directly from agriculture to services. What are the reasons for the huge growth of services vis-a-vis industry in the country? Can India become a developed country without a strong industrial base?	2014
Examine the impact of liberalization on companies owned by Indian. Are they competing with the MNCs satisfactorily?	2013
Has the Indian governmental system responded adequately to the demands of Liberalization, Privatization and Globalization started in 1991? What can the government do to be responsive to this important change?	2016