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General Studies

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ECONOMICS: AN INTRODUCTION

Definition

Economics as a word comes from the Greek: oikos means 'family, household, or estate', and nomos stands for 'custom, law' etc. As the management of household, so the management of national economy. The scale is different but the nature of the operation and the principles that underlie both are the same. The basic assumption that connects both is the scarcity of resources and the need to manage them judiciously as well as equitably. Rational management of scarce resources is the substance of economics. Since last century, rationality has come to include equity and sustainability as well as that adds the long term dimension to it.

Take for example, land. It is a scarce resource. India has 15% of global population but only 2.4% of the global land. Thus there is huge pressure on land. It is needed for agriculture (food and non-food); manufacturing; residential purposes and so on. There should be rational and judicious use of land for which economics can help to make public policy. The challenges associated with land use are being grappled with presently , for instance in the Land Acquisition and Rehabilitation and Resettlement Act 2013 where the land claims of farmers, industry and other sections are addressed.

Similarly, water is scarce and is becoming even more so. There are demands for agricultural, industrial, domestic and other uses. How to apportion the existing amount of water among all these users is a public policy challenge being considered by the Draft National Water Policy (NWP, 2012). Same is the purpose of the food security law and land acquisition law.

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Broadly, economics is a social science that studies human activity aimed at satisfying needs and wants. It encompasses production, distribution, trade and consumption of goods and services

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Initially, economics focused on wealth and later welfare. That is, initially, what mattered was creation of wealth at any cost. It did not interest economists to be sensitive to the human dimension- the misery that it produced. Later, by the late 19th century, there was hue and cry about children being made to overwork and receive paltry payment for their work, to give one example. Then welfare became the focus of the discipline.

As a policy science, economics is always confronted with trade offs as scarcity of resources is the overriding assumption of the discipline. Tradeoffs involve making choices in policies wherein there is a compromise on one goal to achieve another goal. It is a way of balancing among desirable goals. Presently, the policy of Reserve Bank of India aims at moderating inflation that it is the overriding objective of its monetary policy (2015), even as some growth is eroded in the process. Thus, a bit of growth is traded off for price stability. Similarly, government wants to give subsidies to the poor and weak. It may mean more borrowings and thus some fiscal excess but poverty is addressed and thus political stability. Thus, fiscal prudence may be traded off to some extent in pursuit of welfare. The current state of public finance is an accurate description of this dilemma with fiscal deficit targeted at 3.2% of GDP (2017-18) even while 3% of GDP is the stated norm because public investment is urgently required in the given circumstances and thus fiscal discipline is relatively secondary in importance. In the land acquisition law, compensation for the land owners is increased to balance the interests of the industrialists and the farmers and others. Investment may moderate in the process, but social justice gets addressed. Land is to be acquired for manufacturing and consent of the land owner may be conditionally dispensed with in public interest- that is the tradeoff logic.

The focus on tradeoffs arises from the scarce resources that make it necessary to choose between competing alternatives. Choosing one benefit implies forgoing another alternative to a greater or lesser extent. Thus, there is an opportunity cost to the available resources and there is a continuous process of weighing alternatives and balancing them (opportunity cost of the opportunity foregone while choosing another).

Adam Smith, generally regarded as the Father of Economics, author of An Inquiry into the Nature and Causes of the Wealth of Nations (generally known as The Wealth of Nations) defines economics as "The science of wealth." Smith also offered another definition, "The Science relating to the laws of production, distribution and exchange."

Definitions in terms of wealth creation are limited in scope and favour the advantaged. Weak are left out, for example, women, children and old people. The belief is that non-productive activity is a cost on society. It meant that man was relegated to the secondary position and wealth was placed above life. In democratic times, it is not acceptable. There was a demand to balance wealth creation with focus on social and human welfare. Thus arose the shift in the focus to welfare economics- study of man and of human welfare, not of money and goods alone. A new dimension was added to the discipline of economics- one of welfare and equity.

As the production process evolved and as more problems cropped up, the discipline became wider while in search for new foci- sustainable development, green economy, well being, national happiness and so on.It went beyond wealth, welfare and trade offs,

Economics is usually divided into two main branches:

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Microeconomics, which examines the economic behavior of individual actors such as consumers, businesses, households etc. to understand how decisions are made in the face of scarcity and what effects they have on larger economy.

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Macroeconomics, on the other hand, studies the economy as a whole and its features like national income, employment, poverty, balance of payments and inflation.

The two are linked closely as the behaviour or a firm or consumer or household depends upon the state of the national and global economy and vice versa. For example, business and consumer confidence depends on the state of economy.

'Mesoeconomics' studies the intermediate level of economic organization in between the micro and the macroeconomics like institutional arrangements etc. Meso is relative. Study of a sector of economics like auto, infrastructure may be considered mesoeconomics while the study of each unit may fall under micro.

Division of Economics	Focus
Microeconomics	Is concerned with single factors and the effects of individual decisions. Deals with behavior of firms and consumers as to how they make their decisions.
Macroeconomics	National production/output, Gross domestic product, employment, Poverty, Inflation, BOP. Demonetisation, GST, IBC etc.

There are broadly the following approaches in the mainstream economics to boost national economic growth, the basis of all of them being the same: resources are scarce while wants are unlimited (often mentioned as the economic problem)

- During the Great Depression of the 1930s, there was no convincing economic theory either to explain why the economic crash happened or what was to be done to retrieve stability and growth. The entire focus on the discipline at that time was on free markets. British economist John Maynard Keynes changed the complexion by asserting that free markets have no self-balancing mechanisms that lead to full employment. Keynesian economists justify government intervention through public policies that aim to achieve full employment and price stability in times of slowdown and recession.Keynes argued that. An economy's output of goods and services is the sum of four components: consumption, investment, government purchases, and net exports (the difference between what a country sells to and buys from foreign countries) (Read ahead). Any increase in demand has to come from one of these four components. But during a recession, for a variety of reasons, demand slows down and may even turn negative when consumer confidence collapses causing them to reduce their spending. It in turn causes firms to either prune their operations or close down. It leads to more people out of work and the downward spiral. Under such recessionary conditions, it is the Government that has to lead by borrowing and investing. According to Keynesian theory, state intervention is necessary to moderate the booms and busts in economic activity, otherwise known as the business cycle. Intervene when there is bust and withdraw when there is boom. In normal times, it is the market that drives growth through the force of supply and demand though the respective roles of State and market are coming under critical scrutiny post-Lehman. Indian government stepped up expenditure with fiscal and monetary stimuli in the 2008-10 period to withstand the recessionary winds from the west. With growth spurting, the gradual and calibrated exit from the stimulus was begun in the 2010-11. When growth decelerated in 2017-18, the GOI launched Bharatmala as a Keynsian stimulus. It is the biggest ever highway project to develop and expand approximately 83,000 km of roads at an investment of Rs 6.9 lakh crore by 2022.It is the second largest highways construction project in the country after National Highway Development Programme connecting border areas, improving international, port and coastal connectivity and developing highway corridors connecting key economic and commercial hubs.

- Economics is about resource management and politics is about the redistributive side of resources through government power. Politics sets the larger framework in which economics operates. Thus, understanding the two as they interconnect is the substance of political economy studies. While politics sets the values, economists set the prices! In simple terms, political economy describes production, buying and selling, and their relations with law, custom, and government, as well as with the distribution of national income and wealth. It refers to examining how political forces affect the choice of economic policies. If we take the example of demonetization that took place in India in 2016 which is a millennial event, the entire process of choosing to embark on it was a political choice while the economy went through so many fundamental effects of it-banking, fiscal, industrial, agricultural etc. Similarly, unless one studies the connection between land reforms and the political context, its failure can not be fathomed in India. Political economy reveals that the landlords and the political leaders being the same, the policy had inherent limtations to success. In China, a political party, Communist Party of China, decided how the economy is to be structured. The priorities and policies of economy drastically altered according to the beliefs and biases of the political party and its leaders.

Thus, economics can be understood only when the politics that influences it, is made sense of.

- Liberalism dominated economics in its early forms. Later it fell into disrepute as socialist and welfare perspectives came up and held sway. When the latter lost charm starting from the middle of last century and decisively by late last century, liberalism staged a comeback under the term Neoliberalism. As with the earlier version, it is associated with free-market economics: free trade, privatisation, price deregulation, a reduced size of government ("that government is the best which governs the least") and flexible labour markets ("hire and fire"). Neo-liberalism is the underlying philosophy of the Washington Consensus – the free market approach of the IMF and other institutions. Individualism, competition and efficiency are its core values. Neoliberals believe that there is so much rationality and end use in their beliefs that Francis Fukuyama ,the American political economist who wrote the book *The End of History and the Last Man* (1992) argued that the worldwide popularity of free markets after the demise of Soviet communism showed that free markets are the highest point of human evolution and can not be improved upon.Neoliberalism "proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets and free trade". India's economic reforms are largely centred around it. Critics of neoliberalism hold that leaving large role to the market forces can be detrimental to genuine human and sustainable growth. The risk is compounded by the notion of "invisible hand" used by Adam Smith. It says that all economic participants are rational and their self-interest ensures order in the economy. That is the self-interest all participants makes the economic system find its equilibrium. There is no government regulation required as the "invisible hand" of collective self interest provides stability. However, the 2018 great recession is the latest example when the belief in invisible hand was exposed as irrational.

- socialist economics believes that a large part of economic resources should be in giovernemnt hands so that inequality can be minimized and give the workers greater control of the means of production. It comes in many forms- Nehruvian socialism where there is public and private sector coexisting and complementing called mixed economy. An extreme form of socialit economics is communist control where the entire economy is held by State and there is no private property at all. For example, Soviet economy and China under Mao Zedong (1893 –1976).

- Nehruvian economics is a subset of socialist economics. It rests on state -ownership of basic parts of economy like infrastructure, higher education, metal and other industries etc.;socio economic planning because Soviet Russia showed that it could be an.expeditious way of achieving equitable growth, India lacked any significant private sector when we became Independent and also because Nehru personally believed in the values of equity.Given the historical circumstances in which it emerged, Nehruvian economics supports self-reliance in economic growth. The modern foundations of it are revealed in its emphasis on capital goods industry, technical education and R&D- all being interconnected.

- Gandhian economics is the set of ideas that Mahatma Gandhi propounded. Mahatma Gandhi questioned the scarcity assumption when he said: 'Earth provides enough to satisfy every man's need but not for every man's greed.' The principle of Gandhian economic thought is small scale and locally oriented production, using local resources and meeting local needs, so that employment opportunities are made available everywhere, promoting the ideal of Sarvodaya: the welfare of all, in contrast to the rich dominating. Gandhian

economy aims to boost employment which is very desirable for India where there is abundance of labour. It had no aversion to machinery and welcomes it where it avoids drudgery and reduces monotony, for example, sewing machine. It is opposed to labour-displacing technology. It is worth imagining whether Gandhi would support artificial intelligence and machine learning. It emphasises dignity of labour, and criticises the society's contemptuous attitude to manual labour. It insists on everybody doing some 'bread labour'. Another axiom of Gandhian economics is "trusteeship": while an individual or group of individuals is free not only to make a decent living through an economic enterprise but also to accumulate, their surplus wealth above what is necessary to meet basic needs and investment, should be held as a trust for the welfare of all, particularly of the poorest and most deprived. It thus combines economics of development with ethics of equity, self-reliance (with minimum wants), sustainability, trust and cooperation.

- Development economics. By the middle of last century the challenge of enabling economic growth of the poor countries to transition from low income to decent standard of living was the focus for a school of economic thought called the Development economics. The concern was the human challenge of promoting economic growth and structural change (from agriculture to industry) but also improving the well being of the population as a whole through focus on health , education and employment, whether through public or private channels. The most prominent contemporary development economists are Nobel laureates Amartya Sen and Joseph Stiglitz. Currently, Jean Dreze, Ejaz Ghani, Abhijit Banerjee, Jeffrey Sachs and Esther Duflo are some global names in the field.

- China model of economic growth: Beijing Consensus is the name given to the political economy of People's Republic of China under Deng Xiaoping since early eighties which continues till today under Xi Jinping (2012-). The term captures China's economic development model as an alternative to the Washington Consensus of market-friendly policies advocated by the Bretton Woods Twins- World Bank and International Monetary Fund; and the World Trade Organization (WTO). There is no clear set of implications of the term but is generally taken t mean pragmatic economic policy led by State but liberal use of private initiative: "stable, if repressive, politics and high-speed economic growth". It does not follow text book economics but sets out its own mix of State, market and redistribution. Its growing global reach is striking. Officially it called socialism with Chinese characteristics but critics call it capitalism with Chinese characteristics.

- Mercantilism wants Government to make policies for maximising net exports because the best way of ensuring a country's prosperity is to reduce imports and promote exports, thereby generating a net inflow of foreign exchange and maximising the country's gold stocks. Mercantalists believe that the country that has more gold is stronger. That belief however is outdated though the foundational mercantilist views are still influential. Import substitution means selective use of globalization for national prosperity which in the medium to long term is unworkable as national growth is premised at the expense of other countries. It is in contrast to the theory of free trade – which states that countries can have economic growth through the reduction of tariffs and fair free trade. While it dominated European thought between the 16th and 18th centuries, in the current world it is acquiring dominant importance under the US President Donald Trump who stands for "America First" and also Brexit. Brexit argued against import of human capital from the European Union as influx of immigrants from Eastern Europe deprived unskilled British workers of their jobs, lowered their wages and increased unemployment.

- Behavioural economics: Behavioral economics is a relatively new field that combines insights from various fields of study to generate a more accurate understanding of human

behavior. Behavioral models integrate insights from psychology, neuroscience and microeconomic theory. Behavioral economics is concerned with the bounds of rationality of economic agents.Economics has long differed from other disciplines in its belief that most if not all human behavior can be easily explained by relying on the assumption that our preferences are well-defined and stable across and are rational. Richard Thaler, the University of Chicago professor who won the Nobel Memorial Prize in Economic Sciences. In 2017 challenged that view by writing about anomalies in people's behavior that could not be explained by standard economic theory. Thaler inspired the creation of behavioral science teams, often call "nudge units," in public and private organizations around the globe. He suggests that there are many opportunities to "nudge" people's behavior by making subtle changes to the context in which they make decisions.Nudges can solve a variety of problems that governments and businesses alike consider important. (More in the classroom)

- Green Economics: When the growth of economy all over the world created environmental degradation, a school of thought emerged showing alternative paths to growth where there is sustainability of economic growth without damaging the growth rates. It is called green economics and focuses on and supports the harmonious interaction between humans and nature and attempts to reconcile the two. It is referred by many names like sustainable development, green economy. "A Green Economy promotes a triple bottom line: sustaining and advancing economic, environmental and social well-being." New indices of measuring growth have been built to promote green economy: Green GDP, *Social Progress Index and* Environmental Performance Index (EPI) are some examples. Millennium Development Goals and Sustainable Development Goals also advocate green economics.

Measuring Economic Growth

Economic growth is the change- increase or decrease, in the value of goods and services produced by an economy. Measures of national income and output are used in economics to estimate the value of goods and services produced in an economy. Common measures are Gross National Product (GNP) and Gross Domestic Product (GDP).

National Income Accounting

National income accounting refers to a set of rules and techniques that are used to measure the output of a country. It centres around basic concepts of Gross Domestic Product (GDP) and Gross National Product (GNP).

GDP is defined as the total market value of all final goods and services produced within the country in a given period of time- usually a calendar year or financial year or a fraction like quarter.

GDP can be real or nominal. Nominal GDP refers to the current year production of final goods and services valued at current year market prices. Real GDP refers to the current year production of goods and service valued at base year prices. Base year prices are constant prices. For the current national income series introduced in 2015, the base year is 2011-12.

In estimating GDP, only final marketable goods and services are considered. When it is compared to the base year figure, the real growth levels are seen.

In calculating GDP, certain transactions are excluded. For example, gains from resale are excluded but the services provided by the agents are counted. That is, when a used car or house is sold, no new goods are being produced. But the real estate or the auto agent makes some money though commission which adds to the service economy.

Final goods are goods that are ultimately consumed rather than used in the production of another good. For example, a car sold to a consumer is a final good; the components such as tyres sold to the car manufacturer are not; they are intermediate goods used to make the final goods. The same tyres, if sold to a consumer, would be a final goods. Only final goods are included when measuring national income. If intermediate goods were included too, this would lead to double counting; for example, the value of tyres would be counted once when they are sold to the car manufacturer, and again when the car is sold to the consumer.

Only newly produced goods are counted. Transactions in existing goods, such as second-hand cars, are not included, as these do not involve the production of new goods. (mentioned earlier)

GDP considers only marketed goods. If a cleaner is hired, his pay is included in GDP. If one does the work himself, it does not add to the GDP. Thus, much of the work done by women at home-taking care of the children, aged; chores etc. which is called 'care economy' is outside the GDP. Even what the elder sibling teaches the younger one is outside the scope of national accounts.

The value of intermediate goods is a part of the final goods and services and so are not counted separately as it amounts to double counting and exaggerates the value of the output.

Not all goods and services from productive activities enter into market transactions. Imputations are made for some of these non-marketed but productive activities: for example, imputed rental for owner-occupied housing.

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Market Price and Factor Cost

Market price refers to the actual transacted price and it includes indirect taxes- custom duty, excise duty, sales tax, service tax etc.

Factor cost refers to the actual cost of the various factors of production and it includes government grants and subsidies but it excludes indirect taxes.

Factors of Production

Factors of production, which are also called resource or inputs are what we use used in the production process to produce output—that is, finished goods and services. There are three factors of production: land, labor and capital. All three of these are required in combination at a time to produce a commodity.

There are two types of factors: *primary* and *secondary*. Primary factors are land, labor (the capacity to work), and capital goods. Materials and energy (fuel) are considered secondary factors in classical economics because they are obtained from land, labor and capital. The primary factors facilitate production but neither become part of the product (as with raw materials) nor become significantly transformed by the production process (as with fuel used to power machinery). Land includes not only the site of production but natural resources above or below the soil. Some scholars distinguish human capital (skills, talent and knowledge in the labor force) from labor. Capital can have other forms also intellectual capital, social capital (networks of relationships

necessary for cooperative work for production of value) and even civic capital (citizens working together for facilitating social and political order based on constitutional values).

Some scholars list Entrepreneurship as a factor of production.

Factor Costs

Factor costs are the actual production costs at which goods and services are produced by the firms and industries in an economy. They are the costs of all the factors of production such as land, labor, capital, energy, raw materials like steel etc. that are used to produce a given quantity of output in an economy. They are also called factor gate costs (farm gate, firm gate and factory gate) since all the costs that are incurred to produce a given quantity of goods and services take place behind the factory gate i.e., within the walls of the firms, plants etc. in an economy.

Relationship Between Market Price And Factor Cost:

GNP at factor cost = GNP at market price – indirect taxes + subsidies

GDP at factor cost = GDP at market price – indirect taxes + subsidies

Transfer Payments

Transfer payments are made by the government as 'one-way' payment of money for which no money, good, or service is received in exchange. Governments use such payments as means of income redistribution (universal basic income) under social welfare programs such as social security, old age or disability pensions, student grants, unemployment compensation, etc. There is a need to differentiate them from subsidies. Transfer payments are a part of personal income. Subsidies paid to exporters, farmers, manufacturers are not considered transfer payments because they are linked to an economic transaction.

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Transfer payments may be conditional cash transfers or unconditional cash transfers (universal basic income). IGMSY is a transfer payment. It is a conditional cash transfer. Under Indira Gandhi Matritva Sahyog Yojana (IGMSY) GOI provides financial aid of Rs 6,000 to pregnant woman who undergo institutional delivery for hospital admission. The sum is also meant to help with their child's vaccination, as well as nutritional food.The money will be directly transferred to the bank accounts of pregnant women. The scheme is aimed at encouraging institutional deliveries in order to reduce maternal as well as infant mortality.

Direct Benefit transfer of LPG (DBT) scheme PAHAL (Pratyaksh Hanstantrit Labh) is a part of GDP and thus is not a transfer payment.

Transfer payments are excluded in computing gross national product.

Estimating GDP/GNP

There are three different ways of calculating GDP. The expenditure approach adds consumption, investment, government expenditure and net exports (exports minus imports). The income approach adds what factors earn: wages, profits, rents etc. Output approach adds the market value of final goods and services .The three methods must yield the same results because the total expenditures on goods and services (GNE) must by definition be equal to the value of the goods and services produced (GNP) which must be equal to the total income paid to the factors that produced these goods and services.

In reality, there will be minor differences in the results obtained from the various methods due to changes in inventory levels. This is because goods in inventory have been produced (and therefore included in GDP), but not yet sold. Similar timing issues can also cause a slight discrepancy between the value of goods produced (GDP) and the payments to the factors that produced the goods, particularly if inputs are purchased on credit. Inventory is a detailed list of all the items in stock

Gross GDP means depreciation (wear and tear of machinery in their use) of capital stock is not subtracted. If depreciation is subtracted, it becomes net domestic product.

Calculating the real GDP growth-inflation adjusted GDP growth-allows us to determine if production increased or decreased, regardless of changes in the inflation and purchasing power of the currency.

Output expressed as GDP at factor cost at constant prices makes more genuine sense as inflation/deflation is factored out and the distortions of subsidies and indirect taxes are also deducted. Thus, quantitative levels of production changes are expressed.

The data from the current prices is adjusted to the constant prices by using deflator- it helps take out the contribution of inflation to the value of the output. GDP deflator is a price index.

GDP and GNP

The two are related. The difference is that GNP includes net foreign income- what foreigners produce in the country is subtracted from what Indians produce abroad or vice versa. That is meant by net foreign income. GNP adds net foreign income compared to GDP. GDP shows how much is produced within the boundaries of the country by both the citizens and the foreigners. GDP focuses on where the output is produced rather than who produced it- it is a geographical concept. GDP measures all domestic production, disregarding the producing entities' nationalities.

In contrast, GNP is a measure of the value of the output produced by the "nationals" of a country- both within the geographical boundaries and outside. That is, all the output that the Indian citizens produce in a given year – both within India and all other countries makes up the GNP of India. For example, there are Indian and foreign firms operating in India. Together what they produce within the Indian geography is the GDP of India. The profits of foreign firms earned within India are included in India's GDP, but not in India's GNP.

In other words, income is counted as part of GNP according to who owns the factors of production rather than where the production takes place. For example, in the case of a German-owned car factory operating in the US, the profits from the factory would be counted as part of German GNP rather than US GNP because the capital used in production (the factory, machinery, etc.) is German owned. They are a part of US GDP.

GDP is essentially about where production takes place. GNP is about who produces. If it is an open economy with great levels of foreign investment (FDI) and lesser levels of outbound FDI, its GDP is likely to be larger than GNP.

If it is an open economy but more of its nationals tend to move economic activity abroad or earn more from investing abroad compared with non-nationals doing business and earning incomes within its borders, its GNP will be larger than GDP.

If it is a closed economy where nobody leaves its shores, nobody invests abroad, nobody comes in and nobody invests in the country, its GDP will be equal to GNP.

For most countries, GDP and GNP have more or less the same values.

However, for East Timor, GNP is 3 times or so more than GDP. East Timor which gained Independence in 2002 has low level of production of goods and services on Timorese soil—the country's GDP. It receives foreign aid which is counted as remittance from abroad thus enlarging the GNP value. Whether foreign aid is to be so counted is a separate matter of methodology.

Take the case of Ireland. Its GDP is much larger than its GNP. In Ireland, Google, Apple, Microsoft, Accenture and such other multinational corporations are headquartered due to the tax advantage they get as corporate tax rates are very low. They only have registered offices in Ireland without any production activity. These MNCs contribute to its GDP through exports. Here, the difference between GDP and GNP can be significant. This is due to the fact that such exports far outweigh the Irish imports. The higher GDP value however is illusory.

India's GDP is a little more than its GNP.

Analysts tend to say that GDP is a better measure than GNP. The reason is that GDP is domestic production where employment is created; inflation is moderated; tax revenues are more, exports can be made for foreign exchange reserve build up and so on. GNP also has its advantages and India is a big beneficiary of it. remittances from aborad; acquisition of foreign companies; invest abroad to tap on foreign opportunities etc. But the consensus is that former is of greater value than the latter for the reasons cited.

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There are other related concepts too.

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Gross National Product and Net National Product

We have seen GDP and GNP above.

Net National Product

In the production process a country uses machines and equipment. When there is depreciation, we have to repair or replace the machinery. The expenses incurred for this are called the depreciation expenditure. Net National Product is calculated by deducting depreciation expense from gross national product.

NNP = GNP - Depreciation

National Income is calculated by deducting indirect taxes from Net National Product and adding subsidies. National Income (NI) is the NNP at factor cost.

NI = NNP - Indirect Taxes + Subsidies

Per Capita Income is per capita GDP: GDP divided by mid year population of the corresponding year. Similarly, per capita GNP can also be calculated.

A change in prices can distort perception of actual gross domestic product even without an increase or decrease in the quantity of goods and services produced by an economy. In 2015, in India, the goods and services produced were higher than their market prices indicated. That was an exception. Normally, it is the opposite- market value of the production is higher than the actual goods produced. In both cases, there is distortion that can misguide public policy. Therefore, the impact of prices has to be removed to arrive at a true measure of economic growth. A deflator is used to restate output estimates at current prices into what they would be if calculated with reference to prices in an earlier year- be it the immediately preceding year or the base year or any year in between. This will give an idea of the real growth in the economy, minus the price effect. The ratio between the GDP at current prices and GDP at constant prices gives an idea of the increase in prices of all goods and services with reference to the base year. However, the deflator comes with a lag, which limits its usefulness.

When the GDP deflator is in the negative as mentioned above, nominal GDP is less than real GDP. It means there is deflation in the country.

Seasonality

Estimates of GDP should be seasonally adjusted to factor for fluctuations that normally occur at about the same time and the same magnitude each year. Seasonal adjustment ensures that the movements in GDP, or any other economic series, more accurately reflect true patterns in economic activity. Examples of factors that may influence seasonal patterns include weather, agricultural production, holidays and production schedules. Take the case of India. When we say that India's economic growth was 5.7% in the April-June quarter of the 2017-18 fiscal year, it means that it grew that much over the base value in the same quarter of the previous fiscal year. Its accuracy will be lost if it is a comparison with the previous quarter that is January-March as the seasonal factors of the two quarters are different. Southwest monsoons begin in June and continue for 2-3 months which impacts of construction activity. Similarly, October-December quarter should be compared with the same quarter in the earlier years as it has festivals in it that are relatively absent in other quarters.

Potential GDP

Potential gross domestic product (GDP) is the level of output that an economy can produce without inflating the economy. It is the highest level of real gross domestic product (output) that can be sustained over the long term. Sustainability is in terms of prices, fiscal deficit, current account deficit (exports can not be boosted by devaluing the exchange rate as it can be dysfunctional), financial sector not accumulating non-performing assets etc. Potential output depends on ta variety of factors like infrastructure, human capital and skills, potential labour force (which depends on demographic factors), level of technological development and labour productivity. These limits thus pertain natural and institutional factors.

If actual GDP rises and stays above potential output, it is inflationary as demand for factors of production exceeds supply. In the opposite set of conditions, if GDP is below potential GDP, inflation will come down. Ideally, potential GDP is not to be exceeded for the reasons given above. Towards this objective, government's fiscal policy and Reserve Bank of India (RBI) monetary policy is suitably used. The difference between potential output and actual output is referred to as the output or GDP gap.

Hard And Soft Landing

The Hard Landing of the economy means a sudden fall in the growth rate of economy that is otherwise growing well for any reason. The fall is so steep that a rapidly growing economy may slip into recession. It can be internal or external reason. When the economy is gorwing too fast and for long- when there is inflation along with growth, government wil slow it down by monetary tightening to make the growth sustainable. If such slowdown lands the economy all the way into recession, it hard landing otherwise it is soft landing

India's National Income Statistics

The Central Statistical Office (CSO) in the Ministry of Statistics and Programme Implementation (MoSP & I) is responsible for the compilation of NAS. At the State level, State Directorates of Economics and Statistics (DESs) have the responsibility of compiling there State Domestic Product and other aggregates.

The statistics that are released by the CSO and the State DESs relate to various macro-economic aggregates of the Indian economy. The aggregates compiled and released (at current and constant prices) at annual periodicity by the CSO include gross and net domestic product by economic activity, consumption, saving, capital formation and capital stock, public sector transactions and dis-aggregated statements, as well as the consolidated accounts of the nation namely like Gross Domestic Product. The CSO also releases the quarterly GDP estimates.

The CSO revises the base year of the NAS series periodically. The CSO releases the current series of NAS with 2011-12 as Base Year. The first estimates for a reference year are released by the CSO, about two months before the close of the year, in the form of Advance Estimates (AE) of National Income. These estimates present at both current and constant prices and at factor cost, the Gross National Product (GNP), Net National Product (NNP), Gross Domestic Product (GDP), Net Domestic Product (NDP), and Per Capita Income. These estimates are subsequently revised and released as updates of advance estimates. Quick Estimates of NAS and the Revised Estimates of the earlier years are released by the CSO utilising the available data of various sectors provided by the statistical system, in the month of January or February of the following year (with a 10-month lag). Along with the Quick Estimates for the previous financial year, estimates for the earlier years are also revised using the detailed data supplied by various source agencies and final figures released.

"New GDP Series" 2015

The Central Statistics Office (CSO) came out with a new series of national accounts with 2011-12 as base year for computing size of the economy and economic growth rate. It has the effect of broadening the coverage across segments including farm, corporate and unorganised sectors - a move that will likely expand the size the economy's size. The base year of the national accounts is changed periodically to factor in structural changes in the economy. The new series includes data on unorganised manufacturing and services. Under the new series, the data for corporate income is collated from the corporate affairs ministry's MCA21 records, a comprehensive compendium that allows collecting granular information even from the level of the small firms.In the earlier series such data was taken primarily from the Reserve Bank of India's study on companies and finances. The series also incorporates results of recent National Sample Surveys such as those on enterprises, unemployment, debt and investment, situation assessment of farmers and survey of

land livestock holdings.The National Statistical Commission suggested that the base year for computing national account should be revised every five years.

The 2004-05 GDP data was under-estimating industrial growth as the coverage was low and the weights were wrong. New GDP series has captured the changing structure of the Indian economy. The share of manufacturing has increased to 15.8% from 11.9% in the 2004-05 series. The share of agriculture has increased marginally in the new series to 17.2% from 16.8%.

The base year was last revised in 2010.

Real GDP or GDP at constant (2011-12) prices for the year 2016-17 is estimated at `121.90 lakh crore showing a growth rate of 7.1 percent over the year 2015-16 of `113.81 lakh crore.

Nominal GDP or GDP at current prices in the year 2016-17 is projected at Rs. 152.51 lakh crore, with growth rate of 11.5 percent against Rs. 136.75 lakh crore for 2015-16.

The GNI at current prices is estimated at 150 lakh crore during 2016-17, as compared to 135 lakh crore during 2015-16, showing a rise of almost 11% percent. The Gross National Income (GNI) at 2011-12 prices is estimated at 120.35 lakh crore during 2016-17.

The per capita income at current prices during 2016-17 is estimated to have attained a level of Rs.103219 as compared to the estimates for the year 2015-16 of Rs.94130 showing a rise of 9.7 percent.

India is behind by only $237 and $399 billion from 6th and 5th ranked France and United Kingdom, respectively. It is projected that India will be 6th largest economy of world in 2019 by overtaking France and will become 5th largest in 2019 by overtaking United Kingdom.

Per Capita

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India's per capita income grew was Rs1,03,219 in 2016-17 compared to the estimates for the year 2015-16 of Rs94,130 showing a rise of 9.7%. In real terms (at 2011-12 prices), per capita income in 2016-17 rose 5.7% to Rs.82,269.

The Need To Measure Economic Growth

The following aims can be attributed to the study of economic growth:

- when growth is quantified, we can understand whether it is adequate or not for the given goals of the economy. When we can understand its potential and accordingly set targets
- we can adjust growth rates for their sustainability
- we can prevent inflation or deflation to some extent if we see the performance of the economy in quantitative terms
- we can balance the contributions of the three sectors of the economy and steer the direction of growth towards national goals- away from agriculture to manufacturing as in the case of India in recent years
- target appropriate levels of employment creation and poverty alleviation
- forecast tax revenues for governmental objectives
- corporates can plan their business investments

Economic Growth: Its Benefits And Side Effects

The first benefit of economic growth is wealth creation. It helps create jobs and increase incomes. It ensures an increase in the standard of living, even if it is not evenly distributed. Government has more tax revenues: fiscal dividend. Economic growth boosts tax revenues and provides the government with extra money to finance spending projects. For example, the flagship programmes of the government like Mantri Awaas Yojana-Gramin (PMAY-G), Pradhan Mantri Ujjwala Yojana (PMUY), Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY), Pradhan Mantri Gram Sadak Yojana (PMGSY) are a direct result of the tax buoyancy of growth . It sets up the positive spiral: rising demand encourages investment in new capital machinery which helps accelerate economic growth and to create more employment.

Economic growth can also have a self-defeating effect: violate the principles of fairness and equity thus setting off social conflicts. Environmental costs are another risk.

Problems in Calculating National Income

The measurement of national income encounters many problems.

Black Money Illegal activities like smuggling ind unreported incomes due to tax evasion and corruption are outside the GDP estimates. Thus, parallel economy poses a serious hurdle to accurate GDP estimates. GDP does not take into account the 'parallel economy' as the transactions of black money are not registered.

Non-Monetization In most of the rural economy, considerable portion of transactions occurs informally and they are called as non-monetized economy- the barter economy. The presence of such non-monetary economy in developing countries keeps the GDP estimates at lower level than the actual.

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Household Services The national income accounts do not include the 'care economy'- domestic work and housekeeping. Most of such valuable work rendered by our women at home does not enter our national accounting.

Social Services It ignores voluntary and charitable work as it is unpaid.

Environmental Cost National income estimation does not account for the environmental costs incurred in the production of goods. For example, the land and water degradation accompanying the Green revolution in India. Similarly, the climate change that is caused by the use of fossil fuels. However, in recent years, green GDP is being calculated where the environmental costs are deducted from the GDP value and the Green GDP is arrived at.

Reliability of GDP As a Measure of Progress

Economic growth is generally taken as the measure of advancement in the standard of living of the country. Countries with higher GDP often score highly on measures of welfare, such as life expectancy. However, there are limitations to the usefulness of GNP as a measure of welfare:

- GDP does not value intangibles like leisure, quality of life etc. Quality of life is determined by many other things than economic goods.

- the impact of economic activity on the environment may be harmful-pollution, climate change, unsustainable growth, ecological refugees, life style diseases etc.
- It only gives average figures that hide stratification. Economic inequality is not revealed by GDP figures
- Condition of poor is not indicated
- Gender disparities are not revealed
- It does not matter how the increase in wealth takes place- whether by civilian demand or war
- GDP does not measure the sustainability of growth. A country may achieve a temporarily high GDP by over-exploiting natural resources

The major advantages to using GDP per capita as an indicator of standard of living are that it is measured frequently, widely and consistently. Frequently in that most countries provide information on GDP on a quarterly basis, which allows a user to spot trends more quickly. Widely in that some measure of GDP is available for practically every country in the world, which allows crude comparisons between the standard of living in different countries. And consistently in that the technical definitions used within GDP are relatively consistent between countries, and so there can be confidence that the same thing is being measured in each country.

The major disadvantage of using GDP as an indicator of standard of living is that it is not, strictly speaking, a measure of standard of living. For instance, in an extreme example, a country which exported 100 per cent of its production would still have a high GDP, but a very poor standard of living. The argument in favour of using GDP is not that it is a good indicator of standard of living, but that , in general, standard of living tends to increase when GDP per capita increases. This makes GDP a proxy for standard of living, rather than a direct measure of it. Because of the limitations in the GDP concept, other measures of welfare such as the Human Development Index (HDI), Genuine Progress Indicator (GPI) , Gross National Happiness (GNH), Green GDP, natural resource accounting have been suggested.

They are proposed in an attempt to give a more complete picture of the level of well-being and the position with reference to natural resource depletion, but there is no consensus as to which is a better measure than GDP. Some of the above defy quantification. GDP still remains by far the most often-used measure.

Alternatives to GDP

Robert F. Kennedy once said that a country's gross domestic product (GDP) measures "everything except that which makes life worthwhile". The metric was developed in the 1930s and 1940s amid the upheaval of the Great Depression and global war. Even before the United Nations began requiring countries to collect data to report national GDP, Simon Kuznets, the metric's chief architect, had warned against equating its growth with well-being.

Economic activity has depleted natural resources. The philosopher John Stuart Mill noted more than 200 years ago that, once decent living standards were assured, human efforts should be directed to the pursuit of social and moral progress and the increase of leisure, not the competitive struggle for material wealth. Economist John Kenneth Galbraith once observed: "To furnish a

barren room is one thing. To continue to crowd in furniture until the foundation buckles is quite another."

How GDP number misguide about the general welfare GDP is now clear. Increased crime rates do not raise living standards, but they can lift GDP by raising expenditures on security systems. Despite the destruction wrought by the oil spills and environmental disasters like in Uttarakhand in 2013, J&K in 2014 and Chennai in 2015, they boosted GDP because they stimulated rebuilding. Despite the devastation for Houston (USA) and surrounding areas, there could be a pickup in GDP due to rebuilding from the storm, Hurricane Harvey in mid-2017. It could boost GDP when rebuilding results in a national shortage of construction workers or puts pressure on building materials prices.Competition for construction workers could raise wages. Following the massacre in Las Vegas in 2017 October, firearm manufacturers saw their stock prices go up as more guns were expected to be sold.

As Kuznets noted in 1934, "the welfare of a nation can scarcely be inferred from a measure of national income."

Commercial agricultural production in a country might expand, for example, leading to a rise in GDP; but if the increase is made possible by displacing women from land they farm to feed their family, or through practices that degrade the environment, like deforestation or the use of chemical fertilizers, pesticides and herbicides, misery will increase.

Accordingly, other measures of human well-being in a nation-state have been developed, such as the Human Development Index, Bhutan's Gross National Happiness etc. These approaches assess specific indicators of human welfare like longevity, literacy, and maternal and infant mortality, and are not exclusively economic in orientation.

Human Development Index (HDI)

The UN Human Development Index (HDI) is a standard means of measuring well-being. The index was developed in 1990 by the Pakistani economist Mahbub ul Haq, and has been used since 1993 by the United Nations Development Programme in its annual report.

The HDI measures the average achievements in a country in three basic dimensions of human development:

- A long and healthy life, as measured by life expectancy at birth.
- Knowledge, as measured by the adult literacy rate (with two-thirds weight) and the combined primary, secondary, and tertiary gross enrolment ratio (with one-third weight).
- A decent standard of living, as measured by gross domestic product (GDP) per capita at purchasing power parity (PPP) in US Dollars.

Each year, UN member states are listed and ranked according to these measures. The HDI goes beyond a nation's gross domestic product (GDP) to measure the general well-being of people under a host of parameters, such as poverty levels, literacy and gender-related issues.

The 2010 Human Development Report came up for the first time with an Inequality-adjusted Human Development Index (IHDI), which factors in inequalities in the three basic dimensions of human development (income, life expectancy, and education) and adjusts the HDI.

In the Human Development Report 2017, India has been placed at 131th position in the Human Development Index (HDI) among the 188 countries. India's human development index (HDI) value of 0.624 puts it in the "medium human development" category, alongside countries such as Congo, Namibia and Pakistan. It is ranked third among the SAARC countries, behind Sri Lanka (73) and the Maldives (105), both of which figure in the "high human development" category.

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Human Poverty Index (HPI)

The Human Poverty Index (HPI) is an indication of the standard of living in a country, developed by the United Nations (UN) to complement the Human Development Index (HDI). In 2010 it was supplanted by the UN's Multidimensional Poverty Index.

Genuine Progress Indicator (GPI)

Genuine progress indicator (GPI) is a metric that is designed to take fuller account of the well-being of a nation, only a part of which pertains to the size of the nation's economy, by incorporating environmental and social factors which are not measured by GDP. For instance, some models of GPI decrease in value when the poverty rate increases. The GPI separates the concept of societal progress fromeconomic growth.

The GPI is deducts environmental costs of economic activity like biodiversity loss, resource depletion, pollution, loss of farmland and wetlands, and ozone depletion, and social costs like increase in crime and family breakdown.

For example, in coastal mangrove regions of India, shrimp farming generated substantial profits for those involved in the export market. Once the environmental costs of biodiversity loss through destruction of mangroves, ecosystem damage as well as social costs are factored in, however, the economic gains of shrimp farming no longer look like genuine progress, sustainable development, or poverty alleviation.

GPI incorporates sustainability by looking at losses and gains in "natural capital" like resources, biodiversity and ecosystem health.
In a world increasingly dominated by pursuit of "growth at any cost", the GPI provides economic perspectives in support of social justice, poverty alleviation and sustainable development even as the economic growth is maintained.

Some of the he "costs" of economic activity include the following potential harmful effects:

- Cost of resource depletion
- Cost of crime
- Cost of ozone depletion
- Cost of family breakdown
- Cost of air, water, and noise pollution
- Loss of farmland
- Loss of wetlands

Social Progress Index

The *Social Progress Index* measures the extent to which countries provide for the social and environmental needs of their citizens. Fifty-four indicators in the areas of basic human needs,

foundations of well-being, and opportunity to progress show the relative performance of nations. The index is published by the nonprofit Social Progress Imperative, and is based on the writings of Amartya Sen and Joseph Stiglitz.The social and environmental factors include wellness (including health, shelter and sanitation), equality, inclusion, sustainability and personal freedom and safety. India has ranked 93rd among 128 countries on 2017 Social Progress Index report released by Social progress Imperative (SPI).

The index defines social progress as *the capacity of a society to meet the basic human needs of its citizens, establish the building blocks that allow citizens and communities to enhance and sustain the quality of their lives, and create the conditions for all individuals to reach their full potential.*

The index is prepared based on indicators like health, sanitation, personal safety, ecosystem sustainability, shelter, access to knowledge, personal rights, and tolerance and inclusion. India faces challenges across many dimensions. The country scores particularly low on shelter in the basic human needs dimension, access to information in the foundations of well-being dimension, and tolerance and inclusion in the opportunity dimension.

GNH

Gross National Happiness (GNH) is an attempt to define quality of life in more holistic and psychological terms than Gross National Product.

The term was coined by Bhutan's former King Jigme Singye Wangchuck in 1972 to indicate his commitment to building an economy that would serve Bhutan's unique culture based on Buddhist spiritual values. While conventional development models stress economic growth as the ultimate objective, the concept of GNH is based on the premise that true development takes place when material and spiritual development occur side by side to complement and reinforce each other. The four dimensions of GNH are the promotion of equitable and sustainable socio-economic development, preservation and promotion of cultural values, conservation of the natural environment, and establishment of good governance.

Natural Resources Accounting and Green GDP

Natural resources are essential for production and consumption, maintenance of life-support systems, as well as having intrinsic value in existence for intergenerational and other reasons. It can be argued that natural capital should be treated in a similar manner to man-made capital in accounting terms, so that the ability to generate income in the future is sustained by using the stock of natural capital judiciously. By failing to account for reductions in the stock of natural resources, standard measures of national income do not represent economic growth genuinely. Soil, water and biodiversity are the three basic natural resources.

National Biodiversity Action Plan published by Government of India, Ministry of Environment and Forests in 2008 highlights as an action point the valuation of goods and services provided by biodiversity. More specifically, the Action Plan states: to assign appropriate market value to the goods and services provided by various ecosystems and strive to incorporate these costs into national accounting.

In the Nagoya (Japan) meet in 2010 on biodiversity protection, India declared that it will adopt natural resource accounting. The 2010 UN biodiversity summit decided to respect the link between

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economic policy, natural capital and human wellbeing. There should be global partnership is to mainstream natural resources accounting into economic planning. India, Colombia and Mexico accepted it. This will plug deficiencies in traditional accounting systems. As mentioned above, India's national biodiversity action plan has already incorporated some of these concepts.

Green GDP

Green Gross Domestic Product (Green GDP) is an index of economic growth with the environmental consequences of that growth factored in. From the final value of goods and services produced, the cost of ecological degradation is deducted to arrive at Green GDP.

In 2004, China announced that the green GDP index would replace the Chinese GDP index. But the effort was dropped as green GDP figures shrank the size of the GDP to unimpressive levels. An Expert Group was convened in 2011 to examine the prospects of developing green national accounts in India, chaired Shri Partha Dasgupta and submitted its report in 2013.

Sarkozy's Alternative

The Commission on the measurement of economic performance and social progress was set up in 2008 on French government's initiative.

Increasing concerns have been raised since a long time about the adequacy of current measures of economic performance, in particular those based on GDP figures. Moreover, there are broader concerns about the relevance of these figures as measures of social well-being, as well as measures of economic, environmental, and social sustainability.

Reflecting these concerns, President Sarkozy decided to establish this Commission, to look at the entire range of issues. Its aim was to identify the limits of GDP as an indicator of economic performance and social progress, to consider additional information required for the production of a more relevant picture etc. The Commission was chaired by Professor Joseph E. Stiglitz. Amartya Sen and Bina Agarwal are also associated with it. The commission gave its report in 2009.

The Stiglitz report recommends that economic indicators should stress well-being instead of production, and for non-market activities, such as domestic and charity work, to be taken into account. Indexes should integrate complex realities, such as crime, the environment and the efficiency of the health system, as well as income inequality. The report brings examples, such as traffic jams, to show that more production doesn't necessarily correspond with greater well-being.

Stiglitz explains: The big question concerns whether GDP provides a good measure of living standards. In many cases, GDP statistics seem to suggest that the economy is doing far better than most citizens' own perceptions. Moreover, the focus on GDP creates conflicts: political leaders are told to maximise it, but citizens also demand that attention be paid to enhancing security, reducing air, water, and noise pollution, and so forth – all of which might lower GDP growth. The fact that

Happiness Index

The World Happiness Report is a measure of happiness published by the United Nations Sustainable Development Solutions Network. In 2011, the UN General Assembly passed a resolution inviting member countries to measure the happiness of their people and to use this to

help guide their public policies. In 2012, this was followed by the first UN High Level Meeting called "Happiness and Well-Being: Defining a New Economic Paradigm," which was chaired by Prime Minister Jigme Thinley of Bhutan, the first and so far only country to have officially adopted gross national happiness instead of gross domestic product as their main development indicator.

The first World Happiness Report was released in 2012. It drew international attention as the world's first global happiness survey. The report outlined the state of world happiness, causes of happiness and misery, and policy implications highlighted by case studies. In September 2013 the second World Happiness Report offered the first annual follow-up and reports are now issued every year.The report primarily uses data from the Gallup World Poll.

In the reports, leading experts in fields including economics, psychology, survey analysis, and national statistics, describe how measurements of well-being can be used effectively to assess the progress of nations. Reports delve deep into issues relating to happiness, including mental illness, the objective benefits of happiness, the importance of ethics, policy implications, and links with subjective well-being and the Human Development Report.

India ranked at 122 out of 155 countries in the World Happiness Report 2017.

Norway is the happiest country based on the index compiled from data which combine economic, health and polling data compiled by economists that are averaged over three years from 2014 to 2016. It is recommended that statistics and surveys, which normally deal with income, spending, health and housing, include a few extra questions on happiness because it would lead to better policy that affects people's lives. The entire top ten were wealthier developed nations. Yet money is not the only ingredient in the recipe for happiness. In fact, among the wealthier countries the differences in happiness levels had a lot to do with differences in mental health, physical health and personal relationships: the biggest single source of misery is mental illness.China, has made major economic strides in recent years. But its people are not happier than 25 years ago, it found.

The United States meanwhile slipped to the number 14 spot due to less social support and greater corruption; those very factors play into why Nordic countries fare better on this scale of smiles.What works in the Nordic countries is a sense of community and understanding in the common good. The rankings are based on gross domestic product per person, healthy life expectancy with four factors from global surveys. In those surveys, people give scores from 1 to 10 on how much social support they feel they have if something goes wrong, their freedom to make their own life choices, their sense of how corrupt their society is and how generous they are.

Madhya Pradesh's Department of Happiness

In 2016, Madhya Pradesh became the first state to announce its happiness department. Madhya Pradesh said that the department would ensure happiness in the lives of people and stop them from taking extreme steps, such as suicide. MP joined hands with the Indian Institute of Technology (IIT) Kharagpur to develop a happiness index for "measuring the well-being of the people".IIT KGP will develop the Index and analyze data collected by the Government of Madhya Pradesh in order to assess the level of happiness and develop recommendations that can be used to enhance happiness. The institute will also develop online courses on happiness.

Andhra Pradesh

Andhra Pradesh is the second state in the country after Madhya Pradesh to start a Happiness Index Department. Chief Minister heads the newly formed departmentas in Madhya Pradesh. The State

had recently launched an "achieving happiness" programme under which civic bodies organised song and dance events.The Andhra Pradesh government's 'Sunrise AP Vision 2029' has taken Bhutan as a model to focus on matters including psychological well-being, health, time use, education, etc.

Maharashtra

The state of Maharashtra plans to set up a "happiness department" in the government and has set up a seven-member committee to plan the formation of a happiness department under the state department of relief and rehabilitation in mid-2017.

Environmental Performance Index (EPI)

It is a method of quantifying and numerically marking the environmental performance of a state's policies. The 2016 Environmental Performance Index is a project lead by the Yale Center for Environmental Law & Policy (YCELP), Columbia University, in collaboration with World Economic Forum.

The 2016 Environmental Performance Index provides a global view of environmental performance and country by country metrics to inform decision-making. Launched at the World Economic Forum, the EPI is in its 15th year and more relevant than ever to achieving the United Nations' Sustainable Development Goals and carrying out the recent international climate change agreement. The Environmental Performance Index (EPI) ranks countries' performance on high-priority environmental issues in two areas: protection of human health and protection of ecosystems but factors taken into consideration also include tree cover and reduction in carbon intensity.2016 report ranked India 141st among 180 countries worldwide. The ten best performers in EPI are Finland, Iceland, Sweden, Denmark, Slovenia, Spain, Portugal, Estonia, Malta, and France. United Kingdom ranks 12th and the United States ranks 26th.The report stresses, there is no relationship between countries' EPI performance and economic development. "For instance, countries located in Europe tend to have higher EPI scores in relation to their Gross Domestic Product (GDP) per capita", while "China and India both have "high GDP per capita but receive low scores on the overall EPI."

Referring to unsafe water, unsafe sanitation, ambient particulate matter pollution, household air pollution from solid fuels, and ambient ozone pollution, the report states, **"Some countries, like India, perform poorly across all five environmental risk factors".**The report is titled "Global Metrics for the Environment".

Purchasing Power Parity: PPP

Purchasing power parity is defined as the number of units of a country's currency required to buy the same amount of goods and services in the domestic market as one dollar would buy in the US. The concept of purchasing power parity allows us to estimate what exchange rate between two currencies is needed to express the accurate purchasing power of a currency in relation to another

The PPP system allows GDP comparisons to be made by asking how much money would be needed to purchase the same goods and services in two countries and using that to calculate an implicit foreign exchange rate. Purchasing power parity exchange rates are useful for comparing living standards between countries. Actual exchange rates can give a very misleading picture of

living standards. For example, if the value of Indian rupee falls by half compared to the dollar, the Gross Domestic Product measured in dollars will also halve.

However, this doesn't necessarily mean that Indians are any poorer. Measuring income in different countries using purchasing power parity exchange rates helps to avoid this problem. PPP has been developed to remove the distortions in the exchange rate in the forex market. Market exchange rate doesn't reflect the purchasing power of a currency. PPP removes distortions that come with market exchange rates, which are often volatile, affected by political and financial factors that do not lead to immediate changes in income and tend to understate the standard of living in poor countries.

Let us assume that the market exchange rate between Dollar and Rupee is 66. One Dollar in the US fetches one liter of milk in the US. Rs 66 can buy three liters of milk in India. Assume that India's GDP is Rs 660. It is worth $10 by nominal exchange rate in the forex market. If milk is all that the world produces, one concludes that India's GDP is 10 liters of milk, if we use the market exchange rate. Actually, India produces 30 liters of milk. Thus, GDP calculated at market rates of foreign exchange tends to distort GDP. Remedy lies in the World Bank concept of Purchasing Power Parity (a type of exchange rate).Under PPP, we measure the GDP of India by measuring how much milk that Rupees 66 can purchase in India and One Dollar can purchase in the US. Here, one dollar in the US can purchase one liter of milk whereas Rs 22 can purchase one liter of milk in India.

$ 1 = Rs 22

Using this PPP exchange rate instead of market rate, we can calculate that India's GDP of Rs 660 becomes $30. Thus, in terms of PPP, India's GDP is $30 and not $10 which is the value that we arrive at by using market exchange rate. Big Mac Index says the same as can be seen below:

Big Mac Index

New Delhi

The Big Mac index was developed by The Economist magazine in 1986 as a lighthearted guide to whether currencies are at their "correct" level. It is based on the theory of purchasing-power parity (PPP). For example, the average price of a Big Mac in America in January 2017 was $6.6. In India, it was about Rs.120. It means, under PPP, the equation is Rs.18.18 per dollar. Thus, rupee is seen to be grossly undervalued.

How PPP is more reliable than market exchange rate is as follows: Firstly, market exchange rates can quickly change, which artificially changes the value of GDP. Secondly, market exchange rates are determined by demand and supply of currencies that includes speculation and expectations and confidence. The Gross Domestic Product per capita in India was at 6092.60 US dollars in 2016, when adjusted by purchasing power parity (PPP).

Business Cycles

Alternating periods of expansion and decline in economic activity is called business cycle. That is, the ups and downs of the economy. There are four stages in the business cycle: expansion, growth, slowdown and recession. Recession may not follow every time.

Recession

A recession is economic contraction (de-growth) which results in a general slowdown in economic activity. Macroeconomic indicators such as GDP (gross domestic product), investment, capacity utilization, household income, business profits, and inflation fall, while the unemployment rate rises. In the United Kingdom, it is defined as a negative economic growth for two consecutive quarters. This may be triggered by various events, such as a financial crisis (2008), an external trade shock, an adverse supply shock or the bursting of an economic bubble. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply, increasing government spending and decreasing taxation. Recession may end with the corrective measures taken by the government and the market. If it does not end and relapses for any reason, due to external or internal shocks, it is called double dip recession. In 2012, UK was in double dip recession. When recession worsens, with de-growth becoming stubborn and deeper and more and more people lose jobs, it is called depression- statistical markers may differ- whether 10% GDP is lost or more or less.

Great Recession 2008-9

The Great Recession was a period of steep economic decline observed in world economies, particularly the developed world during the late 2000s and early 2010s. The scale and timing of the recession varied from country to country. In terms of overall impact, the International Monetary Fund concluded that it was the worst global recession since the 1930s (the Great Depression). The causes of the recession largely originated in the United States, particularly related to the real-estate market. It began in December 2007 and ended in June 2009, thus extending over 19 months. The Great Recession was related to the financial crisis of 2007–08 and U.S. subprime mortgage crisis of 2007–09. It resulted in the collapse of the financial sector in USA. The banks were then bailed out by the U.S. government.

New Delhi

The recession was not felt evenly around the world. Whereas most of the world's developed economies, particularly in North America and Europe (including Russia), fell into a definitive recession, many of the newer developed economies suffered far less impact, particularly India and China whose economies grew substantially during this period.

2008 Subprime Crisis

The financial crisis is linked to reckless lending practices by financial institutions in the United States. The US mortgage-backed securitieswere marketed around the world. When these securities lost value and were considered toxic, the financial institutions that bought them either went into heavy losses or went bankrupt fully. These companies being listed on the stock market, equities collapsed in their value as a result. Indian banks had negligible exposure to them.

Credit boom fed a global speculative bubble in real estate and equities, which served to aggravate the risky lending practices. The emergence of Sub-prime loan losses in 2007 began the crisis and exposed other risky loans and over-inflated asset prices. With loan losses mounting and the fall of Lehman Brothers on September 15, 2008, a major panic broke out in the global financial transactions. As share and housing prices melted, many large and well established investment and commercial banks in the United States and Europe suffered huge losses and even faced bankruptcy, resulting in massive public financial assistance.A global recession resulted in a sharp drop in international trade, rising unemployment and slumping commodity prices.The conditions

leading up to the crisis, characterized by an exorbitant rise in asset prices and associated boom in economic demand, are considered a result of the extended period of easily available credit, inadequate regulation and oversight etc.Some trace the genesis to the Chinese buying US treasuries with their export earnings thus supplying the US cheap money that they could lend recklessly.

The recession renewed interest in Keynesian economic ideas on how to combat recessionary conditions. Fiscal and monetary policies have been significantly eased to stem the recession and financial risks.

(The best authors on the meltdown are Arun Kumar (JNU); Joseph Stiglitz, Paul Krugman and Dr.C.Rangarajan)

Depression

A depression is a more severe economic downturn than a recession, which is a slowdown in economic activity over the course of a normal business cycle. Technically, recession is negative growth in two successive quarters.

A depression is an unusual and extreme form of recession. Depressions are characterized by their length, by abnormally large increases in unemployment, falls in the availability of credit (often due to some form of banking or financial crisis), shrinking output as buyers are not there and producers cut back on production and investment, large number of bankruptcies including sovereign debt defaults, significantly reduced amounts of trade and commerce (especially international trade), as well as highly volatile relative currency value (often due to currency devaluations). Price deflation, financial crises and bank failures are also common elements of a depression that do not normally occur during a recession.Greece was in depression in 2012 with 50% of the young people out of work.According to the International Monetary Fund, Venezuela's GDP in 2017 is 35% below 2013 levels. That is a significantly sharper contraction than during the 1929-1933 Great Depression in the United States, when US GDP is estimated to have fallen 28%.

Structural Composition of The Economy

Economies can be classified into three sectors by activity: extraction of raw materials (primary), manufacturing (secondary), and services (tertiary). As the economy develops, there is a progression from primary to secondary to tertiary sector. The development of technology, improvement in quality of life, social security, growth of education and culture are the benefits of such transition.

The primary sector of the economy involves changing natural resources into primary products. Most products from this sector are considered raw materials for other industries. This sector includes agriculture, fishing, forestry and all mining and quarrying industries. Primary sector is a larger sector in developing countries; for instance, animal husbandry is more common in Africa than in Japan.

The secondary sector of the economy includes those economic sectors that create a finished, usable product: manufacturing and construction. This sector generally takes the output of the primary sector and manufactures finished goods or where they are suitable for use by other businesses, for export, or sale to domestic consumers. This sector is often divided into light industry and heavy industry.

Light industry is that part of an economy's secondary sector which is less capital-intensive and more labor-intensive operations. They are argely consumer goods. Consumer electronics, clothes, shoes, furniture and household items like consumer electronics are the examples. Heavy industry is capital intensive and produces goods for businesses: auto, steel, cement, petroleum etc producing large quantities. The tertiary sector of economy (service sector) produces "intangible or invisible goods". The tertiary sector of economy involves the provision of services to businesses as well as final consumers. Services may involve the transport, distribution and sale of goods from producer to a consumer, entertainment. The service sector consists of the "soft" parts of the economy such as insurance, government, tourism, banking, retail, education, retail, insurance, and government.

The quaternary sector includes activities which provide information services (information generation, information sharing and research and development); computing, ICT (information and communication technologies), consultancy (offering advice to businesses) and R&D (research and development). The quaternary sector is sometimes included with the tertiary sector, as they are both service sectors but many argue that intellectual services are distinct enough to warrant a separate sector. To many industries, such as the pharmaceutical industry, the sector is the most valuable because it creates future branded products which the company will profit from. This sector evolves in well developed countries and requires a highly educated workforce.

Quinary sector is not clearly conceptualized like the preceding four sectors. Some include the highest levels of decision making in an economy in it: CEOs of firms; HODs in government, science, universities, nonprofit, healthcare, culture and the media. Some include police and fire departments which are public services and not for-profit enterprises.Some economists include care economy in it. Structural change of an economy refers to a long-term and broad based change of the fundamental structure, rather than microscale or short-term change. Originally it meant the way the economy is evolving impacting on the respective contributions of the three sectors of economy (agriculture, industry and services) to Gross Domestic Product (GDP). It may also mean other changes. For example, a subsistence economy is transformed into commercial economy or a regulated economy is liberalized. An insulated and protectionist economy becomes open and globalized. India has been structurally reorienting its economy since the early 1990s under which there is more room for markets; privatization of the public sector; greater flow of foreign investment and foreign goods etc.

Indian Economy: Sectoral Classificaion and Components
I. Agriculture, forestry & fishing
Crops
Livestock
Forestry & logging
Fishing and aquaculture
II. Industry Sector
Mining & quarrying
Manufacturing
Food Products, Beverages and Tobacco
Textiles, Apparel and Leather Products

Metal Products
Machinery and Equipment
Other Manufactured Goods
Electricity, gas, water supply & other utility services
Construction
III. Services Sector
Trade, repair, hotels and restaurants
Trade & repair services
Hotels & restaurants
Transport, storage, communication & services related to broadcasting
Railways
Road transport
Water transport
Air transport
Services incidental to transport
Storage
Communication & services related to broadcasting
Financial, real estate & prof. servs
Financial services
Real estate, ownership of dwelling & professional services
Community, social & pers. Servs
Public administration & defence
Other services

Indian economy is classified in three sectors — Agriculture and allied, Industry and Services. Agriculture sector includes Agriculture (Agriculture proper & Livestock), Forestry & Logging, Fishing and related activities. Industry includes 'Mining & quarrying', Manufacturing (Registered & Unregistered), Electricity, Gas, Water supply, and Construction. Services sector includes 'Trade, hotels, transport, communication and services related to broadcasting', 'Financial, real estate & prof servs', 'Public Administration, defence and other services'. Services sector is the largest sector of India. Services sector accounts for 53.66% of GDP. Industry sector contributes 29.02%. While, Agriculture and allied sector share is 17.32%.

Some Terms

A developed country or industrialized country has advanced technological infrastructure. Most commonly, the criteria for evaluating the degree of economic development are gross domestic product (GDP), level of industrialization, amount of widespread infrastructure and general standard of living.

Developed countries have post-industrial economies, meaning the service sector provides more wealth than the industrial sector. They are contrasted with developing countries, which are in the process of industrialization, or undeveloped countries.

A developing country or underdeveloped country, is a nation with an underdeveloped industrial base, and a low Human Development Index (HDI) relative to developed countries. There is no universal criterion as to what makes a country developing or developed although there are general markers such as a nation's GDP per capita, HDI, demographic state etc. A developing country is well short of the modern and Western standards of democratic governments, economic development, social security and civil rights guarantees for their citizens.

NIC: Newly industrialized country (NIC) is one which adopted the market model of growth; is showing rapid growth of economy for a considerable period of time; falls between a developed country and a developing country characterized by rapid export-driven economic growth and migration of workers from rural to urban areas.For example, India, Brazil, South Africa etc.NICs are attractive investment destinations given their strong economic growth rates and future potential.

World Bank classification of countries (2017)

Category	Per Capita (current US$)
Low-income	< 1,005
Lower-middle income	1,006 - 3,955
Upper-middle income	3,956 - 12,235
High-income	> 12,235

A high-income economy is defined by the World Bank as a country with a per capita income of US$12,235 or more in 2017. The term "first world" commonly refers to those prosperous market economies like the west, Japan etc.

According to the United Nations, for example, some high income countries may also be developing countries. The GCC (Persian Gulf States) countries, for example, are classified as developing high income countries. Thus, a high income country may be classified as either developed or developing. GCC countries for example are rich but not developed. They have pockets of export economy based on oil and gas and the rest of the economy is under developed.

The term developed country, or advanced country, is used to categorize countries that have achieved a high level of industrialization in which the tertiary and quaternary sectors of industry dominate; a high income per capita and a high Human Development Index (HDI).

First, Second, Third and Fourth World countries

First world was the western deeloped world. Second world was the communist countries with command economies but they do not exist today. Third world was made up of the developing countries.

Least Developed Countries (LDCs/ Fourth World countries)

They are countries which according to the United Nations exhibit the lowest indicators of socioeconomic development, with the lowest Human Development Index ratings of all countries in the world. The concept of LDCs originated in the late 1960s. A country is classified as a Least Developed Country if it meets three criteria:

- Poverty. As of 2015 a country must have per capita less than US $1,035 to be included on the list, and over $1,242 to graduate from it.
- Human resource weakness (based on indicators of nutrition, health, education and adult literacy) and
- Economic vulnerability (based on instability of agricultural production, instability of exports of goods and services, economic importance of non-traditional activities, merchandise export concentration, handicap of economic smallness, and the percentage of population displaced by natural disasters)

Least developed countries (LDCs) are low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets.LDC criteria are reviewed every three years by the Committee for Development Policy (CDP) of the UN Economic and Social Council (ECOSOC). Countries may "graduate" out of the LDC classification when indicators exceed these criteria. There are currently 47 countries on the list of LDCs.

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ECONOMIC DEVELOPMENT AND NITI AAYOG

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Independent India's economic development was driven by socio-economic planning by government. India opted to be a planned economy. Planned economy is one in which the state owns, partly or wholly the economy and directs it. State sets the priorities for growth. Private sector has only a residuary role. High level of government regulation characterizes planned economies. It is refered to as command economy or centrally planned economy. State control of economy extends to

- all major sectors of the economy
- distribution of income
- decisions on what should be produced and how much and sold at what price

In a market economy, it is the opposite- state has a minimal role in the management of the economy- production, consumption and distribution decisions are predominantly left to the market. State plays certain role in redistribution. State is called the laissez faire state here. It is a French phrase literally meaning "Let do."

Indicative plan operates where there is a mixed economy with State and market playing significant roles to achieve targets for growth that they together set. It is operated under a planned economy but not command economy.

Indian planned growth is not a classical command economy as it operated in a democratic system. Command economies were classically set up in China and USSR, mainly for rapid economic growth and social and economic justice but have been dismantled in the last two decades as they do not create wealth sustainably and are not conducive for innovation and efficiency. Cuba and North Korea are still command economies.

History of Economic Planning in India

Bombay Plan

India being devastated economically after more than two centuries of colonial exploitation resulting in chronic poverty, eradication of poverty was the driving force for the formulation of various models of growth before Independence.

In 1944 leading businessmen and industrialists (including Sir Purshotamdas Thakurdas, JRD Tata, GD Birla and others) put forward "A Plan of Economic Development for India" -popularly known as the 'Bombay Plan'. It saw India's future progress based on further expansion of the textile and consumer industries already flourishing in cities like Bombay and Ahmedabad. It saw an important role the State in post-Independent India: to provide infrastructure, invest in basic industries like steel, and protect Indian industry from foreign competition. Its objectives were a doubling of the output of the agricultural sector and a five-fold growth in the industrial sectorover 15 years.Bombay Plan was premised on the view that that the economy could not grow without government intervention and regulation.

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Sir Mokshagundam Visvesvarayya

*M. Visvesvaraya (1860-1962) was an engineer by: He designed the Krishnasagar Dam and sponsored the Bhadravati Iron Works. He was an admirer of Japan's industrial progress and also studied the Soviet Five Year Plans and the initiatives of the American President Roosevelt. In 1934 he published his own suggestions for a ten-year plan for India. This was the first attempt at economic planning in India.*It is proposed under the Plan to double the income of the country within ten years. He believed that left to private enterprise, industries will not make satisfactory progress. Government should take the lead; bold policies should be laid down and adhered to; an official organization should be brought into existence, and correct comprehensive reports of progress supported by adequate statistics should be published yearly. In his book titled "Planned Economy for India" (1934), he set the goal of poverty eradication through growth.

National Planning Committee (1938)

The Indian National Congress established a National Planning Committee under the chairmanship of Jawaharlal Nehru. It (1938) stated the objective of planning for development "was to ensure an adequate standard of living for the masses, in other words, to get rid of the appalling poverty of the people". It advocated heavy industries that were essential both to build other industries, and for Indian self-defence; heavy industries had to be in public ownership, for both redistributive and security purposes; redistribution of land away from the big landlords would eliminate rural poverty.

MN Roy

During the 1940's, the Indian Federation of Labour published its People's Plan by MN Roy that stressed on employment and wage goods.

SN Agarwala

He was a follower of Mahatma Gandhi and published Gandhian Plan that emphasized on decentralization; agricultural development; employment; cottage industries etc.

Mixed Economy

India is a mixed economy combining features of both capitalist market economies and socialist command economies. Thus, there is a regulated private sector (the regulations have decreased since liberalization from the late 1980's) and a public sector. The public sector generally covers areas which are deemed too important; or not profitable enough for the private sector. Thus such services as railways and postal system are carried out by the government.

Since Independence, for the first three-four decades the public sector dominated and in fact sectors like banking saw nationalization. From the time of economic reforms since 1991 greater role for the private sector defined the economy- be it by deregulation, divestment or privaisation. Thus, the state-market mix changed towards the market since 1991 but the economy is predominantly mixed.

Planning Goals

India launched five year plans for rapid growth from 1951. The long term goals that were common to all the five year plans:

- Growth
- Modernization

- self-reliance and
- social justice

Economic growth is the increase in value of the goods and services produced by an economy. Growth measures quantitative increase in goods and services. Growth is expected to spread to all sections and regions; raise resources for the Government to spend on socio-economic priorities etc. It takes a long time for growth to trickle down to all people and regions. Therefore, State plans for an expeditious process of inclusive growth.

Growth is the precondition for all other objectives like poverty eradication, employment generation; inequality reduction; human capital building etc. However, the objectives mentioned above need not necessarily emerge from groath.

Economic development is different from growth and refers to growth that includes redistributive aspects and social justice. GDP may be only growth and not welfare and human development like education, access to basic amenities, environmental quality, freedom, or social justice. Economic growth is necessary for development but not sufficient.

Modernization is improvement in technology. It is driven by innovation and investment in R and D. Education is the foundation of modernization. The more modernized the economy, the greater the value created by it.

Self-reliance means relying on the resources of the country and not depending on other countries and the MNCs for investment and growth. India embarked on the goal partly due to the colonial experience and partly due to the need to develop its economy independently. Since India had no foregn exchange to import, it was important that we produce the goods ourselves. Invitation to MNCs re-generated the fears of colonialism returning as neo-colonialism. Nehru-Mahalanobis model of growth that closed Indian economy and relied on basic industries is the main plank for self-reliance. However, opting for the Liberalization,Privatization and Globalization model (LPG) since 1991 and later becoming a founding member of World Trade Organization (WTO) in 1995 made us depart from self-relaince as LPG offered scope for faster growthand also by then India was in a position to globalize and benefit unlike immediately after Independence.

The term self-reliance should not be confused with self-sufficiency – the former means depending on resources of the country and avoid dependence on external inflows; the latter means that the country has all the resources it needs. No country can be self-sufficient.

Social justice means inclusive and equitable growth where inequalities are not steep and benefits of growth reach all- rural-urban, man-woman; caste divide and inter-regional divides are reduced. While the above four are the long term goals of the planning process, each five year plan has specific objectives and priorities.

Financial Resources For The Five Year Plans

The resources for the Plan come from

- Central budget
- State budgets
- PSEs
- Domestic private sector and
- FDI

Gross Budgetary Support

GBS is the amount from the central Budget that goes to fund the plan investments during the plan period of three units: Centre's, assistance to states' budgets to the extent the centre can afford and also the public sector units.

History of Planning

First Plan (1951- 56) The First Plan stressed on agriculture, in view of large scale import of foodgrains and inflationary pressures on the economy. Other areas of emphasis were power and transport. The annual average growth rate during the First Plan was 3.61% as against a target of 2.1%. Renowned economist KN Raj, who died in 2010 was one of the main architects of India's first five-year plan.

Second Plan (1956-61) With agricultural targets of previous plan achieved, major stress was on the establishment of heavy industries. Rate of investment was targeted to increase from 7% to 11%. The Plan achieved a more than targeted growth rate of 4.32%. This Plan envisaged to give a big push to the economy so that it enters the take off stage. It was based on Nehru-Mahalanobis model- self-reliance and basic-industry driven growth.

Nehru-Mahalanobis Model of Economic Growth

Indian economy at the time of Independence was characterized by dependence on exports of primary commodities; negligible industrial base; underproductive agriculture etc. 1st FYP focused on agriculture for food security. But industrialization was urgently needed to modernize the economy and improve its technology.

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The model adopted for the 2nd FYP plan is known as the Nehru-Mahalanobis strategy of development as it was articulated by Jawahar Lal Nehru's vision and P.C.Mahalanobis was its chief architect. The central idea underlying this strategy is well conveyed by the following statement from the plan document. 'If industrialization is to be rapid enough, the country must aim at developing basic industries and industries which make machines to make the machines needed for further development.'

The Mahalanobis model of growth is based on the predominance of the basic goods (capital goods or investment goods which are goods that are used to make further goods like machines, tools, factories, etc). It is based on the premise that it would attract all round investment, ancillarisation, build townships and result in a higher rate of growth of output- trickle down effect. That will boost employment generation, poverty alleviation, exports etc. The emphasis was on expanding the productive ability of the system, through forging strong industrial linkages, as rapidly as possible.

Other Elements of The Model Are

- Import substitution. Protective barriers against foreign competition to enable Indian companies to develop domestically produced alternatives for imported goods and to reduce India's reliance on foreign capital.
- A sizeable public sector active in vital areas of the economy including atomic energy and rail transport.
- A vibrant small-scale sector driving consumer goods production for dispersed and equitable growth and producing entrepreneurs.

In terms of the core objective of stepping up the rate of growth of industrial production, the strategy paid off. Rate of growth of overall industrial production picked up. The strategy laid the foundation for a well-diversified industrial structure within a reasonably short period and this was a major achievement. It gave the base for self-reliance.

However, the strategy is criticized for the imbalances between the growth of the heavy industry sector and other spheres like agriculture and consumer goods etc that resulted. It is further criticized as it relied on 'trickle down effect'- benefits of growth will flow to all sections in course of time. This approach to eradication of poverty is slow and incremental. It is believed that frontal attack on poverty is required. The debates about growth and redistribution-Sen-Bhagawati- debates that raged in 2013 centre around the trickle down effect largely. It should be noted trickle down effect does produce results but given our size, growth has to be in double digits for a long period sustainably for the trickle down effect to work.

Third Plan (1961-66) It tried to balance industry and agriculture. The aim of Third Plan was to establish a self sustaining economy. For the first time, India resorted to borrowing from IMF. Rupee was also devalued for the first time in 1966. India's conflict with Pakistan and repeated droughts also contributed in the failure of this Plan.

Annual Plans As the Third Plan experienced difficulties on the external front (war with China in 1962 and Pakistan in 1965); and the economic troubles mounted on the domestic front- inflation, floods, forex crisis- and there was political instability with the death of Nehru and Lal Bahadur Shastri, the Fourth Plan could not be started from 1966. There were three annual plans till 1969. This period is called plan holiday- that is when five year plans are not implemented. The Annual Plans were: 1966-67, 1967-68 and 1968-69.

Fourth Plan (1969-74) The main objective of this Plan was growth with stability. The Plan laid special emphasis on improving the condition of the under-privileged and weaker sections through provision of education and employment. Reducing the fluctuations in agricultural production was also a point of emphasis of this Plan. The Plan aimed at a target growth of 5.7% and the achievement against this was 3.21%.

Fifth Plan (1974-79) The main objective of the Plan was Growth for Social Justice. The targeted growth rate was 4.4% and we achieved 4.8%. It was cut short by the Janata Party that came to power in 1977.

Janata 6th FYP was launched in 1977 but was removed from official records by the government that came to power in 1980 and the official 6th FYP was launched. The year 1979-80 was thus a gap year when there was no FYP and is called plan holiday.

Rolling Plan

It was adopted in India in 1962, in the aftermath of Chinese attack on India, in the Defence Ministry in India. Professor Gunnar Myrdal (author of 'Asian Drama') recommended it for developing countries in his book - Indian Economic Planning in Its Broader Setting. Rolling plan becomes necessary in circumstances that are fluid. It was contemplated by the Janata government in 1977. In the rolling plan model, even as annual and multi year goals are set, they are not rigidly followed as ground level conditions may not be conducive. It is in between a normal FYP and a plan holiday (annual plans)

The main advantage of the rolling plans is that they are flexible and are able to overcome the rigidity of fixed five year plans by mending targets, projections and allocations as per the changing conditions in the country's economy. The main disadvantage of this plan is that if the targets are revised each year, it becomes very difficult to achieve them. Frequent revisions result in instability of the economy.

Sixth Plan (1980-1985) Removal of poverty was the foremost objective of Sixth Plan. Another area of emphasis was infrastructure, which was to be strengthened for development of both industry and agriculture. The achieved growth rate of 5.7% was more than the targeted one.Direct attack on poverty was the main stress of the Plan.

Seventh Plan (1985-90) This Plan stressed on rapid growth in food-grains production and increase in employment opportunities. The growth rate of 5.81% achieved in this Plan was more than the targeted one. The plan saw the beginnings of liberalization of Indian economy. The 8th Plan could not start in 1990 due to economic crisis and political instability. There were two annual plans- plan holiday.

Eighth Plan (1992-1997) This Plan was formulated keeping in view the process of economic reforms and restructuring of the economy. The main emphasis of this Plan were

- to stabilize the adverse balance of payment scenario sustainably
- improvement in trade and current account deficit
- Human development as main focus of planning.

It was indicative plan for the first time. The Plan was formulated in a way so as to manage the transition from a centrally planned economy to market led economy. The targeted annual average rate of growth of the economy during Eighth Plan was 5.6%. Against this, we achieved an average annual growth of 6.5%. The Plan was based on Rao-Manmohan Singh model of liberalization.

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Rao-Man Mohan Singh Model of Growth

Economic reforms since 1991 are based on the Rao-Manmohan model - Mr. Narasimha Rao, the PM in 1991 and Finance Minister Dr. Man Mohan Singh. Its essence is contained in the New Industrial Policy 1991 and extends beyond it too. The model has the following contents:

- Reorient the role of State in economic management. State should refocus on social and infrastructural development, primarily
- Dismantle, selectively controls and permits in order to permit private sector to invest liberally
- Open up the economy and create competition for PSEs- for better productivity and profitability
- External sector liberalization in order to integrate Indian economy with the global economy to benefit from the resource inflows and competition.

Its success is seen in the more than 6.5% average annual rate of growth of economy during the 8th Plan (1992-1997). Forex reserves accumulated thus alleviating BOP pressures and the foreign flows- FDI and FII increased.

Indicative Planning

It is characterized by an economy where the private sector is given a substantial role. State would turn its role into a facilitator from that of a controller and regulator. With the launch of the economic reforms in 1991, indicative planning was inevitable. It was adopted since 8th five year plan (1992-97). It was decided that trade and industry would be increasingly freed from government control and that planning in India should become more and more indicative and supportive in nature. In other words, the remodeling of economic growth necessitated recasting the planning model from imperative and directive ('hard') to indicative (soft) planning. Since the Government did not contribute the majority of the financial resources, it had to indicate the policy direction to the corporate sector and encourage them to contribute to plan targets. Government should create the right policy climate- predictable, irreversible and transparent- to help the corporate sector contribute resources for the plan: fiscal, monetary, forex and other dimensions.

Indicative planning is to assist the private sector with information that is essential for its operations regarding priorities and plan targets. Here, the Government and the corporate sector are more or less equal partners and together are responsible for the accomplishment of planning goals. Government, unlike earlier, contributes less than 50% of the financial resources. Government provides the right type of policies and creates the right type of milieu for the private sector- including the foreign sector to contribute to the results. Indicative planning gives the Government an opportunity to give the private sector encouragement to achieve growth in areas where the country has inherent strengths. It is known to have brought Japan results in shifting towards microelectronics. In France, too indicative planning was in vogue.

Planning Commission would work on building a long-term strategic vision of the future. The concentration would be on anticipating future trends and evolving strategies for competitive international standards. Planning will largely be indicative and the public sector would be gradually withdrawn from areas where no public purpose is served by its presence. The new approach to development will be based on "a re-examination and re-orientation of the role of the government". This point is particularly stressed in the development strategy of the Tenth Five Year Plan (2002-2007). Indicative planning was not contemplated at the beginning of fifties as there was hardly any corporate sector in India and Government shouldered almost the entire responsibility of socio-economic planning.

Ninth Five Year Plan (1997-2002) The salient features of the Ninth Five Year Plan are a target annual average growth rate of 6.5 per cent for the economy as a whole, and a growth rate of 3.9 per cent for agriculture sector, among others. The key strategies envisaged to realise this target rest on attaining a high investment rate of 28.2 per cent of GDP at market prices. The domestic saving rate, which determines the sustainable level of investment, is targeted at 26.1 per cent of the GDP. Care has been taken to ensure achievement of a sustainable growth path in terms of external indebtedness as well as fiscal stability. Rate of growth achieved was 5.4%. The plan oeriod saw many crises- political instability; south east Asian economic crisis; Kargil war; 2011 September terrorism in USA etc. However, the first India company was listed on the Nasdaq (Infy) followed by many others.

Tenth Five Year Plan (2002–2007) The main objectives of the tenth Five Year Plan of India were:

- Attain 8% GDP growth per year.
- Reduction of poverty rate by 5 percentage points by 2007.
- Providing gainful and high-quality employment at least to the addition to the labor force.
- Reduction in gender gaps in literacy and wage rates by at least 50% by 2007.

Eleventh Five Year Plan 'Towards Faster and More Inclusive Growth' is the central theme of the plan that sought to lower poverty by 10%, generate 70 million new jobs, and reduce unemployment to less than 5% Eleventh Five-Year Plan promised to accelerate economic growth and make it more inclusive. The chief thrust of the plan, that will run from 2007-08 to 2011-12, will be agriculture, education and infrastructure -- all areas that remain a concern in a rapidly growing economy. As many as 27 detailed national targets were set in the plan, ranging from enhancing incomes and reducing poverty, to education, literacy, health, infant mortality, maternal mortality and child development.

Twelth Five Year Plan (2012-17) aimed to achieve annual average economic growth rate of 8 per cent. During the 11th Plan (2007-12), India recorded an average economic growth rate of 7.9 per cent. This, however, is lower than the 9 per cent targeted in 11th Plan.12th Plan aimed to achieve 4 per cent agriculture sector growth during 2012-17. The growth target for manufacturing sector was pegged at 10 per cent. It aimed to bring down the poverty ratio by 10 per cent.

Growth Performance in the Five Year Plans (per cent per annum)

	Target	Actual
1. First Plan (1951-56)	2.1	3.61
2. Second Plan (1956-61)	4.5	4.32
3. Third Plan (1961-66)	5.6	2.38
4. Fourth Plan (1969-74)	5.7	3.21
5. Fifth Plan (1974-79)	4.4	4.80
6. Sixth Plan (1980-85)	5.2	5.69
7. Seventh Plan (1985-90)	5.0	5.81
8. Eighth Plan (1992-97)	5.6	6.7
9. Ninth Plan (1997-2002)	6.5	5.35
10. Tenth Plan(2002-2007)	8%	7.8%
11. Eleventh Plan(2007-12)	9%	7.9%
12. Twelfth FYP	8%	5.1% in 2012-13; 6.9% in 2013-14; 7.2% in 2014-15: 7.6% in 2015-16; 7.1% in 2016-17

Achievements of Planning

In the last about 65 years since planning began, the National Income has increased many times. Today, India is the third largest economy in Asia with about $2.25 trillion GDP after China and Japan. By 2017, For the first time in 150 years, India surpassed its erstwhile colonial master in terms of GDP and is now the fifth largest in the world after the U.S., China, Japan and Germany. By PPP measurement, India is 3rd largest in the world. India overtook Japan to become the world's third-largest economy in purchasing power terms. India's GDP PPP Per Capita is forecast to be billion 7,773.16 $ in Mar 2018 as reported by International Monetary Fund - World Economic Outlook. It records an increase from the last reported number of 7,153.25 billion $ in Mar 2017.

The PPP system allows GDP comparisons to be made by asking how much money would be

needed to purchase the same goods and services in two countries and using that to calculate an implicit foreign exchange rate.

The Economist magazine's proprietary Big Mac Index, which takes the price of a McDonald burger across 120 countries to calculate the 'real' price of their currencies, is another crude way to measure PPP. India was included in the index recently. It showed that the Indian rupee was undervalued by more than 60% against the US dollar in 2016.

Social indicators improved though there is a long way to go- IMR, MMR, literacy, disease eradication etc. (Given elsewhere in the Notes) The industrial infrastructure is relatively strong – cement, steel, fertilizers, chemicals, etc Agricultural growth is also gaining momentum with food grains production at 274 mt in 2016-17.

Forex reserves are $400 b (October 2016) which is a dramatic turnaround from 1991 when we had one billion dollars.

The Government of India has set a target of 175 GW renewable power installed capacity by the end of 2022. This includes 60 GW from wind power, 100 GW from solar power, 10 GW from biomass power and 5 GW from small hydro power.India has emerged as a back office of the world and its prowess in software is growing.India occupies the sixth position among the world's 10 largest manufacturing countries,according to United Nations Industrial Development Organization (UNIDO) report in 2017.India's services sector, which stands at about $1.48 trillion is acknowledged globally.There has been considerable expansion of higher education. At the time of Independence there were 20 universities and 591 colleges, while today (2016) there are more than 700 universities and about 40,000 colleges.

India's literacy rate has increased six times since Independence — from 12 per cent to 74 per cent in 2011.

The failures of planning are equally clear

- As per the ***Rangarajan*** panel estimates, poverty stood at 38.2 per cent in 2009-10 and became worse at 29.5 per cent in 2011-12- (2014)
- Unemployment is high
- Regional imbalances are intensifying
- Malnutrition haunts about half the children in India.

Financial Planning

Here, physical targets are set in line with the available financial resources. Mobilization and setting expenditure pattern of financial resources is the focus in this type of planning.

Physical Planning

Here, the output targets are prioritized with inter-sect oral balance. Having set output targets, the finances are raised.

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Economic Reforms

Since July 1991, India has been taking up economic reforms to achieve higher rates of economic growth so that socio-economic problems like unemployment, poverty, shortage of essential goods and services, regional economic imbalances and so on can be successfully solved. The force behind the reforms is

- Indian economy reached a level of growth and strength to benefit from an open market economy.
- Private sector in India had come of age and was willing and capable of playing a major role
- Indian economy needed to integrate with the world with all the advantages like capital flows; technology; higher level of exports; state of art stock markets; Indian corporates can raise finances abroad and so on.

The country under the leadership of Dr. Manmohan Singh, Union Finance minister (1991-1996 and Prime Minister 2004-14) converted the economic crisis – caused by , domestic cumulative problems of economy, political instability and gulf crisis-into an opportunity to initiate and institutionalise economic reforms to open up the economy. The deep crisis in 1991 could not be solved by superficial solutions. Therefore, structural reforms were taken up.

It was realized that by closing economy to global influences, the country was missing on technology developments and also gains from global trade and investments. India needed exports, FDI and FII for stability on the balance of payments front and higher growth rates for social development. Worldwide, countries were embracing market model of growth, for example China, with proven results. So, India could make the historic shift from centralized planning to market-based model of growth.

Initially reforms were feared and resisted as there was scepticism and fear as the experience in Latin American countries in the 1980s was not a success in economic and social terms. The fears related to

- Inflation as there will be little left for domestic consumption as exports would be the focus to earn foreign exchange
- Large scale unemployment due to capital intensity of growth process to be competitive
- Worsening of poverty as fiscal concerns will reduce social sector expenditure
- Flood of imports as customs duties will come down.
- food security will suffer as social sector expenditure will be reduced
- Pressures on labour sector due to domestic industry's compulsions to cut costs

Some fears have indeed come true- jobless growth and uncertainty in farming. But by and large, reforms have done well.
Reforms mainly targeted the following areas:

- Dismantling the licence raj so that private sector and government were on a level playing field
- Drive public sector towards sustainable profitability and global play by dereservation; disinvestment; professionalization of management etc
- Fiscal reforms for stabile economic growth.
- Banking sector is deregulated and made to conform to stringent reforms for higher competitive strength and performance globally

- move towards free float of rupee and relaxation of controls on convertibility; aggressive export promotion; FDI and FII inflows etc.

Reforms were prioritized and sequenced in such a way as to make them sustainable and render further reforms feasible. For example, first generation reforms involved essentially non-legislative government initiatives- reduce SLR and CRR for the banking sector. Disinvestment of the PSEs. Deregulation of the rupee gradually and later make exchange rate of the rupee market-driven and so on. The second generation reforms involve legislative reforms and touch a wider section of the society- labour reforms; GST, FDI expansion etc. The former prepares the economy for the latter.

Above all, reforms with human face was the goal, unlike elsewhere in the world like in South America in the 1980's. It yielded results- the social effect of the reforms in India is seen in the flagship schemes making an impact on health, education, social protection etc. The reforms gained consensus and showed positive results as can be seen below.

- Rates of growth went up
- BOP crisis has been solved in the first few years and today the country has about $ 400 b forex reserves (2017 October)
- Services sector (tertiary sector) has grown in importance and today contributes almost 60% of GDP (2017) emerging as a global player-India being the global back office.
- Resilience of the economy in the face of Great Recession
- Consumer choice has increased
- Tax-GDP ratio may have shrunk but the tax collections and base increased
- Nature of external debt has changed and the short term component is less
- Indian companies are listed on Nasdaq and New York Stock Exchange and raised billions of dollars for investment
- FIIs and FDI picked up.
- Indian corporates have acquired global majors like Jaguar and Anglo-Dutch steel maker Corus; Bharati bought Zain's African telecom operations.

While the above facts paint a positive picture of reforms, there are deficiencies as well

- poverty is a challenge and reforms with a human face is the need of the hour
- jobless growth is worrying the policy makers
- regional economic imbalances are intensifying
- While foodgrains production is at 274mt(2017), there is still pressure on food security
- farmers are feeling directionless under the WTO regime
- Globalization threatens to destabilize agriculture with cheaper imports and questionable provisions related to intellectual property rights impacting negatively on availability of medicines etc.
- Infrastructure so far received inadequate attention except telecom ,roads and ports
- PSU reforms have not made progress and disinvestment and privatization are still to see substantial movement

Second Generation Reforms

Having begun with the reforms in all the above sectors and seen the economy benefit from them, the second generation reforms were initiated by the end of 1990's. The reason for calling the latter set of reforms SGR is that they followed the initial reforms which laid the foundation for the reform process to deepen. It is a matter of sequencing in line with prioritization; economic preparation; consensus-building and so on. In fact, unless the success in material and human terms of the initial reforms was demonstrated, the next round of 'difficult' reforms would not be possible.

Second generation reforms - labour law flexibility, pension reforms based on employee contribution and the pension funds being deployed in the stock market; GST; liberalized FDI including FDI in retail etc - touch on the lives of ordinary people and need successes in other sectors- first generation reforms- to make a convincing case. Otherwise, they may not be allowed by public opinion as we have seen in the case of FDI-Multibrand retail(Walmart etc) debate.

Second generation reforms are difficult as they are directly involved with the daily lives of people like

- User charges need to be rationalized to make these utilities viable but there are bound to be protests
- Man power rationalization in banks and PSUs through VRS faced resistance.
- Labour law flexibility will make TUs agitate.
- Interst rate cut, for example, for small savings will mean less returns for the middle class etc
- Agro reforms may mean small and marginal farmers' resistance

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However, unless the SGRs are carried out, investment and growth will suffer with long term adverse consequences for poverty alleviation and employment generation. As the long term benefits of the reforms are bound to show in terms of higher growth rates and more social welfare, consensus needs to be built for successful legislation and implementation of SGRs. Labour laws being reformed in 2014 under the Modi government are an example of 2nd generation reforms. Deregulation of petrol and diesel prices and introduction of dynamic pricing (2014-17); LPG subsidy reforms in 2016 etc.

12 FYP-Related

India@75

It is a path breaking initiative. It envisions how India should be in her 75th year of independence and seeks to bring together all stakeholders including the industry, government, institutions, community groups and individuals to translate the vision into a reality.Prof (Late) C.K.Prahalad has been the inspiration behind India@75. While commemorating the 60th year of India's independence, in 2007 he articulated the idea of holistic three dimensional development of India to acquire enough economic strength, technological vitality and moral leadership by 75 years of independence. CII adopted his vision in 2008.The concept was adopted by CII to bring together all stakeholders, including the industry, government, institutions, community groups and individuals to translate the vision into reality.

IBIN

- Planning Commission jointly with India@75 foundation launched in 2013, its unique initiative- India Backbone Implementation Network (IBIN) to remove bottlenecks for improving implementation of policies. "The IBIN, structurally an organisation, is essentially a process that will promote widespread capabilities in the country to systematically convert confusion to coordination, contention to collaboration, and intentions to implementation," an official statement says. IBIN aims to seed new techniques into the service delivery system; build a network of partners to create capability to manage effective stakeholder dialogues, resolve dispute and conduct policy impact analysis.

It will also build a knowledge base of tools, techniques and examples to systematically analyse situations or challenges and proactively create solutions.

IBIN is the model of a process for rapidly improving a nation's capabilities to get things done systematically and democratically s in the Total Quality Movement (TQM) in Japan. In less than two decades, Japan, that had a reputation for poor quality and low-cost products, became the international benchmark of quality in many industries and several of its public services too. The essence of the TQM movement was the deployment, at several levels in many organisations: especially the 'shopfloor' levels, but higher levels also, even to top management, of simple techniques for systems thinking, cooperative action and continuous improvement. These techniques were developed by experts in companies and universities and disseminated in the country through industry and other institutional networks, and through radio, pamphlets, competitions and other means of connecting with the public.

The 'movement' grew as a network: it was not a centrally-managed government programme. There was a principal node in the network: a non-governmental body, the Japanese Union of Scientists and Engineers (Juse), in which many persons from industry and academia, and also government participated to provide a facilitative leadership to the movement.The architecture of IBIN is along similar lines as the TQM movement of Japan. Experience of other countries, such as South Korea and, more recently, Malaysia, which have systematically improved capabilities of coordination and implementation, has also been considered while developing IBIN to fit India's conditions.

NITI Aayog

In 2015, Government of India set up the NITI Aayog or National Institution for Transforming India Aayog with modified functions in comparison to its predecessor Planning Commission. The reasons were that the nature of economy changed towards a market-dominated system and that the rights of states were to be given greater consideration for which a new structure and dynamic was required. Planning Commission is largely portrayed as overriding the sensitivities and priorities of states and thus was not respectful of federalism. Niti Aayog is a policy think-tank of Union Government of India that aims to involve the states in economic and development policy making in India. It provides strategic and technical advice to the government. Prime Minister of India heads the Aayog as its chairperson.

In Hindi, NITI means Policy, and Ayog means Commission."India is a diversified country and its states are in various phases of economic development along with their own strengths and weaknesses. In this context, a 'one size fits all' approach to economic planning is obsolete. It cannot make India competitive in today's global economy"

The NITI Aayog comprises the following:

1. Prime Minister of India as the Chairperson
2. Governing Council comprising the Chief Ministers of all the States /UTs and Lieutenant Governors of Union Territories
3. Regional Councils may be formed to address specific issues and contingencies impacting more than one state or a region. These are formed for a specified tenure. The Regional Councils will be convened by the Prime Minister and will comprise of the Chief Ministers of States and Lt. Governors of Union Territories in the region. These will be chaired by the Chairperson of the NITI Aayog or his nominee
4. Experts, specialists and practitioners with relevant domain knowledge as special invitees nominated by the Prime Minister
5. Full-time organizational framework comprises of
   - Vice-Chairperson
   - Members: four Full-time
   - Part-time members: Maximum of two from leading universities research organizations and other relevant institutions in an ex-officio capacity. Part-time members will be on a rotational basis
   - Ex Officio members: Maximum of four members of the Union Council of Ministers to be nominated by the Prime Minister
   - Chief Executive Officer: To be appointed by the Prime Minister for a fixed tenure
   - Secretariat as deemed necessary

Aim's and Objectives of NITI Ayog

NITI Aayog provides a critical directional and strategic input into the development process. It is a "think-tank" that will provide Governments at the central and state levels with relevant strategic and technical advice across the spectrum of key elements of policy such as Make in India, Digital India and Swachh Bharat.

It will foster better Inter-Ministry coordination and better Centre-State coordination. It will help evolve a shared vision of national development priorities, and foster cooperative federalism, recognizing that strong states make a strong nation.

The NITI Aayog will develop mechanisms to formulate credible plans at the village level and aggregate these progressively at higher levels of government- bottom up approach to development. It will ensure inclusive economic growth.

The NITI Aayog will create a knowledge, innovation and entrepreneurial support system through a collaborative community of national and international experts, practitioners and partners.

NITI Aayog will monitor and evaluate the implementation of programmes and focus on technology upgradation and capacity building.

Through the above, the NITI Aayog will aim to accomplish the following objectives and opportunities:

- An administration paradigm in which the Government is an "enabler" rather than a "provider of first and last resort."

- Progress from "food security" to focus on a mix of agricultural production, as well as actual returns that farmers get from their produce..
- Ensure that the economically vibrant middle-class remains engaged, and its potential is fully realized.
- Leverage India's pool of entrepreneurial, scientific and intellectual human capital.
- Incorporate the significant geo-economic and geo-political strength of the Non-Resident Indian Community.
- Use urbanization as an opportunity to create a wholesome and secure habitat through the use of modern technology.
- Use technology to reduce opacity and potential for misadventures in governance.
- Leveraging of India's demographic dividend, and realization of the potential of youth, men and women, through education, skill development, elimination of gender bias, and employment
- Elimination of poverty, and the chance for every Indian to live a life of dignity and self-respect
- Reddressal of inequalities based on gender bias, caste and economic disparities
- Integrate villages institutionally into the development process
- Policy support to more than 50 million small businesses, which are a major source of employment creation
- Safeguarding of our environmental and ecological assets

NITI Aayog vs Planning Commission

1. Planning Commission had allocative functions – recommending plan financial transfers; centrally sponsored schemes etc. Niti Aayog does not have such function
2. Planning Commission had many more members and all were full time members.
3. Planning Commission was directed by the National Development Council to flesh out the FYPs. Niti Aayog on the other hand has both the political wing composed Union Ministers and Chief Ministers as well as the think tank wing in a single body.
4. Niti Aayog has provision of regional councils that Planning Commission did not have.
5. In the NITI Aayog, State governments play a more significant role through Governing Council than they did in the Planning Commission.Planning Commission - States' role was limited to the National Development Council and annual interaction during Plan meetings

Critical Appraisal

The government's move to replace the Planning Commission with a new institution called 'NITI Aayog' is open to criticism that it is only a nomenclatural change. However, the new body also does contribute to cooperative federalism. Former Planning Commission member Arun Maira." The idea to create an institution where states' leaders will be part and parcel of the collective thinking with the Centre and other stakeholders in formulating a vision for the development of the country is right on as compared with the previous structure, where a handful of people formulated the vision and then presented it to the National Development Council (NDC). This was not entirely absorbed and adopted by the latter."

One important change introduced is to resize and restructure. From 1,250 positions, a downsizing was done to about 500 employees in the institution. There has also been a restructuring within the institution dividing the staff into two hubs—one is the Knowledge and Innovation hub, and the other is called the Team India hub. Team India hub largely interfaces with states because cooperative competitive federalism is one of our important mandates. Knowledge and Innovation hub is going has about 12-14 verticals which will deal with different sectors. It also adopted a different approach in its relationship with states. The relationship under the previous institution (Planning Commission) wasunequal, because the institution gave plan assistance to states and became the 'giver' and states became the 'recipients' of the money. This made the relationship unequal. Now, Niti tried to have a more equal relationship.

There is a very good example of the equality in the relationship (between NITI Aayog and states). In 2015, three sub- groups of chief ministers were set up for making recommendations in three important areas (centrally-sponsored schemes, skill development and Swachh Bharat). The sub-group on centrally-sponsored schemes was asked to study 66 centrally-sponsored schemes and recommend which ones to continue, which to transfer to states, and which to cut down.

NITI Aayog will monitor, coordinate and ensure implementation of the globally accepted Sustainable Development Goals. It is nominated as the nodal body that will bring the 17 development goals into action across India. The SDGs are aimed at eradicating all forms of poverty.

NITI's Achievements By 2017

Vision Document, Strategy & Action Agenda beyond 12th Five Year Plan: Replacing the Five Year Plans beyond 31st March, 2017, NITI Aayog prepared the 15-year vision document keeping in view the social goals set and/ or proposed for a period of 15 years; A 7-year strategy document spanning 2017-18 to 2023-24 to convert the longer-term vision into implementable policy and action as a part of a "National Development Agenda". The 3-year Action Agenda for 2017-18 to 2019-20 is aligned to the predictability of financial resources during the 14th Finance Commission Award period.

I. Reforms in Agriculture:

- **Model Land Leasing Law**
  Taking note of suboptimal use of land with lesser number of cultivators, NITI Aayog has formulated a Model Agricultural Land Leasing Act, 2016 to both recognize the rights of the tenant and safeguard interest of landowners. A dedicated cell for land reforms was also set up in NITI. Based on the model law, Madhya Pradesh has enacted separate land leasing law and Uttar Pradesh and Uttarakhand have modified their land leasing laws. Some States, including Odisha, Andhra Pradesh and Telangana, are already at an advance stage of formulating legislations to enact their land leasing laws for agriculture.

- **Reforms of the Agricultural Produce Marketing Committee (APMC) Act**
  NITI Aayog consulted States on critical reforms –

  i) Agricultural marketing reforms
  ii) Agricultural land leasing

  Subsequently, Model APMC Act version 2 prepared. States are being consulted to adopt APMC Act version 2.

- **Agricultural Marketing and Farmer Friendly Reforms Index**
  NITI Aayog has developed the first ever 'Agriculture Marketing and Farmer Friendly Reforms Index' to sensitise states about the need to undertake reforms in the three key areas of Agriculture Market Reforms, Land Lease Reforms and Forestry on Private Land (Felling and Transit of Trees). The index carries a score with a minimum value "0" implying no reforms and maximum value "100" implying complete reforms in the selected areas.

  As per NITI Aayog's index, Maharashtra ranks highest in implementation of various agricultural reforms. The State has implemented most of the marketing reforms and offers the best environment for undertaking agri-business among all the States and UTs. Gujarat ranks second with a score of 71.50 out of 100, closely followed by Rajasthan and Madhya Pradesh. Almost two third States have not been able to reach even the halfway mark of reforms score, in the year 2016-17. The index aims to induce a healthy competition between States and percolate best practices in implementing farmer-friendly reforms.

II. Reforming Medical Education

A committee chaired by Vice Chairman, NITI Aayog recommended scrapping of the Medical Council of Indi and suggested a new body for regulating medical education. The draft legislation for the proposed National Medical Commission has been submitted to the Government for further necessary action.

III. Digital Payments Movement

- An action plan on advocacy, awareness and co-ordination of handholding efforts among general public, micro enterprises and other stakeholders was prepared. Appropriate literature in print and multimedia was prepared on the subject for widespread dissemination. Presentations/interactions were organized by NITI Aayog for training and capacity building of various Ministries/Departments of Government of India, representatives of State/UTs, Trade and Industry Bodies as well as all other stakeholders.

- NITI Aayog also constituted a Committee of Chief Ministers on Digital Payments in November 2016 with the Chief Minister of Andhra Pradesh, Chandrababu Naidu, as the Convener to promote transparency, financial inclusion and a healthy financial ecosystem nationwide. The Committee submitted its interim report to Prime Minister in 2017.

- Niti Aayog also launched two incentive schemes to promote digital payments across all sections of society - the Lucky Grahak Yojana and the Digi Dhan Vyapar Yojana.

- Digi Dhan Melas were also held for 100 days in 100 cities.

IV. Atal Innovation Mission

The Government has set up Atal Innovation Mission (AIM) in NITI Aayog with a view to strengthen the country's innovation and entrepreneurship ecosystem by creating institutions and programs that spur innovation in schools, colleges, and entrepreneurs in general. In 2016-17, the following major schemes were rolled out:

- Atal Tinkering Labs (ATLs): To foster creativity and scientific temper in students, AIM is helping to establish 500 ATLs in schools across India, where students can design and make small prototypes to solve challenges they see around them, using rapid prototyping technologies that have emerged in recent years.

- Atal Incubation Centres (AICs): AIM will provide financial support of Rs.10 crore and capacity buidling for setting AICs across India, which will help startups expand quicker and enable innovation-entrepreneurship, in core sectors such as manufacturing, transport, energy, education, agriculture, water and sanitation, etc.

V. Indices Measuring States' Performance in Health, Education and Water Management

As part of the Prime Minister's Focus on outcomes, NITI has come out with indices to measure incremental annual outcomes in critical social sectors like health, education and water with a view to nudge the states into competing with each other for better outcomes, while at the same time sharing best practices & innovations to help each other - an example of competitive and cooperative federalism.

VI. Sub-Group of Chief Ministers on Rationalization of Centrally Sponsored Schemes

Based on the recommendations of this Sub-Group, a Cabinet note was prepared by NITI Aayog which was approved by the Cabinet on 3rd August, 2016. Among several key decision, the sub-group led to the rationalization of the existing CSSs into 28 umbrella schemes.

VII. Sub-Group of Chief Ministers on Swachh Bharat Abhiyan

Constituted by NITI Aayog on 9th March, 2015, the Sub-Group has submitted its report to the Hon'ble Prime Minister in October, 2015 and most of its recommendations have been accepted.

VIII. Sub-Group of Chief Ministers on Skill Development

Constituted on 9th March, 2015, the report of the Sub-Group of Chief Ministers on Skill Development was presented before the Hon'ble Prime Minister on 31/12/2015. The recommendation and actionable points emerging from the Report were approved by the Hon'ble Prime Minister and are in implementation by the Ministry of Skill Development.

IX. Task Force on Elimination of Poverty in India

Constituted in 2015 under the Chairmanship of Dr. Arvind Panagariya, Vice Chairman, NITI Aayog, the report of the Task Force was finalized and submitted to the Prime Minister on 11th July, 2016.The report of the Task Force primarily focusses on issues of measurement of poverty and strategies to combat poverty. It is recommended that an expert committee be set up to arrive at an informed decision on the level at which the poverty line should be set." With respect to strategies to combat poverty, the Task Force has made recommendations on faster poverty reduction through employment intensive sustained rapid growth and effective implementation of anti-poverty programs.

X. Task Force on Agriculture Development

The Task Force on Agricultural development was constituted in 2015 under the Chairmanship of Dr. Arvind Panagariya, Vice Chairman, NITI Aayog. The Task Force based on its works prepared an occasional paper entitled "Raising Agricultural Productivity and Making Farming Remunerative for Farmers" focusing on 5 critical areas of Indian Agriculture. These are (i) Raising Productivity, (ii) Remunerative Prices to Farmers, (iii) Land Leasing, Land Records & Land Titles; (iv) Second Green Revolution-Focus on Eastern States; and (v) Responding to Farmers' Distress. After taking inputs of all the

States on occasional paper and through their reports, the Task Force submitted the final report to Prime Minister in 2016. It has suggested important policy measures to bring in reforms in agriculture for the welfare of the farmers as well as enhancing their income.

National Development Agenda

NITI Aayog's third Governing Council meet held earlier in 2017 saw the Prime Minister presenting National Development Agenda.

The National Development Agenda includes:

- Vision: A 15-year-long vision between 2017-18 to 2031-32 that combines national goals with international sustainable goals.
- Strategy: A 5-year long plan between 2017-18 to 2023-24 to convert broader vision into implementable policy.
- Action Plan: A three year short-term action plan between 2017-18 to 2019-2020 to translate policies into action by 2019.

The National Development Agenda aims at good governance and best practices in sustainable and equitable development.It offers a resolution method for inter-sector and inter-departmental issues in order to accelerate the implementation of the development agenda.

There are over 300 specific action points that had been identified, covering the whole gamut of sectors. The period of action agenda coincides with the period of the 14th Finance Commission's award.

India And The Manufacturing Sector

India's development experience with planning in the 1950's had a foundational approach to manufacturing. The Nehru-Mahalanobis model (2nd FYP) is premised on capital goods industry and self-reliance. India had the manpower. Technical institutes were set up and higher education received its due. R&D was focused upon to feed into manufacturing through better technology. Howeve, the momentum could not be sustained as we did not have the land resources necessary; R&R policy could not be implemented satisfactorily and thus land acquisition was difficult in a democracy; domestic private sector investment was scarce; we did not open upto FDI and thus competition suffered as did productivity. Lack of an outward looking policy dented on our competitiveness. By the nineties, China already was becoming an global industrial powerhouse. Since then, the following factors acted as deterrents to India's manufacturing drive.

1. Infrastructure bottlenecks – power, roads, telecom etc.
2. from the last decade, Chinese imports did not allow local manufacturing and in fact led to de-industrialisation in India whether solar cells, tyres, steel, electronic items etc.
3. reservation for the MSMEs and favourable terms to them led to the moral hazard- they developed a vested interest in not scaling up
4. labour laws were made to protect labour that was already working. They could not be retrenched and thus companies preferred capital intensity as there was no liberal "exit policy"
5. India did not spend on R&D for product development.
6. Lack of ease of doing business also hampered investment and industrial growth.
7. In the last two decades, services sector emerged as a globally strong force and it seemed that we could skip the secondary sector and focus on becoming a global back office.

Services sector –led growth in India: Certain dimensions

The services sector is the dominant sector in India's GDP. There is more FDI into services sector than manufacturing. Service exports are making up for merchandise trade deficit. However, India's economic growth path has been markedly different.

In today's developed economies, manufacturing led the growth process in early stages of development. After agriculture matured, services took over the lead role only after a fairly high level of industrial development had been reached. The same pattern was also observed in the East Asian "tiger" economies and in China.

Like many other developing countries, India's economic growth has not conformed to this classical historical pattern of agriculture to industry to services. We opted to promote services sector in preference to manufacturing as we saw global opportunity in it as also because our land resources did not allows us to go for large scale manufacturing- witness the friction in setting up the special economic zones. India differs from China in this regard as well as the fact that China is authoritarian and the government held all the land. Suiting India, the world offered historic opportunities by way of digitization and globalization.

In the 1990's certain government policies favoured services and disadvantaged manufacturing. Compared to manufacturing, services have been lightly taxed and taxing began only in 1994. Rise in per capita income also had a significant effect on the demand for better services in the country- education, health, transport, finance, advertising, telecom, insurance etc.

Inadequate attention to development of physical infrastructure constrained manufacturing more than services. And since the reforms of the early 1990s, trade and foreign investment for services have been more liberal than those for manufacturing. The digital push to economic growth made globalization inevitable and irreversible and raised prospects for service sector growth in India.

Services contribute more than manufacturing to India's "output growth, productivity growth and job growth."

Earlier there were fears that services sector could not sustain an economy but in three critical areas there is parity or even superiority established by the services sector- trade-ability, transport-ability and scal-ability. Thanks to digital technologies connecting the world seamlessly.

About the sustainability of service sector led growth in India, Ejaz Ghani, World Bank economist and a service sector evangelist for India's rapid economic growth, says: "The digital revolution, by lowering transaction costs in services and overcoming problems of asymmetric information, has made services more dynamic than in the past. The emergence of e-commerce platforms is an example of how digital revolution can lower transaction costs, increase productivity as well as make it more inclusive. For many internet-based businesses or services, fixed up-front costs can be high initially, but once the physical infrastructure is in place, each additional customer, user, or transaction incurs very little extra cost.There is mounting empirical evidence that developing countries are relying more on services and less on manufacturing as drivers of growth and job creation .Globalization of services is the tip of the iceberg. Services, which account for more than 70% of global output, are still in their infancy. The long-held view that services are non-transportable, non-tradable, and non-scalable no longer holds for a host of services that can be digitized.The globalization of services provides new opportunities for India to find niches beyond manufacturing, where it can specialize, scale up, and achieve high growth. As the services produced and traded across the world expand with globalization, the possibilities to develop based on services will continue to expand. This pace of change will be rapid in line with the digital revolution. Global internet usage has grown. But this growth is much faster in developing countries. India alone adds one million new users every month to a booming mobile phone market.

Ghani's Prescriptions: Investments in both physical and human infrastructure matter greatly for attracting new enterprises in both manufacturing and service industries. But unlike in the manufacturing sector, investments in human infrastructure, education and skills, matter much more. Given its stage of development, India needs accelerated investments in both physical and human infrastructure to support new drivers of growth and job creation.

Some policy experts have rightly argued that India is on the "brink" of a techno-institutional revolution. Take the example of mobile technology and examine its role in banking. Banking is currently concentrated in the urban areas, but cities are saturated with bank branches. On the other hand, 300 million rural people across 300 districts in India have no access to banking. Expansion of digital technology can play a big role in improving rural access to banking. Financial inclusion can be achieved through last-mile connectivity. Payments Banks since 2016 have been helping in the process. India Post Payments Bank is likely to revolutionalise financial inclusion even more. That in turn could help medium-size cities, small towns and villages to become new drivers of growth. Digital India, Jan Dhan, Skill India, Payments Banks are some examples.

Services Sector Growth And Jobs In India

Three basic groups of services can be defined: traditional services which include "wholesale and retail trade, "hotels and restaurants" and "transport and storage"; modern services which include "communication" (a category that includes telecom services), "financial services" and "real estate-renting-business services" (a category that includes software services); and social services which include "public administration and defence" and "community, social and personal services". The traditional and the social services are non-tradable while the modern services are internationally tradable. The traditional and the modern services are mostly in the private sector while the social services are mostly in the public sector.

Services stand out in many important ways. Some generalities need to be noted to begin with. Services are of three types: traditional, modern and social services. "Modern services"—banking and insurance, education, computer related services, research and development, health, communication, legal services and accounting—together account for about 16% of GDP. Modern and social services are produced in the organised sector and mainly by formal employees. Traditional services are essentially produced in the unorganised sector and mainly by self-employed workers and employ generally low-skilled workers while modern and social services employ high-skilled workers. Labour productivity in traditional services is much lower than that in modern services. In 2010, modern services accounted for less than 11 per cent of total services employment and 38 per cent of services output, while traditional services accounted for 58 per cent of services employment and 40 per cent of services output. Thus, modern services productivity is higher.

SRIRAM'S IAS

Overall, services provide better-quality employment and more high skilled workers in comparison to manufacturing. It helps in formalisation of employment with all the benefits to employees.

New Delhi

As can be inferred from above, there is a wide gap between what the services sector contributes to the economy and its employment.For India, the share of the services sector in GDP is 53.2%, while its share of total employment is much less, at 28.6%.

Construction sector is in the secondary sector in the classification of components of economy by the CSO in the national income calculations.

A common misperception has to be corrected. India's services-led growth has not been "jobless". It has created not only large number of jobs but also high quality, formal, highly skilled jobs. Real wages of both regular-formal and casual employees have also increased though the former have gained much more than the latter.

Manufacturing is far less job-intensive and creates low-skilled jobs unlike the services-led growth. Experts on the basis of the above evidence say that manufacturing-led growth could be used to shift labour out of agriculture and thus reduce underemployment and povertyand the rise in income inequality.

1990s, saw a combination of factors driving services sector growth domestically and globally raising hopes that it can more than substitute for the manufacturing led growth. Digital technology grew at exponential speed and services sector was the biggest beneficiary particularly for India with its higher education advantages. It automatically led to growth in financial services, telecom, retail and spread to transportation, travel, tourism, media, health services and so on as government policies favoured and the percapita incomes rose. Technology facilitated new ways of doing

business via increasing computing power, data storage capacity and data transmission capacity. Telecom connectivity has grown at a rapid pace Farmers who were earlier dependent on middlemen, now have better information on pricing. The organised retail sector has brought in efficiency in the supply chain. We are now seeing the rapid growth of e-commerce and online retail stores.The automobile industry is a key contributor as the rise in sales of personal vehicles has created a multiplier effect on support services required after sales.

Transportation and logistics services grew rapidly as demand for goods grew across the country. Service sector not only creates direct output and direct employment, but also the ancillary services and employment generation. For every job created in the IT and IT enabled services sector, four jobs are created elsewhere.

India's current per capita income is about $1,800 (India in 2017) and has enormous implications for savings growth, consumption demand and the ability to be a sustainable driver for the demand in services. Travel sector is seeing growth as air and road travel grow, in turn leading to a growth in demand for tourism and hotels. It is aided by initiatives like "Paryatan Parv organized by Ministry of Tourism in collaboration with other Central Ministries and State Governments across the country in October 2017.

Similarly other sectors like media, entertainment, health care and education all benefited with increased aspirations of the retail consumer.

Technology continues to drive innovation and creation of new smart business models which are based on leveraging digitisation, mobility and social media. Given these factors, coupled with our demographic dividend and the expected jump to a higher trajectory for both growth and per capita GDP, we have the right conditions for a virtuous cycle to sustain for many years that will have a GOI wants services sector boosted and so has many incentives in wide variety of sectors such as health care, tourism, education, engineering, communications, transportation, information technology, banking, finance, management, among others.

India signed Comprehensive Economic Partnership Agreement (CECA) with Malaysia and Singapore and Comprehensive Economic Cooperation Agreement (CEPA) with Japan and South Korea. Both have a service component.

After the trade facilitation agreement (TFA) in goods under the World Trade Organization (WTO) came into force in 2017, India submitted the draft legal text at the multilateral body for a similar agreement in services which is expected to help in the smooth movement of professionals.The implementation of the Goods and Services Tax (GST) would create a common national market and reduce the overall tax burden on goods. It is expected to reduce costs in the long run on account of availability of GST input credit, which will result in the reduction in prices of services.

India-ASEAN free trade *agreement* (FTA) in *services* and investments *came into force* from 2015 in countries which have ratified it.

FISCAL SYSTEM

Fiscal Policy Definitions

- That part of government policy which is concerned with raising revenue through taxation and with deciding on the amounts and purposes of government spending.
- The government's policy in regard to taxation and spending programs. The balance between these two areas determines the amount of money the government will withdraw from or feed into the economy, which can counter economic peaks and slumps.
- Government spending policies that influence macroeconomic conditions. These policies affect tax rates and government spending, in an effort to control the economy.
- Government policy for dealing with the budget-especially with taxation and borrowing
- The policy of a government in controlling its own expenditures and taxation, which together make up the budget
- Fiscal policy is the means by which a government adjusts its levels of revenue and spending in order to monitor and influence a nation's economy

Fiscal policy involves use of taxation and government spending to influence economy. In other words, fiscal policy relates to raising and spending money in quantitative and qualitative terms.

As far as fiscal receipts are concerned, taxes, user charges (power, water, transport charges etc.); disinvestment proceeds; borrowings from internal and external sources are the main channels. All receipts are not earned and some are borrowed. Receipts and expenditure are divided into revenue and capital accounts. Expenditure is also shown as Plan and Non-plan items.

Fiscal policy deals not only with the quantity but the quality of public finance as well. In other words, not merely how much is raised and spent but how has it been raised- is it raised by way of taxes or borrowings; are they excessive or irrational etc. Also, the way the finances so raised are used- wastefully or productively. How much is spent on plan heads and how much populistically targeted etc also is studied.

Fiscal policy can achieve important public policy goals like growth; equity; promotion of small scale industries; encouragement to agriculture; location of industries in rural areas; labour - intensive growth; export promotion; development of sound social and physical infrastructure etc.

Art.112 of the Constitution mandates that expenditure be shown in revenue and other categories.

Non-Plan expenditure is not a Constitutional term but is in use to emphasize on the point that government spends financial resources for consumption (maintenance) as well as asset creation. It includes expenditure on interest payments; defense; subsidies; and public administration.

A break up of the finances into revenue and capital streams, in general, is as follows:

- Revenue receipts are recurrent receipts. Revenue account includes the following receipts: taxes and non-tax sources. Taxes are income tax , corporation tax, excise duty, customs duty etc; non tax resources include user charges ;interest receipts; dividends; profits etc

- Revenue account expenditure is essentially the non-plan expenditure that does not create assets, that is, - interest payments, defence; subsidies and public administration. It is synonymous with maintenance and consumption expenditure as also welfare expenditure.
- Capital account receipts are recoveries of loans and advances made by the Union Government to States, UTS and PSUs; fresh borrowings from inside the country and from abroad; disinvestment proceeds etc. As is clear from above, some of them are debt and some are non-debt.
- Capital account expenditure is loans made to States, UTs and PSUs; expenditure for asset creation in infrastructure and social areas; loans repaid etc.

Definitions of Deficits

Revenue deficit is the difference between the revenue receipts on tax and non-tax sides and the revenue expenditure. Revenue expenditure is conventionally considered synonymous with consumption and non-development, in general. But in the case of India, the social sector expenditure like on education, labour welfare, health, contributions to agriculture, social security etc on government – flag ship schemes are in the revenue expenditure. When revenue deficit is zero, we can fund for consumption from government's own resources and not borrowing.

ERD

An additional fiscal indicator, namely, effective revenue deficit, was introduced in the FRBM Act by the Finance Act, 2012. Effective revenue deficit has been defined as the difference between "the revenue deficit and the grants for creation of capital assets".

Grants for creation of capital assets are defined as "the grants-in-aid given by the Central Government to the State Governments, constitutional authorities or bodies, autonomous bodies and other scheme implementing agencies for creation of capital assets". The amendment seeks to eliminate effective revenue deficit by 2015 which was later postponed to 2018 March.

The government is committed to reduce the effective revenue deficit to 0.7 per cent in 2017-18 and take it to 0.2 per cent by 2019-20

The 14th Finance Commission suggested the government scrap this concept because the Constitution has provisions only for revenue and capital expenditures."Under the Constitution, there are only two categories of expenditure — the one on the revenue account and that broadly expressed as capital expenditure. Artificially carving out revenue account deficit into effective revenue deficit... leads to an accounting problem and raises the moral hazard issue of creative budgeting," the Commission had said.

Fiscal deficit is the difference between what the government earns and its total expenditure. That is, the difference between what is received by the government on revenue account and all the non-debt creating capital receipts like recovered loans and disinvestment proceeds ; and the total expenditure. It amounts to all borrowings of the government in a given period. It is targeted at 3.2% of GDP in 2017-18 compared with 3.5% in the previous year.

FD = Total expenditure of the Government in a budget minus (Revenue receipts + non-debt creating capital receipts).

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Difference between Gross FD and Net FD. The Central government makes capital disbursements as loans to the different segments of the economy. In the developing countries, a large part goes as loans to other sectors-States and local Governments, public sector enterprises and the like. Net fiscal deficit can be arrived at by deducting net domestic lending from gross fiscal deficit.

Budget deficit considers only the difference between the total budgeted receipts and the expenditure, the amount that was printed by RBI and supplied to the GOI as credit It was abolished in 1997.

Fiscal Deficit mirrors the health of government finances most accurately unlike the budget deficit concept. BD does not cover all borrowings but only that portion of the borrowings for which government relies on printing money by the RBI

Monetised deficit is the borrowings made from the RBI through printing fresh currency. It is resorted to when the government can not borrow from the market (banks and financial institutions like LIC etc.) any longer due to pressure on interest rates or for reasons like fresh money injection into the economy is necessary to push growth up. It means infusion of fresh currency into the market. It corresponds to the budget deficit that is discarded as a concept since 1997. It is discontinued from 2006 as a part of the FRBM 2003.

Primary deficit is the difference between the fiscal deficit and the interest payments. The concept helps in assessing the progress of the government in its fiscal control efforts.

Deficit Financing

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Deficit Financing is the phrase used to describe the financing of gap between Government receipts and expenditure. Such gap is called budgetary deficit. It is financed by printing fresh money by the RBI. The gap can be genuine as the Government wants to spend on welfare and infrastructure for which it has no money and so borrows from the RBI; or due to bad finances of the government; or mainly for consumption and populism.

When the Government has to spend more than what it can raise through tax, non-tax and other sources, it borrows from the market. It can not borrow above a certain amount from the market as it may be inflationary; push up interest rates and thus make it even more costly for the government to service the loan which also tilts the balance away from capital expenditure; and crowd out private investment. Then Reserve Bank of India prints money and supplies credit though at a cost and not free. In other words, when the resources from taxes, user charges, public sector enterprises, public borrowings, small scale borrowings and others are not enough, RBI prints and gives to the Government. It is called deficit financing.

The money printed by the RBI is called high powered money or reserve money or monetary base.

The concept of budget deficit was dropped from 1997 budget and as a result deficit financing also was stopped in that limited sense. That is, as a concept both were discontinued as the two were two sides of the same coin- budget deficit is monetized through deficit financing. In fact, FRBM disallows RBI printing money to finance government deficit in normal conditions.

The beneficial contribution of deficit financing to India's economic planning and development is manifold. First, in the early 1950s, our domestic savings ratio was less than 9 per cent of GDP, and 'at constrained the investment and welfare activity of the government.

Second, the capacity to raise non-inflationary sources of financing (taxes, small savings, genuine public borrowings, etc.) was highly limited.

Third, external aid could supplement domestic funding only to a limited extent. It is better to source debt from inside than outside.

Fourthly, foreign direct investment was discouraged as a source of investment and thus scarcity of investment resulted. Therefore, government borrowing became necessary through monetization.

There are two views on the matter. There are some people who regard deficit financing as essential for the purposes of development and welfare; as a healthy means of stimulating economy. There are those who regard any deficit financing as inflationary and a serious threat to the stability of the economy.

On balance it may be said that, if deficit financing is done prudently and the borrowed money is used well, it is healthy. However, if the borrowed money is wasted for maintenance, is it against good economics as it can negatively affect money supply and inflation; and also dampen growth.

The viability and desirability of deficit financing, in short, depends on

- Extent of borrowing
- End use of the money borrowed.

How Much of Fiscal Deficit Is Right?

Fiscal deficit is bridged by market borrowings and central bank printing fresh currency (monetization), if necessary. To a limited extent, FD is important as the Government's ability to help growth and welfare increases. Government can always return the loans when its revenues improve due to tax buoyancy. However, FD becomes problematic and even destabilizing when it overshoots a rational threshold. Sovereign debt crisis in Greece and the fiscal woes of USA are the result of unsustainably high debt and borrowing.

Therefore, moderation of fiscal deficit is important. Large and persistent fiscal deficits are a cause of concern, as they pose several risks. Fiscal deficits may cause macroeconomic instability by inflating the economy as money supply rises.

Corporate sector is crowded out – they are left with inadequate funds in the markets as the government borrowing requirements increase. Added to that, interest rates will be high as there is pressure on the available money in the market. If the funding route is through RBI monetization, it means inflation and instability. Inflation may mean less savings, less investment and eventually it hurts the sustainability of high growth.

Large deficits, even if they do not spill over into macroeconomic instability in the short run, will require higher taxes in the long term to cover the heavy burden of internal debt. It means, as the FRBM Act says , inter-generational parity is hurt if debt mounts as future generations will have to pay higher taxes to help the government repay the debt.

Government liabilities- interest payments- increase and there is far less for development.

BOP pressures may mount if inflows drop due to the country being downgraded by rating agencies like Standard and Poor, Moody etc. Therefore, FDs must be moderated- they are desirable within limits but hurtful beyond the limits.

The above analysis applies to FD in normal times. But in abnormal times like since 2008-09 when the world slipped into recession impacting Indian economy negatively, FD must be allowed to be increased for the fiscal stimuli which are necessary to arrest downturn in the economy and revive growth. FRBM allows such counter-cyclical expenditure. Even then, deficit should be incurred not for populist expenditure but to stimulate the economy.

The sovereign debt crisis (SDC) of Greece is due to excessive FD. However, an SDC is by definition inability of the government to service the loans taken from offshore credit market in foreign currency. It has no relation with internal debt. Though the two are intimately related as explained here: Greece borrowed from overseas market and spent excessively. Taxes were not collected efficiently and there was large scale evasion. Government revenues fell drastically due to recession and tax leakages. The need for massive borrowing and spending increased. The stimulus package aimed at keeping up social services did not yield any returns in monetary terms which meant that the Government could not return the loans it took and so could not raise further loans that were affordable: government was not able to raise the money at normal rates of interest. It had to pay high rates of interest. That means it was debt-trapped- borrow to pay the existing debt at higher and higher rates. The banks and other financial institutions that invested in Greek government bonds panicked. Their share prices fell. Financial system was in danger of instability. Similar crisis was seen in Ireland later and Spain and Portugal too. These countries are acronymally called PIGS. The lesson from Greek crisis is that FD may be incurred only for productive reasons and ensure good returns and external loans for budgetary purposes are to be at a minimal level. Tax collections should be efficient. Accounts of government should be properly maintained and not dressed up.

New Delhi

Reducing FD

FD has to be reduced and the FRBM targets are to be conformed to, under normal conditions. But upto3% of GDP for FD as laid down by FRBM Act is necessary and desirable as the Government can borrow and spend for welfare and growth.

The extent of reduction and the manner of reduction matter. More resources should be raised from taxes, user charges, disinvestment etc. Expenditure control should not involve cuts on social sector expenditure as it hurts poor and demographic dividend can not be reaped.

The level of FD should be determined keeping in consideration the following

- whether the debt can be put to productive deployment
- The rate of return on the borrowed funds' use is adequate
- the impact on private sector investment by way of crowding out effect etc.

Even more important is not to cut social spending in a move to reduce deficit. In other words, while FD reduction is needed for macroeconomic stability and inter-generational parity. Introduction of GST, the DTC amendments, selective disinvestment, broadening of tax base, tax buoyancy etc. will yield enough to moderate borrowings.

Global Crisis And The FD In India

Global recession impacted India and our growth rate slipped. Tax revenues were hit. There was a massive fall in demand. Corporate sectors postponed investment. Threat to employment was real. Therefore, Government took it upon itself to spend more by borrowing. The result is that fiscal deficit reached an abnormally high level- 6.8% in the year 2009-10. The fiscal measures taken by the government to counter the negative fall -out of the global slow down on the Indian economy paid off.

Firstly, the Government responded by providing three focused fiscal stimulus packages in the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets.

Secondly, the RBI took a number of monetary easing and liquidity enhancing measures to facilitate flow of funds from the financial system to meet the needs of productive sectors.

This fiscal accommodation led to an increase in fiscal deficit from 2.7 per cent in 2007-0.8 to 6.2 percent of GDP in 2008-09.These measures were effective in arresting the fall in growth rate of GDP in 2008-09 and stemmed the fall and achieved a growth of 6.7 per cent. The growth rate further improved to 8.4 % for the next two fiscal years of 2009-10 and 2010-11.

The deficit was financed by raising Internal Debt and from Public Account surplus cash. The unsustainably high fiscal deficit could not be continued for long and had to be phased back to normal levels by a calibrated rollback since 2010-11.

FRBM Act 2003

Fiscal Responsibility and Budget Management (FRBM) Act 2003 was notified in 2004 with the following salient features

- annual targets of reduction in deficits, government borrowing and debt
- Government to annually reduce the revenue deficit by 0.5 per cent and the fiscal deficit by 0.3 per cent beginning fiscal 2004-05.
- elimination of revenue deficit and reduction of fiscal deficit to 3% of GDP by March 31, 2009
- a cap on the level of guarantees and total liabilities of the Government.
- Prohibits Government to borrow from the RBI (primary borrowing) after April 1, 2006. RBI can not print money to lend to the government.
- On a quarterly basis, that Government shall place before both the Houses of Parliament an assessment of trends in receipts and expenditure.
- Annually present the macro-economic framework statement, medium term fiscal policy statement and fiscal policy strategy statement. The three statements would provide the macro-economic background and assessment relating to the achievement of FRBM goals.
- Under exceptional circumstances, Government may be compelled to breach targets. In case of deviations, the Government would not only be required to take corrective measures, but the Finance Minister shall also make a statement in both the Houses of Parliament.

Borrowing from the RBI is permitted in exceptional situations like natural calamities. FRBM was brought in for fiscal discipline; increase plan expenditure; reduce the amount of borrowings; meet consumption from government's own fiscal resources; leave the RBI with autonomy as far as money creation goes etc. Fiscal consolidation is necessary particularly in the era of globalization when the penalty for irresponsibility is high.

New Zealand was the first country to enact a Fiscal Responsibility Act in 1994, thereby setting legal standards for transparency of fiscal policy and reporting, and holding the Government formally responsible to the public for its fiscal performance. A similar legislation, the Charter of Budget Honesty, has been enacted in Australia. The UK, too, has enacted a Code for Fiscal Stability. The global recession from 2008 onwards has made the government breach the FRBM targets vastly. But fiscal consolidation since then has been on track and the target for FD in 2017-18 as mentioned above is 3.2% of GDP and to be made 3% by 2018-19.

FRBM 2.0

The 13th Finance Commission reviewed the Act in 2009 and suggested that there should be greater flexibility regarding the fiscal targets as there is uncertainty in general and also about the global economy.These include agro-climatic events of a national dimension, global recessions impacting the country's exports and shocks caused by domestic or external events like asset price bubbles or systemic crises in important sectors like the financial markets.

Following these recommendations, the Act was amended by the Finance Act 2012. One of the amendments was that, along with the Medium-Term Fiscal Policy Statement, Fiscal Policy Strategy Statement and the Macroeconomic Framework Statement, the Central Government would also have to lay a Fourth Statement viz., the Medium Term Expenditure Framework (MTEF) Statement in both the Houses of Parliament, immediately following the Session of the Parliament in which the Budget has been presented. MTEF statement set forth a three-year rolling target for expenditure indicators.

Another sigmificant change made in the amendment to the FRBM Act in 2012 was that, instead of targeting the revenue deficit, the FRBM Act would target a new concept, the 'effective revenue deficit'—the difference between revenue deficit and grants for creation of capital assets. In essence, this placed capital expenditure out of the purview of the revenue deficit.

Finally, the dates by which the effective revenue deficit and fiscal deficit targets were to be met were extended. The effective revenue deficit was to be eliminated and the fiscal deficit was to be below three per cent by March 2015. These targets were once again revised in the Finance Act 2015, postponing the dates of achievement to March 2018.

Fiscal Consolidation

Fiscal consolidation means strengthening government finances. Fiscal consolidation is critical as it provides macro-economic stability; cuts wasteful expenditure; can enable government to spend more on infrastructure and social sectors. Tax reforms, disinvestment, better targeting of subsidies and so on are the hallmarks of fiscal consolidation.

Enactment of FRBM Act provides an institutional framework and binds the government to adopt prudent fiscal policies. There is a need to involve states to effect overall fiscal consolidation and strengthen the growth momentum.

GST and revised DTC are an important federal effort toward fiscal reforms and consolidation. Also, without fiscal consolidation- conversion of subsidies into capital expenditure that forms assets- it is not possible to step up public investment, especially in areas such as agriculture, where gross capital formation has dropped from 1.9 per cent to 1.3 per cent of GDP since 1990-91.

Fiscal consolidation in India includes the following reforms:

- Revenue reforms include tax reforms on both direct and indirect tax front; rationalization of tax exemptions, improving efficiency of tax collection, and tax stability.
- On the expenditure side, reform areas include cutting out non-essential and unproductive activities, schemes and projects, allocation of resources to priority areas, reducing cost of services, rationalizing subsidies; reduction of time and cost overruns on projects, getting proper 'outcome' from output

The reduction in fiscal deficit should not be achieved by a reduction in plan expenditure. It should be done by way of realisation of higher revenues and rationalizing revenue non-plan expenditure.

Kelkar Committee 2012

A roadmap for fiscal consolidation was worked out by a committee headed by former Chairman of the 13th Finance Commission Vijay Kelkar to retrieve fiscal prudence after the stimulus. Kelkar committee said that the reduction in deficit could be achieved through a combination of share sale of state-owned companies, pruning petro-product subsidies through raising prices of diesel and LPG or cooking gas and implementation of the Goods and Services Tax or GST.Administrative reforms including beefing up of IT infrastructure have also been suggested.

Bimal Jalan Committee on Expenditure Management

NDA Government in 2014 set up Expenditure Management Commission, headed by formerRBI Governor Bimal Jalan, to suggest ways to reduce food, fertiliser and oil subsidies and narrow the fiscal deficit.

The panel has been set up as there is a need to review the allocative and operational efficiencies of the government expenditure to achieve maximum output. Government proposes to overhaul the subsidy regime, including food and petroleum subsidies, and make it more targeted while providing full protection to the poor. The subsidy bill on food, petroleum and fertilisers is estimated at Rs2.4 lakh crore for 2017-18 fiscal.

Austerity

When the fiscal position weaken much, the austerity measures taken can be: ban on five-star venues for government meetings; foreign locations for conferences, exhibitions and seminars; and executive class airline tickets for officials; keep the size of delegations going abroad at an "absolute minimum; banned recruitment for central government posts for one year and the purchase of new vehicles.

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N.K. Singh panel to review India's Fiscal Responsibility and Budget Management (FRBM)

The N.K. Singh panel to review *India's Fiscal Responsibility and Budget Management (FRBM) Act* suggested the creation of a new Fiscal Council and a focus on public debt to GDP ratio- target of 60% debt to GDP by 2023 from the present level of about 68%.

The FRBM Committee, set up in May 2016 to review the Centre's fiscal roadmap, had submitted its four-volume report in January 2017.

The committee favours a debt-to-GDP ratio of 60% for the general government by 2022-23, 40% (38.74%) for the central government and 20% for state governments. Within the framework, the committee has recommended adopting fiscal deficit as the key operational target consistent with achieving the medium-term debt ceiling, at 3% of GDP for three years, between 2017-18 and 2019-20. Revenue deficit-to-GDP ratio has been envisaged to decline steadily by 0.25 percentage points each year from 2.3% in 2016-17 to 0.8% in 2022-23.

The committee has prescribed a so-called glide path to these targets—steady progress towards them—and also suggested that there be some flexibility in the deficit targets on both sides, downwards when growth is good and upwards when it isn't.

The panel has recommended enacting a new Debt and Fiscal Responsibility Act after repealing the existing Fiscal Responsibility and Budget Management (FRBM) Act, and creating a fiscal council.

The proposed three-member fiscal council will prepare multi-year fiscal forecasts for the central and state governments (together called the general government) and provide an independent assessment of the central government's fiscal performance and compliance with targets set under the new law.

However, to deal with unforeseen events such as war, calamities of national proportion, collapse of agricultural activity, far-reaching structural reforms, and sharp decline in real output growth of at least 3 percentage points, the committee has specified deviation in fiscal deficit target of not more than 0.5 percentage points.

The committee said that if there is a sharp increase in real output growth of at least 3 percentage points above the average for the previous four quarters, fiscal deficit must fall by at least 0.5 percentage points below the target.

For any deviations, the Centre would be expected to hold formal consultations with the three-member Fiscal Council that would also make multi-year fiscal forecasts for Central and General governments.

The committee has also called for institutional reforms in general government's fiscal management, including the Centre giving consent to State borrowings under Article 293 of the Constitution.

Major Budget Reforms 2017

- Budget presentation preponed – Union budget was traditionally presented in the last week of February and passed by mid-May. However, in 2017, budget was presented on February 1.
- There was no vote on account(Art.116) thus
- Railway Budget merged – The Railway Budget was presented separately since 1924 on the recommendation of committee led by Sir William Acworth. This was done because Railway revenue was high. But railway revenue has shrunk to 11.5 percent of general revenue. From 2017 onwards, railways will be part of the general budget. By merging the two budgets, the government can take a wholistic view.
- Plan and non-plan expenditure removed
- Shankaracharya committee on calendar for budget

Plan And Non Plan Expenditure Classification And Its Unsustainability

In the Budget, expenditure is shown both as revenue and capital and also as plan and non-plan within both. In conventional understanding, 'Plan' expenditures, as the name implies, encompass annual plan projects contributing to five-year plan; these include projects like dams, roads, power plants etc. Non-Plan expenditure relates to maintenance, consumption and welfare. Non-plan expenditure does not create assets. When a project is being built, it is a plan item of expenditure. When completed and being maintained, it is a non-plan item of expenditure.

However, in India there is plan and non-plan in both revenue and capital expensiture and revenue plan expenditure is composed of flagship programmes as seen below. At present, non-Plan expenditure constitutes approximately 70-75 percent of the budgetary expenditure at central and state levels.

'Non-plan' expenditure may be on the revenue or capital accounts and has the following items

- Interest payments
- Subsidies
- Defence
- Public Admn.
- Loans and grants to States, PSEs and UTs
- acquisition of ships, vessels andaircrafts for Coast Guard Organisation , construction of road works by Border Roads Development Board, purchase of ready-built accommodation for CBDT, construction of office buildings by CPWD, acquisition/construction of residential and non-residential buildings for Indian Missions abroad and investment in International Financial Institutions, Capital Outlay on Police
- grants to foreign governments : for Bhutan, Nepal, African Countries, Bangladesh , Sri Lanka, Myanmar, Afghanistan, Maldives, and other developing countries

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Rangarajan Committee 2012

The high-level expert committee was set up in 2010 under the Chairmanship of Dr. C. Rangarajan to suggest measures for efficient management of public expenditure and was mandated to see whether the classification of expenditure into Plan and Non-Plan is rational and can be continued. The report of the Committee was presented in 2012 and the following are the salient points:

- The government should do away with the distinction between Plan and Non-Plan expenditure and redefine roles of the Planning Commission and the Finance Ministry. Plan and Non-Plan distinction in the budget is not able to provide a satisfactory classification of developmental and non-developmental dimensions of government expenditure. It has therefore become dysfunctional. The committee recommended that Plan and Non-Plan distinction in the budget should be removed.
- The report suggested a basic shift to outputs and outcomes.
- The report also called for strengthening the Central Plan Monitoring System (CPMS) and empowering the citizens to seek information on flow of resources and utilisation with a view to promoting transparency and accountability.

The distinction between plan and non-plan expenditure items has become simplistic and is artificial and untenable. The building of a new school or a primary health centre is considered a Plan investment but its running and maintenance is considered non-Plan spending. Thus, very often it had led to Government allocation being reduced for maintenance as it is classified as non-plan item and will be criticized.

In the Sarva Siksha Abhiyan, expenditure on teachers' salary constituted Plan Revenue Expenditure, and that on construction of school buildings was Plan Capital Expenditure. The government made allocations to the Rural Development Ministry for building roads under the Pradhan Mantri Gram Sadak Yojana as Plan Expenditure, but their maintenance belonged to Non-Plan budget. Similarly, funds for teachers (Kendriya Vidyalayas, Navodaya Vidyalas, other government schools) and for doctors (Health centres and Medical colleges of the government) came from Non-Plan Budget while school buildings and hospital buildings were plan expenditure. Thus there are buildings without employees.

Expensive equipments in hospitals were bought under plan spending but maintenance suffered as employees were not hired. Thus, assets are neglected. New projects are allotted money while the completed projects are neglected.

It is important to take a consolidated view of finances keeping in perspective the interdependence of Plan and non-Plan expenditures.This classification had given rise to a misleading notion that Plan expenditure was developmental and Non Plan was non-developmental. Resource allocation would be easier now by putting plan and non-plan expenditure together; this approach of looking at expenditure as a whole will also help link outlays to outcomes better.

The reasons for scrapping the distinction from 2017-18 are

- 5 Year Plans are discontinued
- Planning Commission is no longer there
- Undesirability of keeping the distinction for the reasons detailed above.

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Public Debt

Public debt includes government's internal debt comprising borrowings inside the country like market loans; borrowing from the RBI through printing; and external debt comprising loans from foreign countries, international financial institutions, NRI deposits, commercial institutions etc. In the expression `public debt and "other liabilities". "Other liabilities" include outstanding against the various small saving schemes, provident funds etc. External debt means what the nation owes to foreign lenders- includes private sector borrowings too. However, public debt includes what the government owes to lenders inside and outside the country. *(More in the classroom)*

Public debt is justified as the government does not have adequate resources and taxation can not be done beyond a point. It should be for productive reasons and also welfare reasons. The spiral of deficit and debt run the risk of undermining the country's creditworthiness, devaluing the currency and destabilising the entire economy with grave social consequences. Therefore, it should be incurred judiciously.

India's debt to GDP ratio, when the total outstanding liability –internal and external, is included as of March 31, 2017, is Rs 68.5%.

Generally, Government debt as a percent of GDP is used by investors to measure a country's ability to make future payments on its debt, thus affecting the country's borrowing costs and government bond yields.

External Debt

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Annual Publication 'India's External Debt: A Status Report 2016-17' prepared by the Department of Economic Affairs, Ministry of Finance, Government of India gives a detailed analysis of India's External Debt position at end-March 2017.

The salient features of the Report are:

- India's external debt stock stood at US$ 471.9 billion, decreasing from 2016.The decline in external debt was due to the decrease in long-term debt particularly NRI deposits and commercial borrowings.
- long-term external debt was US$ 383.9 billion and accounted for 81.4 per cent of total external debt
- Short-term external debt increased by 5.5 per cent to US$ 88.0 billion. This is mainly due to the increase in trade related credits, a major component of short-term debt with a share of 98.3 per cent.
- Government (sovereign) external debt was US$ 95.8 billion and constituted 20.3 per cent of the total external debt.
- India's external debt has remained within manageable limits and the external debt situation has improved as indicated by the increase in foreign exchange reserves cover to debt to 78.4 per cent and fall in the external debt-GDP ratio to20.2 per cent. External debt of the country continues to be dominated by the long-term borrowings.

A cross country comparison based on 'International Debt Statistics 2017' of the World Bank, which presents the debt data for 2015, shows that India continues to be among the less vulnerable countries with its external debt indicators comparing well with other indebted developing countries. External debt comprises of commercial borrowings, NRI deposits, short-term debt as well as multilateral and bilateral debt.

Commercial borrowings continued to be the highest with a share of 37.4 per cent of total external debt, followed by NRI deposits (24.1 per cent) and short-term debt (18.4 per cent). Multilateral debt is at 12% and bilateral debt is at about 5%. The share of US dollar denominated debt continued to be the highest in external debt, followed by the Indian rupee, SDR, Japanese yen and euro.The ratio of concessional debt to total external debt was 8.7 per cent.

The valuation effect arises because external debt is denominated in different currencies, and the US dollar value which is the international unit for debt, fluctuates over time vis-à-vis other currencies. If US dollar appreciated against Indian rupee and most other major currencies or otherwise, there is a change in the total debt stock.

External Debt Management

The prudent external debt management policy of the Government of India continues to focus on monitoring long and short-term debt, raising sovereign loans on concessional terms with longer maturities, regulating external commercial borrowings through end-use, encouraging rupee denominated bonds like Masala bonds; and rationalizing interest rates on Non-Resident Indian deposits.

Rupee Debt

Rupee denominated debt refers to that part of India's total external debt that is denominated in India's domestic currency, the Rupee.

Unlike foreign currency denominated external debt like ECBs, FCCBs etc, in case of rupee denominated debt the *currency risk* (the risk arising from appreciation or depreciation of the nominal exchange rate) is borne by the creditor and not by the borrower. Borrower returns as much as he borrowed (as many rupees) with interest as fixed irrespective of the exchange rate . Thus, if the domestic currency appreciates vis-à-vis the foreign currency, the creditor stands to gain vis-à-vis the borrower since he receives more rupees than the current rate suggests.

In India rupee denominated debt comprises the following categories;

- *Rupee Debt;* Includes the outstanding defense and civilian state credits extended to India by the erstwhile Union of Soviet Socialist Republics (USSR). The repayment is primarily through exports of goods to Russia.
- *Rupee denominated* Non-Resident Indian (NRI) Deposits.
- Foreign Institutional Investors (FII) investment in Government Treasury-Bills and dated securities and
- FII investment in corporate debt securities (with such investments ceiling set by GOI annually).

In short, external debt consists of

- long-term external debt which is the bulk part
- NRI deposits
- multilateral loans
- commercial borrowings
- bilateral loans and
- Trade credit

Internal Debt

Internal debt includes loans raised by the government in the open market through treasury bills and government securities, special securities issued to the RBI and most importantly, various bonds like the oil bonds, fertilizer bonds etc.The money sterilized from the market in by the Market Stabilisation Scheme (MSS) is also shown in the government's statement of liabilities. Introduced in 2004, MSS envisages the issue of treasury bills and/or dated securities to absorb excess liquidity arising out of the excessive foreign currency inflows. (Read ahead)

The internal debt of the government also includes others like the outstanding against small-savings schemes, provident funds, deposits under special deposit schemes etc. These debts are shown under a separate head titled 'other liabilities'.

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Debt should be moderated for the reasons cited in the discussion on FD above.

Masala Bonds

New Delhi

Masala bond is a term used to refer to a financial instrument through which Indian entities can raise money from overseas markets in rupee, not foreign currency. By issuing bonds in rupees, an Indian entity is shielded against the risk of currency fluctuation, typically associated with borrowing in foreign currency. Besides helping diversify funding sources, the cost of borrowing is lower than domestic markets. As masala bonds are denominated in rupees, foreign investors will be taking the currency risk.

Masala is an Indian word for spices. The term was used by International Finance Corporation (IFC) to evoke the culture and cuisine of India. Dim sum bonds are bonds issued outside of China but denominated in Chinese renminbi, and not the local currency. They are named after dim sum, a popular style of cuisine in Hong Kong. Similarly, Samurai bonds for Japan.

Unlike dollar bonds, where the borrower takes the currency risk, masala bond makes the investors bear the risk. The first Masala bond was issued by International Finance Corporation in 2014 when it raised money to fund infrastructure projects in India. Later in International Financial Corporation for the first time issued green masala bonds to be used for private sector investments that address climate change in India.

In 2016 HDFC issued Masala bonds and thereby became the first Indian company to issue masala bonds and later NTPC issued first corporate green masala bonds. NHAI, Shriram Transport Finance and Indiabulls Housing Finance are the others (2017).

An investor who buys a bond issued by an Indian entity at a rate that is, say, 200 basis points above the globally accepted pricing benchmark — the London Interbank Offered Rate or Libor is optimistic about India, and hoping that currency and inflation would be stable enough to ensure good returns after factoring in exchange rate risks. With India's GDP or national income rising, and projected to grow at a reasonably fast rate over the next few years, many overseas investors like to buy such bonds to earn higher returns compared to the US and Europe where interest rates are still low.

The key for the success of these bonds will be a stable exchange rate. If the masala bonds take off it could lower India's cost of capital over a period of time. Inflows from these financial instruments could also support the rupee. It is seen as a small incremental step towards internationalisation of rupee and full rupee convertibility. Masala bonds are a step to help internationalise the Indian rupee and also deepen the Indian financial system. IFC's 5-year green Masala bond is listed on the London Stock Exchange. Similar offerings from other countries have also been after the food or culture of that country like "dim sum" label for Chinese offshore issues or "Samurai" bonds for Japanese offshore issues.

Before masala bonds, corporates have had to rely on avenues such as external commercial borrowings or ECBs. The challenge with the likes of ECBs is the entity raising money is faced with a currency risk - they have to be raised and repaid in dollar terms.

The Reserve Bank of India has issued guidelines allowing Indian companies, non-banking finance companies (HDFC, India Bulls Housing Finance are examples of such companies) and infrastructure investment trusts and real investment trusts (investment vehicles that pool money from various investors and invest in infrastructure and real estate sectors) to issue rupee-denominated bond overseas.

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Zero Base Budgeting

Tenth Plan Approach Paper says that ZBB will be followed for rationalization of expenditure. The ZBB methodology was taken up first in 1987 in the Union Budget and was recommended for the Government departments and PSUs. Many state governments also applied it, for example, Government of Rajasthan and Maharashtra .The Maharashtra Government renamed it ' Development -based budget'

Under the ZBB, a close and critical examination is made of the existing government programmes, projects and other activities to ensure that funds are made available to high priority items by eliminating outdated programmes and reducing funds to the low priority items. Governmental programmes and projects are appraised every year as if they are new and funding for the existing items is not continued merely because a part of the project cost has already been incurred. Programmes are discarded if the cost-benefit ratio is below the prescribed norms.

The objective of the ZBB is to overhaul the functioning of the government departments and PSUs so that productivity can be increased and wastage can be minimised. Scarce government resources can be deployed efficiently. ZBB as a resource planning and control technique and process yielded substantial benefits in the advanced countries like New Zealand, UK, Australia and Sweden in terms of efficiency gains, better resource use, lower costs and finally surplus budgets, particularly in New Zealand. However, the use of ZBB to human development programmes and poverty alleviation and employment generation programmes is limited and the results are cumulative and can not be assessed annually.

The Economic Survey 2014 says that the expenditure on social schemes needs to be rationalised. 'What is needed is a 'zero budgeting' approach with a revamp, reorganization, and convergence of schemes.' Zero-based budgeting runs contrary to traditional budgeting where the previous year's budget is taken as a base. It re-evaluates the entire budget

WMAs

Prior to 1997, the RBI lent to central government against ad hoc Treasury bills, (since mid-50's) This provision for extending short-term financing was created to bridge temporary mismatches in receipts and payments. However, the central government slipped into the practice of rolling over this facility, resulting in automatic monetisation of the government's deficit. Automaticity refers to RBI having to print money if the Government's cash balances with the RBI went below a threshold fixed. It had no choice but to create currency and lend to the Government of India. The process of creating 91-day bills and subsequently funding them into non-marketable special securities at a very low interest rate (4.6%) emerged as a principal source of borrowing. It was thought to be irrational for the reasons that the interest rate is not market driven and was very concessional. Nor did the RBI have any voice in deterring the same. Nor was there a limit to how much could be printed in this way.

In the case of state governments, the RBI provides two types of WMAs. Normal WMAs are clean or unsecured advances extended at the bank rate(marginal standing facility), while special WMAs are extended against the government securities. The latter is exhausted first and then the former may be sought to a limited extent. If the state government borrows over and above the WMA allowed for it by the RBI, it is called overdraft and there is a limit to that too set by the RBI.

Adhoc Treasury Bills and WMA

Union Government replaced adhoc treasury bills with WMAs in 1997. WMAs given by RBI to GOI do not require any collateral. Its amount is limited and arrived at the beginning of the fiscal year through consultation between Government and the RBI. There are penal interest rates if the pre-agreed amount is violated. Ways and Means Advances are made at the Repo Rate. Overdraft is charged penally at two percent above the repo rate

Replacement of the adhoc bills with WMA represents an advance in fiscal discipline and harmonization of the fiscal and monetary policies as the RBI is consulted in Governmental short term borrowing and the `automaticity' is dropped in the creation of currency by the RBI to fund governmental expenditure.

Some Words

Fiscal Drag

A situation where inflation pushes income into higher tax brackets- bracket creep. The result is increase in income taxes but no increase in real purchasing power. This is a problem during periods of high inflation. Government gains due to higher tax collections and the economy suffers as growth is dragged down due to less demand. In high-growth and high inflation economies ('overheated'), fiscal drag acts as an automatic stabiliser, as it acts naturally to keep demand stable.

More in the Classroom

Fiscal Neutrality

When the net effect of taxation and public spending is neutral: neither stimulating nor dampening demand.

Crowding Out

Excessive government borrowing can lead to shrinkage of the liquidity in the market; forces the interest rates to go up; private investment is crowed out for two reasons: liquidity availability is less and the rates are high. Investment suffers and growth decelerates. The Government also may not spend the borrowed resources well to generate returns. It may spend on populist schemes. However, if the government deploys the funds well, it may have a 'crowding in' effect: the infrastructure built can have a multiplier effect on investment, jobs, tax collections and growth. For example, Bharatmala that was announced in October 2017.

Pump-Priming

Deficit financing and spending by a government on public works in an attempt to revive economy during recession – countercyclical measures. It can raise the purchasing power of the people and thus stimulate and revive economic activity to the point that deficit spending will no longer be considered necessary to maintain the desired economic activity.

Small Savings

Small savings instruments are Post Office Monthly Income Schemes and Time Deposits; National Savings Scheme; Indira Vikas Patra; Kisan Vikas Patra; Public Provident Fund and so on. They are aimed at promoting safe and long-term savings by individuals. They are called small savings because the amount saved is relatively small. They are initiated by the central Government but mobilized by the State Governments; and are deposited with and managed by the central government. As a reward State Governments receive all such savings as loan.

Small savings are a sizeable portion of the financial savings of the country. They contribute to the finances of the Government- federal and State- that is, they are an important source of borrowing for the government. These schemes have a built in tax concession that enhances their attraction for the small savers. They also earn a rate of interest that is higher in comparison to what the banks offer. They are meant to be savings by low income and other groups but are open to all.

Small savings instruments in India are retailed through 1.53 lakh post offices of which about 1.29 lakh are in rural areas.

The National Small Savings Fund (NSSF), in the Public Account of India has all the small savings. Money in the Fund is invested in Central and State Government Securities. The investment pattern is as per norms decided from time to time by the Government of India.

The Fund is administered by the Government of India, Ministry of Finance (Department of Economic Affairs) under National Small Savings Fund (Custody and Investment) Rules, 2001, framed by the President under Article 283(1) of the Constitution.

2017

The government in 2017 exempted all but four States from mandatory investment norms for the National Small Savings Fund (NSSF). It means that all other states except the four are not on-lent the savings mobilized. They have other ways of raising loans, presumably at cheaper rates. But the

centre needs to keep up with these schemes to promote savings and offer attractive rates to senior citizens and such other needy.

It will help the Centre lower its dependence on market borrowings through the RBI, it will also help keep the fiscal deficit in check though only in statistical terms. Public Account of India where the NSSF is placed is outside the budgetary approvals from Parliament. However, repayment of the principal and interest will be from the Union Budget. Economists said the Centre could provide other public sector units a dispensation similar to the one given to the FCI.

Public Goods, Merit Goods And Demerit Goods

Public goods are those goods whose consumption by some does not diminish them for others. That is, they are non-rivalrous. Common examples include law and order, parks, street-lighting, defence etc. They are goods meant for the entire public. Merit goods are goods like education, health care etc. that are important for the society as a whole- that is, they have positive externalities. Market may not supply them in adequate quantities. Government supplements the market. Demerit goods are those whose consumption should be discouraged. They have negative externalities. Examples include: tobacco, alcohol etc. Thirteenth Finance Commission calls them sin goods and wants them to be harshly taxed.

Giffen Goods

They include goods whose demand goes up when the price increases. They are the status markers and exclusivist in nature.

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Twin Deficits

Budget deficit (fiscal deficit) and current account deficit-the former fuelling the latter as the borrowings increase are known as twin deficits. USA is a prime example. So is India!!!!

(Recent developments in the classroom)

'Fiscal Cliff'

A combination of expiring tax cuts and across-the-board government spending cuts that were scheduled to become effective Dec. 31, 2012. The idea behind the fiscal cliff was that if the federal government allowed these two events to proceed as planned, they would have a detrimental effect on an already weak economy, perhaps sending it back into an official recession as it cut government spending and investment, collected more taxes which cut down both consumption and investment, increased unemployment rates and undermined consumer and investor confidence.

MONETARY AND CREDIT POLICY

Definitions:

- The strategy of influencing movements of the money supply and interest rates to affect output and inflation
- The actions of a central bank that determine the size and rate of growth of the money supply, which in turn affects interest rates.
- A macroeconomic policy tool used to influence interest rates, inflation, and credit availability through changes in the supply of money available in the economy
- An attempt to achieve broad economic goals by the regulation of the supply of money
- The regulation of the money supply and interest rates by a central bank in order to control inflation and stabilise currency
- Monetary policy is the process of managing a nation's money supply to achieve specific goals—such as constraining inflation, achieving full employment etc.
- Monetary policy is made by the central bank to manage money supply to achieve specific goals—such as constraining inflation, maintaining an appropriate exchange rate, generating jobs and economic growth. Monetary policy involves changing interest rates, either directly or indirectly through open market operations, setting reserve requirements, or trading in foreign exchange markets.

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Monetary Policy

The use by the Central Bank of interest rate and other instruments to influence money supply to achieve certain macro economic goals is known as monetary policy. Credit policy is a part of monetary policy as it deals with how much and at what rate credit is advanced by the banks. Objectives of monetary policy are:

- accelerating growth of economy
- price stability
- exchange rate stabilization
- balancing savings and investment
- Generating employment and

Monetary policy can be expansionary or contractionary: expansionary policy increases the total supply of money in the economy, for example, in 2008-09 all over the world including India, to beat recession/slowdown; and a contractionary policy decreases the total money supply by tightening credit conditions. Expansionary policy is traditionally used to combat unemployment in a recession by lowering interest rates, while contractionary policy has the goal of raising interest rates to control inflation.

Historically, Monetary Policy was announced twice a year - a slack season policy (April-September) and a busy season policy (October-March) in accordance with agricultural cycles. However, since monetary Policy has become dynamic in nature, RBI reserved its right to alter it from time to time, depending on the state of the economy. Reserve Bank of India decided to announce Bi-monthly Monetary Policy Statements- once every two months- from April 1, 2014. This statement is in keeping with the recommendation of the Urjit Patel Committee.

The tools available for the central bank to achieve the monetary policy ends are the following

- Bank rate
- Reserve ratios
- Open market operations
- Intervention in the forex market and
- Moral suasion

Bank Rate

Bank Rate is the rate at which RBI lends long term to commercial banks. Bank Rate is a tool which RBI uses for managing money supply. Any revision in Bank Rate by RBI is a signal to banks to revise deposit rates as well as prime lending rate (PLR is the rate at which banks lend to the best customers. It is not in use any more.)

Since beginning of the last decade, bank rate is in a limbo. It has no effective use. It is a penal rate. In 2011, the bank rate was aligned with the newly introduced marginal standing facility. Today it stands at 6.5% (2017).Bank Rate is aligned with Marginal Standing Facility (MSF) rate, which, in turn, is linked to the policy repo rate. Alignment was because the MSF is also a penal rate. (Read ahead).

Earlier, bank rate was the policy rate. Bank rate has been replaced with repo rate as the policy rate for many years now. The Bank Rate today acts as the penal rate charged on banks for shortfalls in meeting their reserve requirements (cash reserve ratio and statutory liquidity ratio). Read ahead.

Ready Forward Contracts (Repos)

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

In India, RBI lends on a short term basis to banks on the security of the government bonds (repo). Banks undertake to repurchase the security at a later date- over night or few days. RBI charges a repo rate for the money it lends. It is 6.25 % presently (2017)

Reverse repo is when RBI borrows from the market (absorbs excess liquidity) on the basis of securities and repurchases them the next day or after a few days. The rate at which it borrows is called reverse repo rate as it is the reverse of the repo operation. Reverse repo rate 25 basis points (0.25%) below the repo rate- 6% (2017)

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

Repo rate is known as policy rate and is used as signal to the financial system to adjust their lending and borrowing operations.

MSF

In 2011, RBI introduced the Marginal Standing Facility as a window through which the commercial banks can borrow from the RBI at a rate that is more than the repo rate. It is meant to ease liquidity in the market. Banks can use the repo route for the securities that they hold over and above the mandatory SLR level- 19.5% of bank deposits. If the banks do not have securities over and above the SLR requirement for any reason, MSF is open to them. They can use securities below the stipulated SLR. MSF is open to the banks that want to borrow from the RBI even if the credit is costlier. However, there are limits to how much can be borrowed from the MSF window. The aim is to ease liquidity.

MSF is the penal rate- because the SLR limit is breached. Bank rate is also a penal rate- for breaching the SLR and CRR limits. Therefore, there is a need to bring the bank rate on par with the MSF as was done by the RBI in 2011-12. Both stand at 6.25% today (2017).

MSF window also has become necessary because the repo operations are limited to a specific period during the day. Banks have securities in excess of the SLR requirement as is a safe investment and also repo window opens. Only Scheduled Commercial banks use this route. They use the *collateral of* government securities *including* SLR. (Read above)

LAF

Liquidity Adjustment Facility (LAF) was introduced by RBI in 2000. Funds under LAF are used by the banks for their day-to-day mismatches in liquidity. LAF covers credit at repo and reverse repo rates. *Under LAF, Minimum credit limits are* Rs. 5 crore. It has uses for Banks, NBFCs, DBs (Development banks) and government. That is, all the clients of RBI. Money is lent by the RBI at Repo rate. *Collateral used includes* all the government securities.

NEW DELHI

Reserve Requirements

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

Statutory Liquidity Ratio (SLR)

It is the portion of time (fixed deposits) and demand liabilities(savings bank and current accounts) of banks that they should keep in the form of designated liquid assets like government securities and other RBI-approved securities like public sector bonds ; current account balances with other banks and gold .SLR aims at ensuring that the need for government funds is partly but surely met by the banks. SLR was progressively brought down from 38.5% in 1991 to 19.5% (2017).

The main objectives for maintaining the SLR ratio are the following:

- to control the expansion of bank credit. By changing the level of SLR, the Reserve Bank of India can increase or decrease bank credit expansion.
- to ensure the solvency of commercial banks.
- to make the commercial banks to invest in government securities like government bonds so that government has adequate financial resources for its commitments

SLR is a blunt instrument and was unchanged for more than a decade and half till the Lehman-induced global financial and economic crisis of 2008.

Banking Regulation Act, 1949 fixed the floor and cap on SLR at 25% and 40% respectively. But the amendment made in the statute in 2007 removed the lower limit but retained the cap at 40%. RBI has, as a result, the freedom to reduce the SLR to any rate depending on the macro economic conditions. The amendment was an enabling one. SLR is governed by the provisions of Section 24 of the Banking Regulation Act.

CRR

CRR is liquidity management and a monetary tool to regulate money supply. It is the portion of the bank deposits that a bank should keep with the RBI in cash form. CRR deposits earn no interest. The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 fixed the floor and cap on CRR at 3% and 20% respectively. But the amendment made in these statutes in 2007 removed the limits- lower and upper. RBI has, as a result, greater operational flexibility to make its monetary adjustments. CRR is adjusted to manage liquidity and inflation. The more the CRR, the less the money available for lending by the banks to players in the economy. CRR was 15% in 1991 and today it is 4% (2017). If inflation is high, money supply needs to be taken out and so CRR is generally increased. But in a regime of moderate inflation, low CRR is in place. CRR is governed by the provisions of Section 42 of the Reserve Bank of India Act, 1934.

RBI uses CRR either to drain excess liquidity or to release funds needed for the growth of the economy from time to time. Increase in CRR means that banks have less funds available and money is sucked out of circulation. Thus it serves two purposes is a portion of bank deposits is kept with RBI and is totally risk-free enables RBI to control liquidity in the system, and thereby, inflation. RBI increases CRR to tighten credit and lowers CRR to expand credit. During the downturn after the global Great Recession 2008 October onwards, CRR was reduced but as growth and inflation returned since 2009, CRR was gradually increased.

CRR as a tool of monetary policy is used when there is a relatively serious need to manage credit and inflation. Otherwise, normally, RBI relies on signaling its intent through the policy rates of repo and reverse repo. Based on these rates, RBI conducts open market operations for liquidity management.

Incremental CRR

In a circular to banks, the RBI said that on the increase in deposits between September 16 and November 11, scheduled banks will have to maintain incremental CRR of 100%. This measure is intended to absorb a part of the surplus liquidity arising from the return of the demonetised ₹500

and ₹1,000 bank notes. RBI observed that with the demonetisation decision, there was a surge in deposits relative to the expansion in bank credit, leading to large excess liquidity in the system.

It assessed that the magnitude of surplus liquidity available with the banking system was expected to increase further in the weeks to come. In view of this, RBI decided to absorb this surplus liquidity by applying an incremental CRR as a purely temporary measure. The process of putting in place other liquidity absorption measures like issuance of Market Stabilization Scheme (MSS) bonds was taking time and in the meantime the incremental CRR hike was an interim measure. It also aimed at signaling RBI's apprehension that interest rates could fall sharply with such unprecedented excess of liquidity.

Banks raise deposits to lend and make profitBut in the case of remonetisation deposits, they will be allowed to be withdrawn after some time- months or weeks and if the bajkks don't have the money having lent all, there will be a crisis. The deposits that came into the banking system as a result of the demonetization were not voluntary but forced. They were not savings but only to get remonetized. Thus, their nature is different. They were not to be lent and therefore had to taken out of the system. That explains the 100% CRR on these deposits within a certain period. That is why it is called incremental CRR and not CRR. CRR continued to be 4%.

SLR vs CRR

Both Cash Reserve Ratio (CRR) and SLR are instruments in the hands of RBI to regulate money supply in the markets. Both manage liquidity. But they are used for different purposes. CRR has a short and medium term relevance while SLR is a long term tool. SLR enables banks to earn money while CRR part does not earn any interest.CRR is maintained in cash form with central bank, whereas SLR is money held as govt. securities and kept with the banks themselves.

Open Market Operations of RBI

New Delhi

OMOs of the RBI can be described as outright purchase and sale of government securities in the open market (open market essentially means banks and financial institutions) by the RBI in order to influence the volume of money and credit in the economy. Purchase of government securities injects money into the market and thus expands credit; sales have the opposite effect- absorb excess liquidity and shrink credit. Open market operations are RBI's most important and flexible monetary policy tool. Open market operations do not change the total stock of government securities but change the proportion held by the RBI, commercial and cooperative banks.

There are two methods that the RBI uses to control the money supply in the economy-

- Qualitative Method
- Quantitative Method- through reserve requirements and ratios

Qualitative Method

By *Quality* we mean the uses to which bank credit is directed.

For example- the Bank may feel that speculators or the big industrialists are getting a disproportionately large share in the total credit, causing various disturbances and inequality in the economy, while the small-scale industries, consumer goods industries and agriculture are starved of credit. Correcting this type of discrepancy is a matter of Qualitative Credit Control.

Because it does not reduce the total quantum of credit available to the market but changes the quantum of what is available to a particular sector.

Qualitative Method controls the manner of channelizing of cash and credit in the economy. It is a 'selective method' of control as it restricts credit for certain section and may expand for the others known as the 'priority sector' depending on the situation.

Tools used under this method are-

Margin Requirement
Lending to a select sector may be accompanied by having to set aside a certain percentage of money for safety. When banks have to keep aside some money (margin) whenever they lend to the specified sectors, it hurts them with blocked funds. Thus, the credit flow to such sectors comes down as intended. In case the flow of credit has to be increased, the margin requirement will be lowered.

Rationing of Credit
Under this method there is a maximum limit to loans and advances that can be made, to a particular sector which the commercial banks cannot exceed. RBI fixes ceiling for specific categories. Such rationing is used for situations when credit flow is to be checked, particularly for speculative activities.

Both these tools make up selective credit controls(SCCs) that can be imposed for meeting various goals like discouraging hoarding and black-marketing of certain essential commodities by traders etc by giving them less credit. In SCCs, the total quantum of credit does not change, but the amount lent and the cost of credit may be changed for specific sector or sectors.

Controlling credit in the Economy is amongst the most important functions of the Reserve Bank of India. The basic and important needs of Credit Control in the economy are-

- To encourage the overall growth of the *"priority sector"* like agriculture etc
- To keep a check over the channelization of credit so that credit is not delivered for undesirable purposes.
- To achieve the objective of controlling "Inflation" as well as "Deflation".
- To boost the economy by facilitating the flow of adequate volume of bank credit to different sectors to develop the economy.

Moral Suasion

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

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

MCLR And Base Rate

Passing on the rate changes made by the MPC is crucial for growth, equity, inflation management etc. It is called monetary policy transmission. The experience with the Marginal Cost of Funds Based Lending Rate (MCLR) system introduced in 2016 for improving the monetary transmission has not been entirely satisfactory, even though it has been an advance over the Base Rate system that was introduced in 2011. An internal Study Group has been constituted by the Reserve Bank of India (RBI) to study the various aspects of the MCLR system from the perspective of improving the monetary transmission and exploring linking of the bank lending rates directly to market determined benchmarks. The Group will submit the report by September end 2017.

MCLR is based on current cost of funds rather than overall cost of funds which was used to calculate based rate. This will ensure quicker transmission of RBI rate cuts to borrowers.

Market Stabilization Bonds

For normal liquidity management, there are open market operations of the RBI when the RBI sells and buys G-secs as the market conditions demand. But when the need to absorb huge amounts of cash arises for example post-demonetisation in 2016, normal OMOs do not work. Similar has been the condition since 2004 when India started attracting foreign currency inflows of unprecedented magniture. In 2004, RBI floated Government securities, as a part of the Market Stabilization Scheme, to absorb excess liquidity from the market. When RBI started buying US dollars with freshly minted rupee it led to over-supply of the domestic currency raising inflationary fears. MSS was introduced to mop up this excess liquidity. The excess liquidity is the result of RBI buying dollars from the market. MSS is a sterilization effort of the central bank. The normally available government securities are not enough for the RBI to suck out the huge rupee supply (printed money) that was caused for buying dollar. Therefore, the MSS was started.

New Delhi

There are limits to MSS. The limits were raised to absorb the post-demonetisation deposits. The raising took time and in the meantime the incremental CRR was brought in at 100% of incremental deposits as detailed above.

Interest Rates And Their Significance

Interest rates are the rates offered to money that is deposited in the banks; rates offered for investment in bonds; rates at which money is borrowed from banks and financial institutions etc.

Savers want higher interest rate while investors want the cost of credit to be low. There has to be a balance. The determinants of interest rates are:

- Inflation- the higher the inflation, the higher the interest rates because the same money invested in commodities and other assets should not fetch more, because of the inflation. Savers need to be ttracted which is possible only when their money neutralizes inflation.
- Need for growth :lower interest rates reduce cost of credit and facilitate investment for growth
- Promotion of savings
- Government's need to borrow: the magnitude of government's borrowing programme also determines interest rates. The more the borrowing, the higher the interest rates.

- Need to generate demand :as interest rates come down, consumer demand for credit goes up and there will be a stimulus for growth
- Global trends as we need to retain foreign funds. For example, interest rates on NRI deposits are kept high to attract their dollar deposits under the FCNR (B).

Deregulation of Interest Rates

As a part of banking sector reforms, interest rates have been deregulated. The rationale is that banks can adjust rates quickly according to market conditions; financial innovations should be facilitated; competitive rates can be good for savers and investors; global alignment is possible more dynamically; etc. RBI however, uses repo rates and CRR adjustments to influence interest rates.

Floating and Flexible Rates of Interest

There are two types of interest rate- fixed and floating. If they are offered together (when they co-exist), it is called flexible interest rate regime. Floating interest rates are linked to an underlying benchmark rate. In other words, the interest rate offered 'floats' in relation to the interest rate of a government security instrument of similar maturity (5 years or 10 years maturity etc) as determined by the market. That is, floating rates of interest are basically market driven rather than 'fixed'. The effective rate is adjusted on a quarterly or semi-annually or annually.

Inflation Targeting

Under this policy approach the target is to keep inflation in a particular range or at a particular level. Government and the RBI agree on convergence between the fiscal and the monetary policies to achieve the common goal. RBI is given autonomy to manage inflation while the government agrees to have a fiscal policy that will contribute to price stability- for example, not borrow excessively etc. India does not follow it.

This monetary policy approach was pioneered in New Zealand. It is currently used in the Eurozone, Australia, Canada, New Zealand, Sweden, South Africa, Norway and the United Kingdom. (See Chapter on I

Urjit Patel Committee 2014

An expert committee appointed to examine the current monetary policy framework of the Reserve Bank of India (RBI) in early 2014 suggested that the apex bank should adopt the new CPI (consumer price index) as the measure of the nominal anchor for policy communication. That is, the policy should centre around the new CPI and not any other index like WPI etc.

The expert committee was headed by Urjit R. Patel, Deputy Governor of the Reserve Bank of India. Recommendations are:

- The target for inflation should be set at 4 per cent with a band of +/- 2 per cent around it.
- The nominal anchor should be defined in terms of headline CPI inflation, which closely reflects the cost of living and influences inflation expectations relative to other available metrics. This target should be set in the frame of a two-year horizon.

- The committee asked the Central Government to ensure that the fiscal deficit as a ratio to GDP (gross domestic product) is brought down to 3.0 per cent by 2016-17. "Administered setting of prices, wages and interest rates are significant impediments to monetary policy transmission and achievement of the price stability objective and so these required a commitment from the government towards their elimination.
- The Patel panel felt that the monetary policy decision-making should be vested with a monetary policy committee (MPC). It went on to recommend that the Governor of the RBI should be the Chairman of the MPC.

While Urjit Patel committee said that RBI should fix inflation target, Central government believes that it should specify 'inflation targets' for the Reserve Bank of India (RBI) to achieve. The reason is that t is best that inflation targets are set by the governments elected by the people.

Indian Financial Code (IFC), MPC and Inflation Targeting

The Financial Sector Legislative Reforms Commission was constituted in 2011. The commission was set up since it was felt there was a need to review the legal and institutional structures of the financial sector in India and recast these in tune with contemporary requirements. The commission gave its first report in 2013 containing an analysis of the current regulatory architecture and a draft Indian Financial Code to replace the bulk of the existing financial laws. IFC proposes changes in the way monetary policy is made and public debt is managed etc. Indian Financial Code (IFC) suggested an MPC to take rate decisions by a majority vote.

Under the pre-MPC set-up, the government appointed RBI Governor, who controlled the monetary policy and had veto power over the existing advisory committee of RBI members and outside appointees that sets rates. The final policy is usually a consensus arrived at by the governor, the Deputy Governor in-charge of monetary policy and the Executive Director In-charge of monetary policy. But ultimately the responsibility is the governor's.

There are three advantages of taking the decision of monetary policy formulation away from the Governor and giving it to a committee. First, a committee can represent different viewpoints and studies show that its decisions are typically better than an individual's. Second, spreading the responsibility for the decision can reduce the internal and external pressure that falls on an individual. Third, a committee will ensure broad monetary policy continuity when any single member including the governor changes.

It leads to institutionalising the process of monetary policy formulation which is vital given that the government has given the RBI a clear inflation objective.

Reserve Bank of India

The central bank of the country is the Reserve Bank of India (RBI). The Reserve Bank of India Act, 1934 came into effect in 1935. The Act provides the Statutory basis of the functioning of the bank.It was established with a share capital of Rs. 5 crores on the basis of the recommendations of the Hilton Young Commission. The share capital was entirely owned by private shareholders in the beginning. The Government held shares of nominal value of Rs.2,20,000.

Reserve Bank of India was nationalised in the year 1949. The general superintendence and direction of the Bank is entrusted to Central Board of Directors of 20 members, the Governor and

four Deputy Governors, one Government official from the Ministry of Finance, ten nominated Directors by the Government to give representation to important elements in the economic life of the country, and four nominated Directors by the Central Government to represent the four local Boards with the headquarters at Mumbai, Kolkata, Chennai and New Delhi.

RBI

Functions

The Reserve Bank of India Act of 1934 entrusts all the important functions of a central bank to the reserve bank of India.

Bank of Issue

Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government. The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes.

RBI should maintain gold & foreign exchange reserves of Rs. 200 cr, of which Rs. 115 cr. should be in gold. This is a technical criterion. In reality, in a growing globalized economy like ours, as foreign currency inflows take place, the RBI will acquire them by printing more rupee thus adding to the rupee stock and the money supply keeping the demand for money satisfied in the economy for the given macroeconomic goals. The only restriction on RBI is the systemic one- it should not create instability with too much or too less of money supply. Money supply should have a correspondence to the goods in the economy and the rates of growth.

Banker to Government

The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser. The Reserve Bank is agent of Central Government and of all State Governments in India. The Reserve Bank has the obligation to transact Government business, to receive and to make payments on behalf of the Government and to carry out their other banking operations. The Reserve Bank of India helps the Government - both the Union and the States to raise loans. The Bank makes ways and means advances to the Governments. It acts as adviser to the Government on all monetary and banking matters.

Banker's Bank And Lender of The Last Resort.

The Reserve Bank of India Acts As The Bankers' Bank

The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities by rediscounting bills of exchange. CRR deposits of banks are kept with the RBI. Since commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crises, the Reserve Bank is the lender of the last resort.

Controller of Credit

The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through the variety of instruments available to it like reserve requirements etc (see above). According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons. All its monetary policies are aimed at this function directly or indirectly.

Agent and Adviser of The Government

The RBI acts, as the financial agent and adviser to the Government. It renders the following functions:

a) As an agent to the Government, it accepts loans and manages public debts on behalf of the Government.

b) It issues Government bonds, treasury bills, etc.

c) Acts as the financial adviser to the Government in all important economic and financial matters.

Debt Management Office (DMO)

Public Debt Management Agency (PDMA) is a specialized independent agency that manages the internal and external liabilities of the Central Government and renders advice. PDMA manages the issue and trading of Government securities and undertakes cash management for the government.

PDMA is considered to be set up with the objective of "minimising the cost of raising and servicing public debt over the long-term within an acceptable level of risk at all times, under the general superintendence of the central government". This will include managing the public debt and related activities.

As of now, RBI manages the market borrowing programmes of Central and State Governments. External debt is managed by the GOI. DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates ECB guidelines and policies. Establishing a debt management office would consolidate all debt management functions in a single agency and bring in holistic management of the internal and external liabilities.

New Delhi

It is considered as an internationally accepted best practice that debt management should be disaggregated from monetary policy, and taken out of the realm of the central bank. Most advanced economies have dedicated debt management offices. Several emerging economies, including Brazil, Argentina, Colombia, and South Africa, have restructured debt management in recent years and created an independent agency for the same.

There is a conflict of interest between setting the short term interest rate (i.e. the task of monetary policy) and selling bonds for the government. RBI has to manage inflation for which the rates have to be kept high when the prices are high. But being a debt manager, it has to borrow at lower rates of interest for the GOI.

Where the Central Bank also regulates banks, as in India, there is a further conflict of interest. If the Central Bank tries to do a good job of discharging its responsibility of selling bonds, it has an incentive to mandate that banks hold a large amount of government paper. This bias leads to flawed banking regulation and supervision, so as to induce banks to buy government bonds, particularly long-dated government bonds. Having a pool of captive buyers undermines the growth of a deep, liquid market in government securities, with vibrant trading and speculative price discovery. This, in turn, hampers the development of the corporate bond market - the absence of a benchmark sovereign yield curve makes it difficult to price corporate bonds.

Ministry of Finance formed an Internal Working Group, Chaired by Shri. Jahangir Aziz, to analyse how best to move forward on establishing a DMO. Report of the Internal Working Group on Debt

Management (2008), suggested creating a "National Treasury Management Agency (NTMA)" as an independent public debt management office.

Dr Raghuram Rajan chaired Committee on Financial Sector Reforms (2009) constituted by the Planning Commission pointed out that internationally, there has been a strong movement towards establishing independent debt management offices (DMOs) which is now considered as the best practice, and favoured it.

Justice B. N. Srikrishna chaired FSLRC or Financial Sector Legislative Reforms Commission report (2013) also recommended setting up the independent "Public Debt Management Agency (PDMA) at the earliest.

The Constitution of India gives the executive branch of the Government t powers to borrow upon the security of the Consolidated Fund of India. Reserve Bank as an agent of the Government (both Union and the States) implements the borrowing program. The Reserve Bank draws the necessary statutory powers for debt management from the Reserve Bank of India Act, 1934. While the management of Union/Central Government's public debt is an obligation for the Reserve Bank, the Reserve Bank undertakes the management of the public debts of the various State Governments by agreement. The debt management functions comprise of formulation of a calendar for primary issuance, deciding the desired maturity profile of the debt, size and timing of issuance, designing the instruments and methods of raising resources, etc. taking into account government's needs, market conditions, and preferences of various segments while ensuring that the entire strategy is consistent with the overall macro-economic policy objectives.

The Indian central bank has countered this by saying that in countries such as India, given the large size of the government borrowing programme, the sovereign debt management is much more than merely an exercise in resource-raising, as it could impact interest rates which, in turn, could have wider public policy implications.Other arguments which have been put forward by those backing the RBI are that the size and dynamics of government borrowing programmes have a much wider influence on interest rate movements, systemic liquidity and even loan growth through the crowding out of private sector loan demand.Management of public debt, therefore, has necessarily to be seen as part of broader macroeconomic management framework involving various trade-offs. According to them, once this is recognised, the centrality of central banks in this regard becomes quite evident and that only central banks have the requisite market pulse and instruments which an independent debt agency, driven by narrow objectives, will not be able to do.

The concern which has been flagged off is that if debt management is moved away from the RBI to DMO, which could function as an extended arm of the ministry of finance, the possibility of conflict of interest is greater as the government is the owner of the majority of banks in India.This conflict of interest is more potent in the backdrop of banking sector continuing to be the dominant player for government market borrowing, with banks holding over 50% of outstanding government securities. As an interim arrangement for a full-fledged agency for managing public debt to be called as Public Debt Management Agency (PDMA), the government in 2016 set up Public Debt Management Cell (PDMC) at RBIs Delhi office.

RBI as National Clearing House

In India RBI acts as the clearing house for settlement of banking transactions. This function of clearing house enables the other banks to settle their interbank claims easily. Further it facilitates the settlement economically. It essentially means the inter-bank cheque clearing settlement.

RBI as Lender of Last resort

The RBI acts as a lender of last resort or emergency fund provider to member banks. If the commercial banks are not able to get financial assistance from any other sources, then as a last resort, they can approach the RBI for the necessary financial assistance. In such situations, the RBI provides credit facilities to the commercial banks on eligible securities including genuine trade bills which are usually made available at repo Rate/MSF. This facility comes into operation when the bank is struggling to survive and there are no sources of credit available because of its weakness.

Custodian of Foreign Reserves

The Reserve Bank of India has the responsibility to act as the custodian of India's reserve of international currencies. It takes up operations in the forex market to stabilize the exchange rate of rupee and ensure that there is no speculation and there is order. To be able to do so effectively, it holds forex reserves which it acquires from the market (purchases). It has about $400 b of forex reserves (2017 November) which includes foreign currency assets, gold and IMF's SDRs. SDRs are increasing in importance since 2008 when dollar stability came under question. Diversification and hedging of risk is being done by all central banks. Even though rupee exchange rate is market driven, RBI watches the movement to ensure order and normalcy and there is no volatility. Thus, it maintains exchange rate oversight. It has many levers which we will discuss in the chapter ahead on BOP.

Supervisory Functions

The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, setting reserve ratios etc. They are:

- Granting license to banks.
- Inspect and make enquiry or determine position in respect of matters under various sections of RBI and Banking Regulation Act.
- Implementation of Deposit Insurance Scheme.
- Periodical review of the work of commercial banks.
- Giving directives to commercial banks.
- Control the non- banking finance corporations.
- Ensuring the health of financial system through on-site and off-site verifications
- Banking Regulation (Amendment) Act 2017 enables the GOI to authorise the RBI to issue directions to banks to initiate insolvency resolution process to recover bad loans.

Promotional Functions

Since Independence, the range of the Reserve Bank's functions has steadily widened. The Bank now performs a variety of developmental and promotional functions. The Reserve Bank promotes banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialised financing agencies. Accordingly, the Reserve Bank helped in the setting up of the IFCI and the SFC; the Industrial Development Bank of India in 1964, the Agricultural Refinance

Corporation of India in 1963 and the Industrial Reconstruction Corporation of India in 1972. These institutions were set up directly or indirectly by the Reserve Bank to promote savings, and to provide industrial finance as well as agricultural finance. NABARD was set up in 1982. It has an important role in facilitating microfinance for financial inclusion. Further, its innovations include banking correspondent model for rural banking.

Functions of Central Bank, In Sum

- monopoly on the issue of banknotes
- the Government's banker
- bankers' bank
- Lender of Last Resort
- manages the country's foreign exchange and gold reserves
- regulation and supervision of the banking industry;
- setting the official interest rate - used to manage both inflation and the country's exchange rate.

The central bank's main responsibility is making of monetary policy to ensure a stable economy, including a stable currency. It aims to manage inflation (rising average prices) as well as deflation (falling prices). It is the lender of last resort, and assists banks in cases of financial distress (see Note on bank runs).

Furthermore, it holds foreign exchange reserves and official gold reserves, and has influence over exchange rates. Some exchange rates are managed, some are market based (free float) and many are somewhere in between ("managed float" or "dirty float"). India falls in the market-determined category largely. Typically a central bank controls certain types of short-term interest rates (repo and reverse repo rates). These influence the stock- and bond markets as well as mortgage and other interest rates.

New Delhi

RBI Act Amended 2006

Government made amendments to RBI Act 1934 and Banking Regulation Act for allowing the apex bank to have more flexibility to fix the Cash Reserve Ratio (CRR). It removed the floor and cap on CRR to provide flexibility to RBI to manage liquidity. This would result in better liquidity management in the system.

RBI And Bitcoin

Bitcoin is a worldwide private cryptocurrency and digital payment system. It is the first decentralized digital currency, as it works without a central repository or single administrator. It was developed under the name Satoshi Nakamoto and released as open-source software in 2009. The system is peer-to-peer, and transactions take place between users directly, without an intermediary.These transactions are verified by network nodes and recorded in a public distributed ledger called a *blockchain*.

Bitcoins are created as a reward for a process known as *mining*. They can be exchanged for other currencies, products, and services. Because of bitcoin's decentralized nature, restrictions or bans on it are impossible to enforce, although its use can be criminalized.The legal status of bitcoin varies substantially from country to country and is still undefined or changing in many of them. While some countries have explicitly allowed its use and trade, others have banned or restricted it.

The Reserve Bank of India is in control of fiat but not bitcoins which is private. A fiat currency is the legal status given to a currency issued by the central bank. Non-fiat cyptocurrencies like bitcoins are not approved or disapproved by the RBI nor does RBI find them to be viable and desirable.

Reserve Bank had talked of possible "black money" risks from virtual currencies like bitcoins and that they are "susceptible to misuse" by terrorists and fraudsters for laundering money. Some have expressed concerns that bitcoin could be a Ponzi scheme. Bitcoins can be inflationary and thus RBI should have a role in regulating it.

The Reserve Bank of India has not given any licence and authorisation to any entity or company to operate such schemes or deal with bitcoins or any virtual currency (VCs). An inter-disciplinary committee, which includes an RBI representative, has been constituted by the Finance Ministry to examine the regulatory framework with regard to virtual currencies in 2017.

Autonomy for RBI

RBI being the architect of the monetary policy requires autonomy to be effective. Advocates of central bank independence argue that a central bank should be autonomous to manage money, credit and exchange rate dynamics in the globalizing economy. It helps check populist pressures and schemes that the political leadership may be tempted to indulge in. For example, the RBI may come under pressure to reduce rates to allow banks to lend easy to corporates and consumers to stimulate growth even as the inflation is high. It can resist the pressure if it has autonomy.

Others believe that the elected governments should have the final say within which RBI should be autonomous both while tendering advice and also with enough discretionary powers. For example, demonetization of 2016 November when the government suggested to the RBI and RBI agreed.

The recent measures to make RBI independent are

- replacement of adhoc treasury bills with WMA from 1997
- FRBM Act empowers RBI with autonomy- no primary borrowing from 1-4-2006.
- RBI Act amended in 2006 to give it more power for reserve requirement management

The arguments in favour of autonomy are:

- monetary stability which is essential for the efficient functioning of the modern economic system can be best achieved if professional Central bankers with the long term perspective are given charge. Otherwise, political leadership may be tempted to populism
- without such autonomy, government tends to be profligate with its policies of automatic monetization

The arguments against are:

- democratic systems are run with Parliament and Cabinet making all important policies
- monetary policy is an integral policy of the overall economic policy and so RBI has to subordinate itself to the larger objective.

The best course is to have a middle path like in the MPC where the RBI and others together take decisions.

RBI Dividend

The RBI functions according to the Reserve Bank of India Act of 1934. Chapter 4, section 47 of the Act, titled "Allocation of Surplus funds" lays down that profits("surplus) made by the RBI from its operations should be transferred to the GOI.The original provision states :"After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds .. the balance of the profits shall be paid to the Central Government."

The RBI earns its profits through its open market operation; forex market interventions etc. When what it costs the RBI is deducted from the gross profit, net is arrived at and that is called surplus and goes to the GOI.

Specified Bank Notes (Cessation of Liabilities) Act 2017enabled the Central Bank to write off the unreturned amount from its balance sheet after the demonetisation.The written-off amount, under the law, can be transferred to the government as a special dividend.

The Centre had budgeted Rs 58,000 crore as dividend from the RBI in 2017. The Reserve Bank of India (RBI) paid a dividend of Rs 30,659 which was less than half of the Rs 65,876 crore that was transferred in FY 2015-16. The fall in the amount may be due to the additional costs incurred because of printing of new currency notes and in managing the excess liquidity due to the unexpected and huge inflow of deposits into the banking system post remonetisation.

The lower dividend may make it necessary to borrow more from market thus widening the fiscal deficit, unless tax collections or some other budgetary source shows better than expected performance.

Money Supply

New Delhi

This refers to the total volume of money circulating in the economy. Money supply can be estimated as narrow or broad money.

M1 equals the sum of currency with the public and demand deposits with the banks. It is the narrow money.

M3 or the broad money, as it is also known, includes time deposits (fixed deposits), savings deposits with post office saving banks and all the components of M1.

These notions are important for the RBI to understand the demand in the economy so that it can gauge inflation, demand and so on for it to adjust the same. But with the coming of credit cards, bitcoins etc, the utility of these concepts is relatively diminished.

Liquidity Trap

A **liquidity trap** is a situation when rates and reserve requirements are lowered to stimulate demand but it does not impact on reviving demand and growth. There are no takers for bank credit. It happens in times of recession that is getting worse. There are deflationary expectations and the economy can be faced with the problem of short-term interest rates reaching or nearing zero. This makes the monetary policy ineffective. To come out of liquidity trap, QE is attempted. Otherwise, recession can turn into depression.

Quantitative Easing

The term quantitative easing describes an unconventional form of monetary easing used to stimulate an economy. It involves the central bank to buy financial instruments which in ordinary times are not accepted for OMOs- for example, the housing market securities that were discredited in the USA since 2008. It is a step that is taken after the interest rate reduction to very low levels and similar downward adjustment of reserve ratios like CRR fail to induce any positive change. It involves printing fresh currency and de-risking lending as rates and supply of money ease to unprecedented levels. Central bank uses unconventional means, other than the usual monetary policy tools, to flood the financial system with new money through quantitative easing.

Federal Reserve of the US (its central bank like the RBI) used quantitative easing to overcome the liquidity crisis since the fall of Lehman Brothers in 2008 September when many banks went bankrupt and credit froze. It worked as US came out of recession. In 2017, GDP of USA increased at about 3% leading to announcement of its ending in October 2017.

EU, Japan and Britain also used the technique of QE to shore up growth.

Taper Tantrums

The unconventional monetary policy called quantitative easing means printing money by the central bank and supplying it to the market to stimulate demand and revive growth. US Central Bank Federal Reserve Started it in 2009 and since it is not meant to be a long term solution to recession and deflation, it is being phased out with the return of growth and inflation. Also, continuation of QE unduly leads to asset bubbles. Closing it in phases is called -tapering. When QEs is being tapered, markets react adversely as rates become dearer and consumers will not like it. Bonds sell off and stocks may fall as money supply decreases. On the other hand, when rates go up as taper takes effect, global money goes to USA as it earns them more in US banks. Other currencies may fall as Indian Rupee did in 2013 when QE taper started. These aftershocks of QE taper are called —taper tantrum. The US Federal Reserve in 2017 September announced the unwinding of the biggest experiment in the history of central banking starting from October. It will start the process of normalizing its balance sheet from October.There is such talk again and the question is how India will be affected. India is said to be more comfortable in late 2017 for the following reasons:

1. Real GDP growth is good though the potential is far higher than the actual. Therefore, foreign flows will continue thus checking any fall in rupee.
2. The country's foreign exchange reserves are at a record high of $404 billion in November 2017 mainly due to a rise in foreign currency assets (FCAs) and will arrest the possible fall in rupee.
3. Because India's interest rate is relatively high, existing foreign money will stay and more will come to take advantage of it.

Experts suggested that because of the volatility created in domestic and global markets due to the QE taper, there should an international mechanism to regulate it as US dollar is a global reserve currency and US GDP is worth about $19 trillion.

FSDC

Financial Stability and Development Council is apex-level body constituted by government of India. The idea to create such a super regulatory body was first mooted by Raghuram Rajan Committee in 2008.The recent global economic meltdown has put pressure on governments and institutions across globe to regulate the financial sector towards greater stability.

The new body envisages to strengthen and institutionalise the mechanism of maintaining financial stability, financial sector development, inter-regulatory coordination along with monitoring macro-prudential regulation of economy.

Its Chairperson is the Union Finance Minister of India.

Members are:

- Governor Reserve Bank of India (RBI),
- Finance Secretary and/ or Secretary, Department of Economic Affairs (DEA),
- Secretary, Department of Financial Services (DFS),
- Chief Economic Advisor, Ministry of Finance,
- Chairman, Securities and Exchange Board of India (SEBI),
- Chairman, Insurance Regulatory and Development Authority (IRDA),
- Chairman Pension Fund Regulatory and Development Authority (PFRDA),
- Joint Secretary (Capital Markets), DEA, will be the Secretary of the Council,
- The Chairperson may invite any person whose presence is deemed necessary for any of its meeting(s).

Responsibilities

- Financial Stability
- Financial Sector Development
- Inter-Regulatory Coordination
- Financial Literacy
- Financial Inclusion
- Macro prudential supervision of the economy including the functioning of large financial conglomerates
- Coordinating India's international interface with financial sector bodies like the Financial Action Task Force (FATF), Financial Stability Board (FSB) and any such body as may be decided by the Finance Minister from time to time.

17th Meeting of FSDC

The seventeenth Meeting of the Financial Stability and Development Council (FSDC) was held in mid-2017.

The Council noted that India has macro-economic stability today on the back of improvements in its macro-economic fundamentals, structural reforms with the launch of the Goods and Services Tax (GST), action being taken to address the Twin Balance Sheet (TBS) challenge, financial market confidence, reflected in high and rising bond and especially stock valuations and long-term positive consequences of demonetization. The Council also discussed the issues and challenges facing the Indian economy.

The Council also took note of the progress of Financial Sector Assessment Program for India, jointly conducted by the International Monetary Fund and the World Bank. Council directed that the assessment report should be finalized by the end of this calendar year. FSDC took note of the developments and progress made in setting up of Computer Emergency Response Team in the Financial Sector (CERT-Fin) and Financial Data Management Centre and discussed measures for time bound implementation of the institution building initiative. A brief report on the activities undertaken by the FSDC Sub-Committee Chaired by Governor, RBI was placed before the FSDC. The Council discussed the Central KYC Registry (CKYCR) system. The Council also deliberated on strengthening the regulation of the Credit Rating Agencies (CRAs).

CKYCR: Central KYC Registry or CKYCR replaces the multiple KYC submission process while opening savings bank accounts, buying life insurance or investing in mutual fund products into one time centralized process. The Government of India authorized the Central Registry of Securitization and Asset Reconstruction and Security interest of India (CERSAI) to manage Central KYC Registry process. From 1st August, 2016 this new process was made applicable to all individuals.

India and Financial Stability Board (FSB)

FSB was established in 2009 under the aegis of G20 by bringing together the national authorities, standard setting bodies and international financial institutions for addressing vulnerabilities and developing and implementing strong regulatory, supervisory and other policies in the interest of financial stability. India is an active Member of the FSB having three seats in its Plenary represented by Secretary (EA), Deputy Governor-RBI and Chairman-SEBI. The FSDC Secretariat in the Department of Economic Affairs coordinates with the various financial sector regulators and other relevant agencies to represent India's views with the FSB.

Macro Prudential Analysis

New Delhi

Macro prudential analysis is a method of economic analysis that evaluates the health, soundness and vulnerabilities of a financial system. Macro prudential analysis looks at the health of the financial institutions in the system and performs stress tests(simulate financial crises and check impact on the banks and other financial institutions) and scenario analysis to help determine the system's sensitivity to economic shocks.

Monetary Policy Committee (MPC)

Monetary policy decisions by central banks are crucial for individuals for their consumer loans, corporates for their investment and government for its fiscal operations like borrowing. They are also crucial for savings, economic growth, price stability and financial stability. Therefore, the decisions need to be taken by a committee as many governments do. Committee system has many voices; not subject to vagaries of individual judgement; has multiple stakeholders and institutional continuity

In 2016, the Government amended the RBI Act to create Monetary Policy Committee (MPC). MPC was set up consequent to the agreement reached between Government and RBI to task RBI with the responsibility for price stability through inflation targeting. The Reserve Bank of India and Government of India signed the Monetary Policy Framework Agreement in February 2015.

Subsequently, in the Finance Act 2016 the government amended the Reserve Bank of India (RBI) Act, 1934 for giving a statutory backing to the MPC Agreement and for setting up a Monetary Policy Committee (MPC). By this amendment, it was written into the preamble of the RBI Act that the primary objective of the monetary policy is to maintain price stability, while keeping in mind the objective of growth and to meet the challenge of an increasingly complex economy. A new Chapter was introduced in the RBI Act detailing the operation of MPC. The new MPC is to be a six-member panel headed by the RBI Governor that is expected to bring value and transparency to interest rate-setting decisions. It is entrusted with the task of fixing the benchmark policy interest rate (repo rate) to contain inflation within the specified target level. The MPC replaces the system where the RBI governor, with the aid and advice of his internal team and a technical advisory committee, had complete control over monetary policy decisions.

It has three members from the RBI- Governor, the RBI Deputy Governor in charge of monetary policy, one official nominated by the RBI Board; and three independent members to be selected by the Government. The three central government nominees of the MPC appointed by the search cum selection committee will hold office for a period of four years and will not be eligible for re-appointment. RBI Act prohibits appointing any Member of Parliament or Legislature or public servant. A search committee will recommend three external members, experts in the field of economics, banking or finance, for the Government appointees. The MPC will meet atleast four times a year to decide on monetary policy by a majority vote. And if there is a tie, the RBI governor has the deciding vote.

Functions of the MPC: Under the Monetary Policy Framework Agreement, the RBI will be responsible for containing inflation targets at 4% (give or take 2%) in the medium term. Central Government determines the inflation target in terms of the headline (unadjusted) Consumer Price Index, once in every five years in consultation with the RBI. RBI would have to give an explanation in the form of a report to the Central Government, if it failed to reach the specified inflation targets for three consecutive quarters. It shall, in the report, give reasons for failure, remedial actions as well as estimated time within which the inflation target shall be achieved. Further, RBI has to publish a Monetary Policy Report every six months, explaining the sources of inflation and the forecasts of inflation for the coming period of six to eighteen months.

MPC decides the changes to be made to the policy rate (repo rate) so as to contain the inflation within the target level specified to it by the Central Government. Minutes of the MPC meeting are published by RBI after 14 days. In addition, subsequent to the MPC meeting, RBI has to publish a document explaining the steps to be taken by it to implement the decisions of the Monetary Policy Committee.

The MPC takes decisions based on majority vote (by those who are present and voting). In case of a tie, the RBI governor will have the second or "casting" vote. It is a casting vote in the sense that it breaks a tie. The decision of the Committee would be binding on the RBI. The government may, if it considers necessary, convey its views, in writing, to the MPC from time to time. RBI is mandated to furnish necessary information to the MPC to facilitate their decision making and if any Member of the MPC, at any time, requests the RBI for additional information, including any data, models or analysis, the same have to be provided, not just to that member but to all members.

In 2002 Y. V. Reddy Committee recommended for a MPC to decide policy actions. Subsequently, suggestions were made to set up a MPC in 2006 by the Tarapore Committee, in 2007 by the Percy Mistry Committee, in 2009 by the Raghuram Rajan Committee and then in 2013, both in the report of the Financial Sector Legislative Reforms Commission (FSLRC) and the Dr. Urjit R. Patel

Committee.As can be seen from above, India's shift to an MPC is driven by a clear inflation-targeting framework.

Negative Interest Rates

The Bank of Japan, the European Central Bank and several smaller European countries started negative interest rates regime lately. It is an attempt to spur demand and revive economy. Negative interest on excess reserves of banks parked with the central bank is an instrument of unconventional monetary policy applied by monetary authorities in order to encourage lending by making it costly for commercial banks to hold their excess reserves at central banks. Commercial banks have accounts with the central bank as the central bank is a bankers' bank. When they deposit their excess of money in their central bank accounts, generally they get paid for it. But in the NI regime, it is the reverse. Thus, NI is a rate when lender pays the borrower.Such policy can be associated with very slow economic growth, deflation, and attempts to prevent currency appreciation. The European Central Bank and central banks of other European countries, such as Sweden, Switzerland, and Denmark, have paid negative interest on excess reserves—in effect taxing banks for exceeding their reserve requirements - as an expansionary monetary policy measure. It makes lending by banks cheaper as banks will not keep their excess reserves in a central bank deposit account due to negative returns. They have to lend it. Further, there is competition among banks to lend their excess reserves and that also will push rates down. Low rates should make euro investors try to move to places where interest rates are higher, such as the U.S. When they do so, they sell euros and buy dollars which can weaken their currency for keeping exports high and attracting tourists. The Swiss National Bank, for instance, wants to keep the Swiss franc from strengthening against the euro. The criticism: Older people who depend on interest income are hurt and may cut their consumption more deeply than those who benefit – rich owners of equity. Many investors will shift their portfolios toward riskier assets, exposing the economy to greater financial instability.

Demonetisation

On 8 November 2016, the Government of India announced the demonetisation of all ₹500 and ₹1,000 banknotes of the Mahatma Gandhi Series.The government sought to curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. Those with these notes had to deposit them in the bank and exchange them for new notes though initially there were some restrictions. By the end of August 2017, 99% of the banned currency was deposited in banks, leaving only around ₹14,000 crore of the total demonetised currency discarded.

The Indian government had demonetised bank notes on two prior occasions—once in 1946 and then in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. In 1946, the pre-independence government hoped demonetisation would penalise Indian businesses that were concealing the fortunes amassed supplying the Allies in World War II. In 1978, the Janata Party coalition government demonetised banknotes of 1000, 5000 and 10,000 rupees, again in the hopes of curbing counterfeit money and black money. Demonetisation under the two occasions was done bh an ordinance while the 2016 decision was an executive decision.

Monetary Policy Transmission

(In the classroom)

INFLATION: CONCEPTS, FACTS AND POLICY

Inflation means a persistent rise in the price of goods and services. While inflation may the proof of growth- assuming it is the demand that is riving up prices, inflation when unchecked hurts welfare as it reduces the purchasing power of money. It impoverishes the poor disproportionately more as a greater proportion of their incomes are needed to pay for their consumption. Inflation reduces savings; pushes up interest rates; dampens investment; leads to depreciation of currency thus making imports costlier which feeds into inflation further.

Depending upon the rate of growth of prices, inflation can be of the following types:

Creeping inflation is a rate of general price increase of upto 4% a year. It has the same effect of erodeing the purchasing power of money when continued over many years, but it is "manageable." It is largely welcome inflation as it shows there is growth and is even refered to as price stability. It is a deterrent to deflation. It may even be considered good for the economy as producers an traders make reasonable profits encouraging them to invest.

Trotting inflation is when creeping inflation increases a few more hundreds of basis points. (A basis point is 1/100. 100 basis point is 1%).

If not controlled, trotting inflation may accelerate into a galloping inflation which may be around 8-10% a year.

If it aggravates, galloping inflation can aggravate to "runaway" inflation which may change into a hyperinflation.

Hyperinflation is when prices are "out of control." That is, a monthly inflation rate of 20 or 30% or more- 'an inflationary cycle without any tendency toward equilibrium'. The worst is a monetary collapse, if prices are not reined in, in time, money loses its value and either barter may become popular or a foreign currency will become the dominant medium of exchange

It must be noted that rates of growth of prices that are attached to the above mentioned terms are not of universal application. The tolerance levels differ from country to country. Developed countries have far lower tolerance levels compared to developing countries. In India , from 2008-13, inflation ruled above 10% which is most unlikely to be tolerated in advanced economies.

Other related concepts are:

- deflation when there is a persistent general fall in the level of prices
- disinflation is the reduction of the rate of inflation
- stagflation which is a combination of inflation and rising unemployment due to recession and
- Reflation, which is when inflation returns after a spell of deflation and recession thus showing that growth is back as seen in the US and EU after the great recession (2007-09) when growth was revived.

Measures of Inflation

GDP deflator

It is the most comprehensive measure of inflation as it reports the change in prices of all domestically produced final goods and services in an economy. The GDP deflator is not based on a fixed market basket of goods and services but applies to all goods and services domestically produced as implied above.

Cost of living index

A certain standard of living requiring a specific set of goods and services is defined and the basket is tracked for price rise to check affordability. The cost of living is the cost of maintaining such predefined standard of living. When their cost goes up, the index goes up and is refered to as "dearer.". It has a value of 100 in the base year. An index value of 105 indicates that the cost of living is five percent higher than in the base year.

PPI

The price at which the producer sells to the wholesaler/distributor is the producer price. Tracking it is done by the Producer price index (PPIs). It gauges the change in the prices received by a producer. The difference with the WPI is accounted for by logistics, cost of credit, warehousing costs, transportation costs, margins, risk considerations etc. Producer price inflation measures the increase in prices of inputs like raw materials, wages, rupee exchange rate if imports are involved etc. The Department of Industrial Policy and Promotion, Ministry of Commerce and Industry set up a working group on the PPI in August 2014 under the chairmanship of **B.N. Goldar** to outline the timeline for launch of the PPI series.

WPI

Wholesale price index comprises transactions at first point of bulk sale in the domestic market.

CPI

Consumer price index measures the changes in prices paid by the consumer at the retail level. It can be for the whole economy or group-specific- for example, CPI for industrial workers etc as in India.

Types of Inflation Based On Causes

- **Demand-pull inflation:** inflation caused by increases in demand due to increased private and government spending, etc. It involves inflation rising as real gross domestic product rises and unemployment falls. This is commonly described as "too much money chasing too few goods". For example, food inflation related to protein items have been high-priced for many years in India as demand has shot up due to consumption patterns in India shifting due to income increases. Demand-pull inflation can be caused by money supply increasing. For example, the expansionary monetary policy of the RBI in 2009 saw rates come down and easy and cheap credit pushed up prices as demand grew. Wage inflation, money supply growth etc create this type of inflation. Collapse of demand causes prices to plunge- for example international crude prices crashed since 2014(there are many reasons other than the global slowdown though: US shale gas coming up; renewables emerging in a big way; Iran sanctions were lifted; Iraq was able to produce and export as the country stabilized)
- **Cost-push inflation:** When the cost of production goes up, it leads to cost-push inflation. For example, a higher prices for inputs; higher cost of capital; in India, monsoon failure and

damage to production; international commodity prices go up, for example, crude or food or metals. It is also refered to as "supply shoc," caused by reduced supplies due to increased prices of inputs, for example, crude prices globally had gone up till 2014 causing supply constraints which meant higher costs of production and so higher prices. Just as a shortage of goods tends to push prices up, an oversupply of commodities tends to induce the opposite effect on prices.

- **Structural inflation:** A type of persistent inflation caused by deficiencies in certain conditions in the economy such as a backward agricultural sector that is unable to respond to people's increased demand for food, inefficient distribution and storage facilities leading to artificial shortages of goods, backward technology and the resulting underproductivity is also a structural source of inflation. Food inflation witnessed for a decade in India till mid-2010s was structural in nature as the preference for protein foods is far ahead of its supplies and this is a phenomenon driven by income rise.
- **Speculation** in the commodity exchanges
- **Cartelization** of producers when they come together and manipulate the prices in the market for the goods or services that they produce for their own profits. For example, Competition Commission of India (CCI) had imposed penalties in 2016 upon 10 cement companies and their trade association i.e. Cement Manufacturers Association (CMA) for cartelisation in the cement industry.
- **Hoarding,** that is, accumulation of huge quantities of goods and releasing them into the market in conditions of scarcity at higher prices is also a cause of inflation. In 2017 September, Income Tax department raided major onion traders in Lasalgaon and surrounding areas in Nashik district of Maharashtra, one of the largest onion markets in the country on the basis of information that the onion traders of Lasalgaon and adjoining towns were involved in the hoarding of onions and planning to create an artificial scarcity in the market to inflate the prices. Essential Commodities Act, 1955 aims to check hoarding, among other things. In 2014, GOI included onions and potatoes for one year under the ECA to curb hoarding. The decision taken by the Cabinet Committee on Economic Affairs (CCEA) imposed limits on the quantity of onions and potatoes that individuals and wholesale traders could stockpile. It empowered state governments to take measures to prevent hoarding.
- Imported inflation when a country that depends on imports has its prices rising due to international prices of them rising or due to exchange rate depreciating

High Inflation Hurts

If inflation is high in an economy, the following problems can arise

- low income groups are particularly hurt
- People on a fixed income (e.g. pensioners, students receiving scholarships) will be worse off in real terms due to higher prices and same income as before
- inflation discourages exports as domestic sales are attractive . Inflation may erode the external competitiveness of domestic products if it leads to higher production costs such as wage increases, and higher interest rate.
- inflation can drag down growth as investment climate turns bad due to instability and uncertainty and also as interest rates are raised and cost of credit increases

- Inflation may discourage saving and thus hit investment. The savings pattern also gets skewed in favour of unproductive assets like gold as inflation may be higher than interest rates and yield is negative.
- Inflation tax is a hidden tax. It is the financial loss in the value of money incurred by holders of cash. Another way of seeing it is: when the government wants to tax people, they resist it. But the government needs the money. So it prints and releases the money into market and that inflates the economy which means people pay more for the goods and services they consume. The end result is that the tax that they did not pay is paid by way of price rise.
- strikes can take place for higher wages which can cause a wage spiral. Also if strikes occur in an important industry which has a comparative advantage the nation may see a decrease in productivity, exports and growth.
- Govt. fiscal deficit may go up as the need to subsidise is more to make goods and services affordable

Small Amount of Inflation Can Be Good

Inflation means growth, normally- higher incomes and more demand and so more inflation. It can be argued that a low level of inflation can be good if it is a result of innovation. Thus, there is encouragement for innovation .Also, a small price rise is necessary for wages to go up. It further helps the economy keep off deflation which can otherwise set off a recession. Besides, inflation at a moderate level is an incentive to the producer. Some see mild inflation as "greasing the wheels of commerce."

Losers: Individuals on fixed incomes, retirees, all creditors (who lent at fixed rate of interest.)

Gainers: Individuals whose incomes rise faster than inflation, debtors (who will pay back at fixed rate of interest).

Optimal Inflation

For the consumer, inflation should be negative which means prices should drop in absolute terms as it helps him afford goods and even save. That is possible when supplies outstrip demand on a sustainable basis which is not possible as the producer incurs losses. Negative inflation which is desirable from consumer viewpoint is also possible if government subsidises goods and services adequately. But that is impossible fiscally as deflation hurts fiscal receipts and on top of it, subsidies bill will damage the fiscal position even more. Besides, consumer will not be benefited if prices fall due to recession-driven deflation as it may hurt his own job and business prospects in the medium run.

So we can aim at inflation that is in the positive territory that augurs well for economic well being for all- producers and consumers alike. Too much inflation hurts from all sides. Too little is no incentive for growth. There has to be price stability at a moderate level of inflation. But the question remains how much of inflation will be good for the economy- growth, welfare and stability wise. In India, Reserve Bank of India and Government of India signed a Monetary Policy Framework Agreement in 2015 which says that the objective of monetary policy framework is mainly to maintain price stability, while keeping in mind the objective of growth. The monetary policy framework would be operated by the RBI. RBI would aim to contain consumer price

inflation within 4 percent with a band of (+/-) 2 percent. This level of inflation is considered optimal from growth, stability, fiscal consolidation, foreign trade and welfare perspectives.

Concepts

Open Inflation

One of the primary responsibilities of the government is to ensure affordability of goods and services. Governments subsidise goods and services to keep them inexpensive. For example, kerosene, food, transport etc. The inflation that results when the government does not suppress it with subsidies and monetary policy is called open inflation.

Suppressed Inflation

Inflation is too big a risk for the economy for the government to allow it to continue unchecked. Therefore, fiscal and monetary actions are taken to manage it. That is called suppressed inflation. It is named so because, the problem of inflation is only managed and not resolved. It may reemerge if fiscal policies changed- reduce subsidies etc.

Headline Inflation

Headline inflation is a measure of the total inflation. It is an unadjusted number. It is the overall inflation as it is reported. It is best understood when contrasted with core inflation given below. Headline inflation is what consumers experience.

'Core' or' Underlying Inflation'

Core or underlying inflation measures the long-run trend in the general price level. Temporary effects on inflation are factored out to calculate core inflation. For this purpose, certain items are excluded from the computation of core inflation. These items include: changes in the price of fuel and food which are volatile or subject to short-term fluctuations and/or seasonal in nature like food items. In other words, core or underlying inflation is an alternative measure of inflation that eliminates transitory effects .The main argument here is that the central bank should effectively be responding to the demand side- for example, the money available in the market, demand for credit and so on and not the supply shocks like energy and food. Headline inflation on the other hand includes the official rate of increase in prices that excludes no item in the basket. Core inflation excludes the changes in the fuel and food articles and the food processing part of manufacturing.

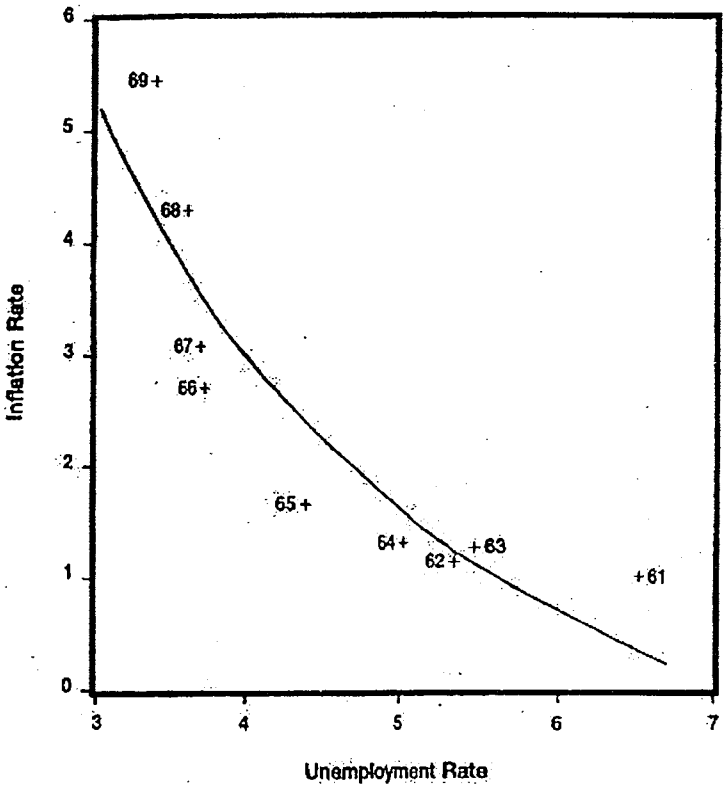
Headline and core inflation are calculated both at the wholesale and consumer levels. CPI (Combined, that is rural and urban) headline inflation is considered when inflation is being targeted in the country by the RBI since 2015.

Philips's Curve

The inverse relationship between rate of inflation and rate of unemployment is shown in the Phillips curve: price stability has a trade-off against employment. Some level of inflation could be considered desirable in order to minimize unemployment.

Potential output (sometimes called the "natural gross domestic product") is an important concept in relation to inflation. It is the level of GDP where the economy is at its optimal level of production, given various constraints- institutional and natural. (Discussed elsewhere in the Notes)

If GDP exceeds its potential, inflation will accelerate and if GDP falls below its potential level, inflation will decelerate as suppliers attempt to use excess capacity by cutting prices.



Deflation

Deflation is a prolonged and widespread decline in prices that causes consumers and businesses to curb spending as they wait for prices to fall further. It is the opposite of inflation, when prices rise, and should not be confused with disinflation, which merely describes a slowdown in the rate of growth of prices. Deflation may occur at the wholesale or retail level. It may result for demand side or supply side reasons.

Deflation is hard to deal with because it is self-reinforcing. Deflation needs to be checked with Keynsian stimulus or it can breed deeper deflation, leading to what is known as a deflationary spiral.

When an economy experiences deflation, demand from businesses and consumers to buy products goes down because they expect to pay less later as prices fall further. With crashing demand, producers can not to sell and go bankrupt, unemployment rises reducing demand further. That causes deflation to become even more aggravated. It makes it more expensive to service existing debts. As debt becomes unserviceable, the risk of default and bankruptcy rises too and banks become reluctant to lend as their own NPAs rise.

Remedy:

- Tax cuts to boost demand from consumers and businesses
- Lowering central bank interest rates to encourage economic activity
- Printing more currency to boost money supply
- Capital injections into the banking system
- Increase government spending on projects that boost the return on private investment

India did not face the threat of deflation at the retail level but till December 2015 for 14 consecutive months, Wholesale Price Index (WPI) inflation was in the negative.

Inflation And Corruption

The link is as follows

- through black money
- hoarding not being checked
- commodity prices being manipulated through speculation as NSEL crisis shows.

Inflation Targeting

Inflation targeting focuses mainly on achieving price stability as the ultimate objective of monetary policy. This approach entails the announcement of an inflation target- either a number or a range, that the central bank promises to achieve over a given time period. The targeted inflation rate will be set jointly by the RBI and the government, the responsibility of achieving the target would rest primarily on the RBI. This would reflect an active government participation in achieving the goal of price stability with fiscal discipline by way of a rational borrowing programme (not borrowing in excess).

Monetary policy and fiscal policy have to converge for achievement of inflation targeting Advantage is that it promotes transparency in the conduct of monetary policy. Further, it increases the accountability of monetary authorities to the inflation objective.

Reserve Bank of India (RBI), entered into an agreement with the Ministry of Finance in 2015 that mandates the RBI to bring inflation below 6% by January 2016, and 4% (plus or minus 2%) in the following years. Target is set by GOI in consultation with RBI but the RBI is responsible for achieving it.

In case of failure to meet targets, RBI has to explain the reason for its failure to meet as well as give a timeframe within which it will achieve it. RBI will publish the operating targets as well as operating procedure for the monetary policy though which the target for the monetary policy will be achieved. The RBI will also be required to bring a document every six months to explain the sources of inflation and forecast for inflation for next 6-18 months.

As recommended by Urjit Patel Committee in 2013, RBI has been using headline CPI (Combined) inflation as the nominal anchor for targeting.

This flexible inflation targeting framework which is a paradigm shift is positive for India because it increases monetary policy transparency, predictability and chances of effectiveness.

Indices of Inflation

Changes in the price levels at the wholesale and retail level are tracked by various price indices in India- WPI and CPI. 3 CPIs exist for different consumer groups each of which is homogenous.

All price indices use a particular year as a "base year". That means that rises or falls in prices are measured with reference to the price in that year. For example, the base year used for the Wholesale Price Index is 2011-12 from the fiscal year 2017-18. Wholesale prices of all products in the basket with their respective weightages in that year add upto "100". If, in the base year, the wholesale price of *gur* was Rs.2 a kg, and rose by 50 paise the following year, it would mean that

the wholesale price index for *gur* would rise to 125. But the movement of an index is based on the average of price movement of all the goods in the basket and not just one article.

Ideally the same base year should be used for all indices but different base years are used for different price indices due to convenience, data availability, logistics etc.

WPI

Main uses of WPI

The main uses of WPI are the following: a) Provides estimates of inflation at the wholesale transactions level for the economy as a whole. This helps in timely intervention by the Government to check inflation, in particular inflation in essential commodities, before the price increase spills over to retail prices. WPI is used as deflator for many sectors of the economy for estimating GDP by CSO. It is also used to deflate nominal values of production in high frequency IIP. Global and domestic investors also track WPI as one of the key macro indicators for their investment decisions.

The Indian WPI is updated on a monthly basis. The WPI is published by the Economic Advisor in the Ministry of Commerce and Industry, with a month lag. The various commodities taken into consideration for computing the WPI can be categorized into primary article, fuel and power, and manufactured goods. Primary articles included for the computation of WPI include food articles, non-food articles and minerals. In the fuel, power, light and lubricants, electricity, coal mining and mineral oil are included. The manufactured goods category encompasses food products; beverages, tobacco and tobacco products, wood and wood products, textiles, paper and paper products, basic metals and alloys, rubber and rubber products and many others. The index is a vital guide in economic analysis and policy formulation.

The WPI is not intended to capture the effect of price rise on the consumer though it generally and broadly indicates it. WPI has an All India character. It is due to these attributes that it is widely used in business and industry circles and in Government and is generally taken as an indicator of the rate of inflation in the economy. The inflation rate is calculated on point to point basis i.e. on the basis of the variation between the index of the latest week of the current year and for the corresponding week of the previous year.

There are a number of agricultural commodities, especially, some fruits and vegetables, which are of a seasonal nature. Such seasonal items are handled in the index in a special manner. When a particular seasonal item disappears from the market and its prices are not quoted, the index of such an item ceases to get compiled and its weight is distributed over the remaining items and new seasonal items, if any, in the concerned sub-group.

Limitations on WPI

The accuracy of WPI is unsatisfactory even after the introduction of the revised series in 2017. Services such as rail and road transport, health care, postal, banking and insurance, for example, are not part of the WPI basket. Neither are the products of the unorganised sector that are estimated to constitute about 35 per cent of the total manufactured output of the country. The index thus falls well short of being a broad based indicator of the price level even in its construction.

New All-India Wholesale Price Index (WPI)

The Government periodically reviews and revises the base year of the macroeconomic indicators as a regular exercise to capture structural changes in the economy and improve the quality, coverage and representativeness of the indices. As a part of the ongoing exercise, the base year of All-India WPI has been revised from 2004-05 to 2011-12 by the Office of Economic Advisor (OEA), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry to align it with the base year of other macroeconomic indicators like the Gross Domestic Product (GDP) and CPI. The revision entails shifting the base year to 2011-12 from 2004-05, changing the basket of commodities and assigning new weights to the commodities. For the new series with base 2011-12=100, Working Group was chaired by Late Dr. Saumitra Chaudhuri, Member, erstwhile Planning Commission and comprised most stakeholders. WPI basket does not cover services.

What Is New In The New Series

In the new WPI series significant improvement in concept, coverage and methodology has been made. In the revised WPI basket, the number of items has been increased from 676 to 697. Efforts have been made to enhance the number of quotations from 5482 to 8331. The increase in number of quotations has been done across the major groups to ensure comprehensive coverage and representativeness. New definition of wholesale price index does not include taxes in order to remove impact of fiscal policy. This also brings new WPI series closer to Producer Price Index and is in consonance with the global practices. Further for the first time a Technical Review Committee has been set up to recommend appropriate methodological intervention to continuously improve coverage, quality and timeliness of the WPI.

The new series also present separate 'WPI Food Index' which along with CPI Food Price Index published by CSO would help monitor the food inflation effectively.. The seasonality chart of the Fruits and Vegetables Sub Group under the Food Articles has been updated in the new series. Prices of seasonal fruits and vegetables will be available for longer period. For example, tomato price index will now be available around the year as against eight months in the earlier series of WPI (base 2004-05). Cauliflower was earlier available only for six months but now it will be available for eight months in year.

Why is the indirect tax not been included in the compilation of WPI in the new series?

A significant change in the new series of WPI has been the exclusion of indirect taxes while compiling indices of manufactured products. The Working Group for revision of WPI had recommended that taxes should not figure in this measure so that price signals emerging from production side of the economy are not influenced by the fiscal policy.

Excluding indirect taxes brings the new series of WPI conceptually closer to the concept of output Producer Price Index (PPI). This is also in keeping with the international best practices. The exclusion of indirect taxes would also ensure the continuity and compatibility of new WPI series when Goods and Services Tax (GST) is introduced.

Summary of New WPI

The base year of wholesale price index (WPI) has been revised to 2011-12 from 2004-05 by the Office of the Economic Adviser. Govt. of India, Ministry of Commerce & Industry Department of Industrial Policy & Promotion (DIPP) who is in charge of the WPI. Under the revised series, WPI will continue to consist of three major groups namely, Primary Articles, Fuel & Power and Manufactured Products. Item level prices do not include indirect taxes in order to remove the impact of fiscal policy. There has been an increase in number of source agencies in general across

all major groups while dormant sources have been removed. Additionally, a new WPI Food Index has been compiled combining the Food Articles under Primary Articles and Food Products under Manufactured Products.

WPI with 2011-12 base year						
Groups	**Weight**	**Items**	**Quotations**	**Weight**	**Items**	**Quotations**
Base year	**2004-05**	**2004-05**	**2004-05**	**2011-12**	**2011-12**	**2011-12**
Primary Articles	20.12	102	579	22.62	117	983
Fuel & Power	14.91	19	72	13.15	16	442
Manufactured Products	64.97	555	4,831	64.23	564	6,906
WPI	100	676	5,482	100	697	8,331

The overall inflation trajectory of FY17 has shifted downwards due to the change in the base year. The Government of India (Allocation of Business) Rules, 1961, with subsequent amendments, assigns the responsibility for compiling the WPI to the Office of the Economic Adviser in the Department of Industrial Policy and Promotion under the Ministry of Commerce and Industry. The Economic Adviser holds the final authority for all decisions regarding the WPI.

CPI

A **Consumer Price Index (CPI)** measures changes in the prices of a basket of consumer goods and services purchased by households. The CPI measures price changes by comparing, through time, the cost of a fixed basket of commodities. It is based on a point to point comparison like the WPI- that is, prices at two points of time are compared. For example, prices of October 2018 are compared to the prices of October 2017. Sub-indexes are computed for different categories and sub-categories of goods and services, being combined to produce the overall index with weights reflecting their shares in the total of the consumer expenditures covered by the index. CPI can be used to index (i.e., adjust for the effect of inflation) the real value of wages, salaries, pensions, for regulating prices etc.

The dearness allowance of Government employees and wage contracts between labour and employer is based on this index.

Over the years, CPIs have been widely used as a macroeconomic indicator of inflation, and also as a tool by Government and Central Bank for targeting inflation and monitoring price stability (2015 onwards based on Urjit Patel committee report in 2013) . CPI is also used as deflators in the National Accounts. Therefore, CPI is considered as one of the most important economic indicators.

Consumer price index numbers were known as "Cost of Living Index Numbers" prior to 1955. The Sixth International Conference of Labour Statisticians recommended the change in nomenclature from Cost of Living Index to Consumer Price index. The Cost of living index is a more broader term which includes not only changes in prices but several other factors like change in consumption habits and standard of living.

Presently the consumer price indices compiled in India are:

- CPI for Industrial workers CPI (IW)
- CPI for Agricultural Labourers CPI (AL)

- Rural Labourers CPI (RL)
- CPI(Urban)
- CPI(Rural)

Till 2012, in India there were only following three CPIs compiled and released on national level.

- Industrial Workers (IW) (base 2001),
- Agricultural Labourer (AL) (base 1986-87) and
- Rural Labourer (RL) (base 1986-87)

There was another CPI called the Urban Non-Manual Employees (UNME) (base 1984-85) but was discontinued by the CSO from 2010. For Industrial Workers (CPI-IW), a basket of 370 commodities is tracked; for Agricultural Labourers (CPI-AL), 60 commodities. The baskets and the weightages to each item have been determined on the basis of surveys of consumption patterns. All-India figures declared are averages.

Each commodity is given a specific weightage, which differs from one index to another index. For example, the CPI-AL would give a greater weightage to foodgrains than the CPI-UNME (since discarded), since a greater proportion of the agricultural labourer's expenditure would go toward foodgrains, and he would be unlikely to buy the sort of items the office-goer would buy.

In the organised sector, CPI-IW is used as a cost of living index. In accordance with the Government of India (Allocation of Business) Rules, 1961, as amended from time to time, it is the responsibility of the Ministry of Labour to compile and release the data on the CPI for Industrial Workers and the data on the CPI for Rural Labourers.

New CPI Series 2015

The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation in 2015 revised the Base Year of the Consumer Price Index (CPI) from 2010=100 to 2012=100. In this revised series, many methodological changes have been incorporated, in order to make the indices more robust.Due to change in the consumption pattern from 2004-05 to 2011-12, the weighing diagrams (share of expenditure to total expenditure) have changed. A comparison of weighing diagrams of the old and revised series is given in the table below:

- The number of Groups, which was five in the old series, has now been increased to six. 'Pan, tobacco and intoxicants', which was a Sub-group under the Group 'Food, beverages and Tobacco', has now been made as a separate Group. Accordingly, the Group 'Food, beverages and Tobacco' has been changed to 'Food and beverages'.
- Egg, which was part of the Sub-group 'Egg, fish and meat' in the old series, has now been made as a separate Sub-group. Accordingly, the earlier Sub-group has been modified as 'Meat and fish'.
- Sample size for collection of house rent data for compilation of House Rent Index, which was 6,684 rented dwellings in the old series, has now been doubled to 13,368 rented dwellings in the revised series.

The new CPI index, weight of food and beverages is **45.86%** and weight of fuel and light segmen is **6.84 %**.

The basket of items and their weighing diagrams have been prepared to make it consistent with the international practice of shorter reference period for most of the food items and longer reference period for the items of infrequent consumption/purchase.

Price data are collected from selected towns by the NSSO and from selected villages by the Department of Posts.

Consumer Price Indices (Rural, Urban, Combined), compiled by the Ministry of Statistics and Programme Implementation, reflects the realistic picture of the prices of consumer goods and services because of the following reasons:

- prices are collected from 1,181 selected village markets covering all districts of the country for rural areas and from 1,114 urban markets of 310 selected towns of urban areas;
- these markets are, more or less equally, distributed over different weeks of a month to capture price variations during the month;
- only transaction prices, that is prices actually paid by the consumers, are collected for compilation of indices;
- the items having significant share in the overall consumption expenditure of the households, including the Public Distribution System (PDS) items and the items consumed by majority of the households are included in the basket

All cities/towns having population (Census, 2001) more than nine lakh and State/UT capitals not covered therein have been selected. The Consumer Price Index is released every month on 12th day of the following month.

The Reserve Bank of India (RBI) has started using CPI-combined as the sole inflation measure for the purpose of inflation management and monetary policy. As per the agreement on Monetary Policy Framework between the Government and the RBI (February 2015) given in detail elsewhere in the Chapter, the sole objective of RBI is price stability and a target is set for inflation as measured by the Consumer Price Index-Combined- 4% is the anchor with 2% up and down to make the range.

Difference Between Wholesale Prices And Consumer Prices

WPI measures price rise at the wholesale level. Wholesale means sale in large quantities and usually meant for resale. It covers a certain set of goods that are traded at the wholesale level. CPI on the other hand measures price rise at the retail level. There is a difference between the two in terms of prices. The difference is due to a number of factors. A substantial portion of the difference is accounted for by the retailers' margins which are built into what the consumer pays. Besides, the way the two indices are calculated differs both in terms of weightage assigned to products as well as the kind of items included in the basket of products.

While wholesale prices are more or less the same throughout the country, consumer prices or retail prices vary across regions (rural and urban) and also across cities according to the consumer preferences for certain products, supplies and purchasing power. Besides, taxes levied by states comprise an important component of the variation in prices of many products.

Divergence Between WPI and CPI

WPI reflects the change in average prices for bulk sale of commodities at the first stage of transaction while CPI reflects the average change in prices at retail level paid by the consumer. Major difference is in two index baskets. The prices used for compilation of WPI are collected at ex-factory level for manufactured products, at ex-mine level for mineral products and mandi level for agricultural products. In contrast, retail prices applicable to consumers and collected from various markets are used to compile CPI. The reasons for the divergence between the two indices can also be partly attributed to the difference in the weight of food group in the two baskets. CPI Food group has a weight of 39.1 per cent as compared to the combined weight of 24.4 per cent (Food articles and Manufactured Food products) in WPI basket. Similarly weights of the major petroleum products such as petroleum and HSD also vary significantly. The CPI basket consists of services like housing, education, medical care, recreation etc. which are not part of WPI basket.

A significant proportion of WPI item basket represents manufacturing inputs and intermediate goods like minerals, basic metals, machinery etc. whose prices are influenced by global factors but these are not directly consumed by the households and are not part of the CPI item basket. Thus even significant price rise or decline in items included in WPI basket need not necessarily translate into CPI in the short run. The rise or fall in prices at wholesale level spills over to the retail level after a lag. Middlemen and indirect taxes that add on make the CPI higher. The divergence is likely to get greater as the new WPI series excludes indirect taxes.

Which Index Should One Use?

The WPI is useful in certain contexts. For example, for industrialists, the costs of setting up a factory over the course of several years; and further to calculate the costs of production and returns over several years. The basket of items in the CPI does not include machinery, chemicals, and so on; secondly, the price of electricity in the CPI is the consumer tariffs, not the industrial tariffs; and so on.

Services And Price Index

While the WPI now does not include services, consumer price index (CPI) meant for industrial workers includes certain services such as medical care, education, recreation and amusement, transport and communication. On the other hand, some of the other major services such as trade, hotels, financing, insurance, real estate and business services do not find a mention either in the CPI(IW). In India, the services sector accounts for about 57 per cent of the GDP. In 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry constituted an Expert Committee to render technical advice for development of Service Price Index (SPI) and its related issues. The Committee is chaired by Prof. C. P. Chandrasekhar.

Producer Price Index

The process of introducing the producer price index (PPI) is underway in India. It means prices of goods as they are sold to the wholesalers by the producers. The difference between WPI and PPI is accounted for by the margins and other transport and distribution costs. The government in late 2014 set up a committee to devise Producer Price Index. The 13-member committee is headed by Professor BN Goldar and has representation from various central ministries and departments.

Food Price Indices

WPI food index

The government in mid-2017 revised the wholesale price index (WPI) by shifting to a new base year of 2011-12 from 2004-05 and added a new WPI food index to capture the rate of inflation in food items. Revision of macroeconomic data is undertaken to reflect changes in the economy.The WPI Food index is compiled by taking the aggregate of WPI for "Food Products" under "Manufactured Products" and "Food Articles" under "Primary Articles" using weighted arithmetic mean.In view of the sensitivity of food to the overall well being of people, it is important to track their prices as they fluctuate. During the 11th FYP period, food prices soared hurting the poor disproportionately. If we track the WPI food prices, the gap with the CPI food component can be better understood and remedies applied.

Consumer Food Price Index (CFPI)

Consumer Food Price Index (CFPI) is a measure of change in retail prices of food products consumed by a defined population group in a given area with reference to a base year. The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation (MOSPI) started releasing Consumer Food Price Indices (CFPI) for three categories -rural, urban and combined - separately on an all India basis from 2014. Like Consumer Price Index (CPI), the CFPI is also calculated on a monthly basis and methodology remains the same as CPI.

FAO Food Price Index

Globally, food price index is being released by Food and Agriculture Organization of the United Nations. The FAO Food Price Index is a measure of the monthly change in international prices of a basket of food commodities. It consists of the average of five commodity group price indices (Cereal, Vegetable Oil, Dairy, Meat and Sugar) weighted with the average export shares of each of the groups for 2002-2004.

New Delhi

National Housing Bank Residex

RESIDEX, the country's first official housing price index (HPI) was launched in 2007 covering 26 cities and was published till 2015 on a quarterly basis. It was discontinued then and has been revived in 2017. The revamped RESIDEX has been expanded to 50 cities spread over 18 States and UTs. These include 38 smart cities, of which 18 are state capitals. NHB RESIDEX enables the policy makers, banks, housing finance companies, builders, developers, investors, individuals, etc., to track the movement of housing prices across different cities in India on quarterly basis.NHB RESIDEX helps buyers and sellers to check and compare prices before entering a transaction. They can also analyse the price trends across different citiesIt not only has expanded city coverage (rising from 26 to 50, to be eventually raised to 100), a new base year (2012-13) and new data sources (with data from banks and home finance companies and market surveys).The NHB Residex currently offers two sets of quarterly Housing Price Indices (HPIs) across the cities it tracks. List prices of under-construction property, collated through a survey of developers, are captured in the'Market HPI'. Data reported by banks and finance companies that extend home loans, is collated into the'Assessment HPI'.

House Price Index (HPI) of Reserve Bank of India (RBI)

The Reserve Bank compiles quarterly house price index (HPI) (base: 2010-11=100) for ten major cities, viz., Mumbai, Delhi, Chennai, Kolkata, Bengaluru, Lucknow, Ahmedabad, Jaipur, Kanpur

and Kochi. Based on these city indices, an average house price index representing all- India house price-movement is also compiled. These indices are based on the official data of property price transactions collected from registration authorities of respective state governments.

Beginning with Mumbai city, the Reserve Bank initiated the work of compiling a house price index (HPI) in 2007 .Over the quarters, the coverage has been extended by incorporating 9 more major cities, viz., Delhi, Chennai, Kolkata, Bengaluru, Lucknow, Ahmedabad, Jaipur Kanpur and Kochi and the base is shifted to 2010-11=100.1 Besides separate HPI for individual cities, an average HPI representing all-India house price movement is also compiled.

Collection of Statistics Act, 2008

Collection of Statistics Act, 2008 was made to bring in new rules aimed at improving data collection. Government will levy higher penalty for not sharing data and tougher punishment will be imposed in cases where manipulation of data is involved, they say.

Under the new Act, people or companies not divulging data would have to pay a fine of Rs 1,000 and they would be given a 14-day notice period to comply. If the information is not provided even after two weeks, the penalty will rise to Rs 5,000 per day.

Under the old Act, which was passed in 1953, the penalty was only Rs 500 for the first default and Rs 200 per day thereafter.

The new penalty scheme will ensure that data collection is done on time. It will increase the accuracy of the data. The Act also makes wilful manipulation or omission of data a criminal offence, punishable by a prison term that may extend up to 6 months. This penalty will also apply if a company prevents or obstructs any employee from collecting data. The Collection of Statistics Act, 2008, gives powers to the government to classify any statistics as "core statistics" and also determine the method to collect and disseminate the same.

Deflation

Deflation is a prolonged and widespread decline in prices that causes consumers and businesses to curb spending as they wait for prices to fall further. It is the opposite of inflation, when prices rise, and should not be confused with disinflation, which merely describes a slowdown in the rate of inflation. Deflation occurs when an economy's annual headline inflation indicator -- typically the consumer price index -- enters negative territory.

Deflation is hard to deal with because it is self-reinforcing. Put simply, unless it is stopped early, deflation can breed deflation, leading to what is known as a deflationary spiral. When an economy has fallen into deflation, demand from businesses and consumers to buy products falls because they expect to pay less later as prices fall. But as producers struggle to sell and go bankrupt, unemployment rises, reducing demand further. That causes deflation to become more pronounced.

It makes it more expensive to service existing debts. This is as true of governments, who have borrowed trillions of dollars globally to prop up the financial sector, as it is for consumers. As debt becomes more expensive to pay off, the risk of default and bankruptcy rises too, making banks more wary of lending. This reduces demand and further exacerbates the deflationary problem.

Remedy for remedy

- Tax cuts to boost demand from consumers and businesses
- Lowering central bank interest rates to encourage economic activity
- Printing more currency to boost money supply
- Capital injections into the banking system
- Increase government spending on projects that boost the return on private investment

India did not face the threat of deflation as demand has not dropped so much. Also, food scarcity meant food prices did not fall. In fact they rose.

India and Deflation

On the WPI, we faced disinflation- rate of growth of prices fell but not prices themselves till the first quarter of 2009. In the second quarter and later, there was 'deflation' on the WPI. This negative inflation is due to higher base as inflation peaked in July 2008 due to international energy and food price rises because of speculation.

But since late 2014, WPI was in persistent deflation zone till 2016.

Growth -Inflation Trade Off

With high growth, economy overheats. Overheating of the economy means demand overshoots supply and there is pressure on prices. As growth creates more employment, incomes and demand, prices rise.

As prices rise, the central bank intervenes and raises rates to cool investment and consumption demand and so price rise is moderated. Repo rate- the policy rate- is the tool along with CRR and OMOs available to the central bank as signals to the economy that it is ready to act to soften prices -partly because the poor suffer disproportionately and partly because inflation can derail the medium and long term growth.

Such intervention by the central bank has a dampening impact on growth as higher interest rates prevent easy borrowing and thus demand slackens.

We witnessed the same in India with CRR and repo rates going down from 2009 for one year and later till 2011 going up in response to inflation in the country. The primary goal of the RBI is to moderate and stabilize prices as the inflation targeting framework of 2015 February madates.

Thus, growth and inflation are intimately connected- one being traded for the other depending upon where the growth situation stands.

As prices stabilise, growth resumes and a new and higher base is set for the growth process. Growth and inflation do have a trade off but that is only in the short term. As Dr.C.Rangarajan says, growth is a marathon while overheating and slow down are temporary pauses to gain greater strength.

Further, unless the RBI raises the policy rates with inflation going up, there is a danger of banks failing to attract deposits as real interest rates become negative and savings may be diverted to unproductive assets like gold with serious consequences- inside and outside for the economy.

Government Steps To Control Inflation

The Government has taken a number of short term and medium term measures to improve domestic availability of essential commodities and moderate inflation. It has procured record food grains. Even after keeping the minimum buffer stock, there are enough food grains to intervene in the market to keep the prices at reasonable level. A Strategic Reserve of 5 million tonnes of wheat and rice has also been created to offload in the open market when prices are high. This is in addition to the buffer stock held by FCI every year.

The price situation is reviewed periodically at high-level meetings such as the Cabinet Committee on Prices (CCP).

Fiscal Measures

- Reduced import duties on food items
- Import duties are raised on gold etc to contain CAD and step rupee depreciation

Administrative Measures

- Ban on exports of food items
- Dehoarding

Monetary Measures

Repo rates were kept high to make credit dearer.

Other Measures Taken To Control Inflation

The measures taken by the Government along with decline in global oil and commodity prices have contributed towards achieving low inflation. The measures taken by Government include, advising states to allow free movement of fruits and vegetables by delisting them from the APMC Act, banning of export of all pulses (except *kabuli channa* and organic pulses and lentils upto certain quantity), zero import duty on pulses and onion, empowering States/UTs to impose stock limits in respect of onion, pulses, edible oil, and edible oilseeds under the Essential Commodities Act, modest increase in minimum support prices in last two years etc. The vigilant monetary policy stance by the RBI and adoption of a Monetary Policy Framework agreement between Government and RBI has also led to moderation in inflation by bringing in an element of certainty of action by the RBI.

Disinflation in India 2017: The Structural Basis

In 2017, the Economic Survey of GOI and inflation watchers have opined that there could be a paradigm shift in the inflationary situation in India as well as the world.

There is deceleration of rate of growth of prices in the country for some months. It is called deflation. There are structural reasons for it according to experts. Oil prices are low since 2014 and will never go back to the earlier levels. US crude exports are forecast to exceed that of most Organization of the Petroleum Exporting Countries (OPEC) members by 2020.

Because of Chinese growth slowing, pressure on metal prices is expected to continue.

Globalization and lower inflation may go together due to labour's declining pricing power as a result of the threat of globalization – either be competitive or close down. Investment and jobs may shift if labour unionises and becomes aggressive. Expansion of the global labour force due opening up of Asia and the former Soviet bloc almost doubled the effective labour force involved in world trade.

Robots are another threat to labour.

In India, there are other factors that point to lower inflation. The fiscal deficit has come down, the rupee has strengthened, the rains have been good and the government has successfully managed food prices.

SRIRAM'S IAS
New Delhi

MONEY MARKET AND CAPITAL MARKET IN INDIA: INSTRUMENTS AND DYNAMICS

There is need and demand for funds for a short period of time- less than one year. The need may be for a large amount but the period is short. The need is for working capital requirements, repayment of loans, consumption etc. That is the reason for a structured entity called money market. It is a part of the financial markets involved in short-term borrowing, lending, buying and selling with original maturities of one year or less. Trading in money markets is done over the counter. Over-the-counter (OTC) trading is done directly between two parties, without the supervision of an exchange.)

Money market can be defined as a market for short-term funds with maturities ranging from overnight to one year and includes financial instruments that are considered to be close substitutes of money. Money market transactions could be both secured (with collateral) and unsecured (clean, without collateral).

Banks and financial institutions (IDBI, LIC etc.) individuals, mutual funds, companies and government are the main lenders and borrowers. The informal market operates through small-scale money-lenders as well as others outside the RBI control.

Money market instruments broadly are: call money; bill market (both commercial bills and treasury bills) Certificates of Deposit (CD); Commercial paper (CP).

Call Money

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Call/Notice money is money borrowed or lent for a very short period. If the period is more than one day and up to 14 days it is called 'Notice money' otherwise the amount is known as Call money'. No collateral security is required to cover these transactions and goodwill and reputation are the basis apart from the documents like promissory notes. The call market enables the bank and institutions to even out their day to day deficits and surpluses of money.

Commercial banks, both Indian and foreign, co-operative banks, Discount and Finance House of India Ltd.(DFHI), Securities trading corporation of India (STCI) participate as both lenders and borrowers and Life Insurance Corporation of India (LIC), Unit Trust of India(UTI), National Bank for Agriculture and Rural Development (NABARD)can participate only as lenders.

Interest rates in the call and notice money market are market determined.

A primary dealer is a firm that buys government securities directly from a government, with the intention of reselling them to others, thus acting as a market maker of government securities.

Government Securities

The Government securities comprise dated securities issued by the Government of India and state governments as also, treasury bills issued by the Government of India.Reserve Bank of India manages and services these securities through its public debt offices located in various places as an agent of the Government. T-Bills are a money market instrument.

Treasury Bills

Treasury bills (T-bills) are short-term investment opportunities, generally up to one year. They are thus useful in managing short-term liquidity. At present, the Government of India issues three types of treasury bills through auctions, namely, 91-day, 182-day and 364-day. There are no treasury bills issued by State Governments.Treasury bills are available for a minimum amount of Rs.25,000 and in multiples of Rs. 25,000. Treasury bills are issued at a discount and are redeemed at par. Treasury bills are also issued under the Market Stabilization Scheme (MSS).While 91-day T-bills are auctioned every week on Wednesdays, 182-day and 364-day T-bills are auctioned every alternate week on Wednesdays. They are available in primary and secondary market. Treasury bills are available for a minimum amount of Rs.25,000 and in multiples of Rs.25,000. Treasury bills are issued at a discount and are redeemed at par.Treasury bills are zero coupon securities and pay no interest. They are issued at a discount and redeemed at the face value at maturity. For example, a 91 day Treasury bill of Rs.100/- (face value) may be issued at say Rs.98.20, that is, at a discount of say, Rs.1.80 and would be redeemed at the face value of Rs.100/-. The return to the investors is the difference between the maturity value or the face value (that is Rs.100) and the issue price.The usual investors in these instruments are banks, insurance companies, FIs etc. T-bills auctions are held on ***the Negotiated Dealing System (NDS)*** and the members electronically submit their bids on the system.

Cash Management Bills (CMBs)

Government of India, in consultation with the Reserve Bank of India, has decided to issue a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatches in the cash flow of the Government. The CMBs have the generic character of T-bills but are issued for maturities less than 91 days. Like T-bills, they are also issued at a discount and redeemed at face value at maturity.

New Delhi

Inter Bank Term Money

Inter bank market for deposits of maturity beyond 14 days and upto three months is referred to as the term money market.

Certificates Of Deposit

Certificate of deposit (CD) is issued by scheduled commercial banks and Financial institutions (FI). Regional rural banks and Local area banks can not issue CDs.

CD is a negotiable promissory note, secure and short term (up to a year) in nature. A CD is issued at a discount to the face value, the discount rate being negotiated between the issuer and the investor. Minimum amount of a CD should be Rs.1 lakh. The maturity period of CDs issued by banks should be not less than 15 days and not more than one year. The FIs can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue. CDs can be issued to individuals or firms.

Inter Corporate Deposits Market

Apart from CPs, corporates also have access to another market called the inter corporate deposits (ICD) market. An ICD is an unsecured loan extended by one corporate to another. Existing mainly as an avenue for low rated corporates, this market allows fund- surplus corporate to lend to other corporates.

Commercial Paper

It represents short term unsecured promissory notes issued by top rated corporates, primary dealers (PDs),satellite dealers (SDs) and the all-India financial institutions (FIs). CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. However, the maturity date of the CP should not go beyond the date up to which the credit rating of the issuer is valid. CP can be issued in denominations of Rs.5 lakh or multiples thereof.

The main features of these papers are:

- corporates having tangible net worth of not less than Rs.4 crore can issue them
- All CPs require credit rating from a credit rating agency
- Minimum amount invested by single investor is Rs. Five lakh or multiple thereof.
- CPs are issued at a discount to face value.

Ready Forward Contracts (Repos)

Repo is an abbreviation for Repurchase agreement, which involves a simultaneous "sale and purchas" agreement. When banks have any shortage of funds, they can borrow it from Reserve Bank of India or from other banks. The rate at which the RBI lends money to commercial banks on the basis of government securities is called repo rate.

Commercial Bills

Bills of exchange are negotiable instruments drawn by the seller (drawer) of the goods or services on the buyer (drawee) of the goods for the value of the goods delivered. These bills are called trade bills. These trade bills are called commercial bills when they are accepted by commercial banks for discounting. If the bill is payable at a future date and the seller needs money immediately, he may approach his bank for discounting the bill. The bank or any other discounting body takes a commission for it.

Discount and Finance House of India (DFHI)

It wet up in 1988 by RBI to strengthen the bill market. It has been established to deal in money market instruments in order to provide liquidity. Thus the task assigned to DFHI is to develop a secondary market in the existing money market instruments. The main objective of DFHI is to facilitate the smoothening of the short term liquidity imbalances by developing an active money market and integrating the various segments of the money market. At preset DFHI's activities are restricted to:

- Dealing in Treasury Bills
- Re-discounting short term commercial bills.
- Participating in the inert bank call money, notice money and term deposits and
- Dealing in Commercial Paper and Certificate of deposits.
- Government dated Securities

Libor

The London Interbank Offered Rate is the average interest rate estimated by leading banks in London that they would be charged for what they borrow from other banks. It is usually

abbreviated to BBA Libor (for British Bankers' Association Libor). It is the primary benchmark, along with the Euribor, for short term interest rates around the world. Many financial institutions, mortgage lenders and credit card agencies set their own rates relative to it.

Mibor - Mumbai Inter-Bank Offer Rate

The Committee for the Development of the Debt Market that had studied and recommended the modalities for the development for a benchmark rate for the call money market. Accordingly, NSE had developed and launched the NSE Mumbai Inter-bank Bid Rate (MIBID) and NSE Mumbai Inter-bank Offer Rate (MIBOR) for the overnight money market in 1998. The MIBID/MIBOR rate is used as a bench mark rate for majority of deals.

Money Market Reforms

On the recommendations of the Sukhmoy Chakravarty Committee on the Review of the Working of the monetary system (1985) and the Narasimham Committee Report on the Working of the Financial System in India, 1991, The Reserve Bank of India initiated a series of money market reforms basically directed towards the efficient discharge of its objectives.

Reforms made in the Indian Money Market are

- Deregulation of the Interest Rate
- Money Market Mutual Fund (MMMFs) are allowed to sell units to corporates and individuals
- Discount and Finance House of India (DFHI) was set up in 1988 to impart liquidity in the money market. It was set up jointly by the RBI, Public sector Banks and Financial Institutions.
- Liquidity Adjustment Facility (LAF) LAF adjusts liquidity in the market through absorption and or injection of financial resources by the RBI.
- In order to impart transparency and efficiency in the money market transaction the electronic dealing system has been started. It is useful for the RBI to watchdog the money market.
- Establishment of the CCIL: The Clearing Corporation of India limited (CCIL) in 2001.
- Development of New Market Instruments like CMBs
- MSS since 2004 that came to great use in 2016 post-demonetisation.

Capital Market

It refers to market for funds with a maturity of 1 year and above called as term funds that include medium and long term funds. The demand for these funds comes from both the government for its investment purposes and also the private sector. Banks, public financial institutions like LIC and GIC; development financial institutions, mutual funds are the main participants in the market. The components of the capital market in India are the following:Government securities, industrial securities that include the shares and debentures of Indian companies- both the primary and secondary market, DFIs (IFCI, IDBI, State Financial Corporations (SFCs); UTI, ICICI (private sector) Financial intermediaries: merchant banks; mutual funds; leasing companies; venture capital companies and others.

G-Secs (Gilt Edged Securities)

A Government security is a tradable instrument issued by the Central Government or the State Governments through RBI. It acknowledges the Government's debt obligation. Such securities are short term (usually called treasury bills or Cash Management Bills with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or more). In India, the Central Government issues both, treasury bills and bonds (dated securities) while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). Government securities carry zero risk of default and, hence, are called risk-free gilt-edged instruments. Government of India also issues savings instruments (Savings Bonds, National Saving Certificates (NSCs), etc.) or special securities (oil bonds, Food Corporation of India bonds, fertiliser bonds, power bonds, recapitalization bonds etc.). They may not be tradable and are, therefore, not eligible to be SLR securities. They are not issued through the RBI.

Dated Government securities are long term securities and carry a fixed or floating coupon (interest rate) which is paid on the face value, payable at fixed time periods (usually half-yearly). The tenor of dated securities can be up to 30 years. The G-Sec instrument is in the nature of a bond.

GOI Dated Security can be held by any person, firm, company, corporate body or institution, State Governments, Provident Funds and Trusts. Non-Resident Indians (NRIs, viz., Indian citizens and Individuals of Indian origin), Overseas corporate bodies predominantly owned by NRIs and Foreign Institutional Investors registered with SEBI and approved by Reserve Bank of India are also eligible to invest in the government stock. G-Sec are issued both in demat and physical form. The minimum investment in G-Secs is Rs 10,000. G-Secs could be of the following types:

Dated Securities: They have fixed maturity and fixed coupon rates payable half yearly and are identified by their year of maturity.

New Delhi

Floating Rate Bonds: They are bonds with variable interest rates with a fixed percentage over a benchmark rate. There may also be a cap and a floor rate attached, thereby fixing a maximum and minimum interest rate payable on it.

Capital Indexed Bonds: They are bonds where the interest rate is a fixed percentage over the inflation rate: WPI or CPI depending on the terms.

Reserve Bank of India sets limits to FPI investment in GOI securities, state development loans (SDLs) and corporate bonds.

State Development Loan (SDL)

State Governments also raise loans from the market through the RBI. SDLs are dated securities issued through an auction similar to the auctions conducted for dated securities issued by the Central Government. Interest is serviced at half-yearly intervals and the principal is repaid on the maturity date. Like dated securities issued by the Central Government, SDLs issued by the State Governments qualify for SLR. They are also eligible as collaterals for borrowing through market repo as well as borrowing by eligible entities from the RBI under the Liquidity Adjustment Facility (LAF).

DFIs or Development Banks

Financial institutions assume a critical role in the provision of long term credit. A development finance institution (DFI) can be broadly categorised as All-India or State / regional level institutions depending on their geographical coverage of operation. Functionally, All-India institutions can be classified as

- term-lending institutions (IFCI Ltd., IDBI, IDFC Ltd., IIBI Ltd.) extending long-term finance to different industrial sectors
- refinancing institutions (NABARD, SIDBI, NHB) extending refinance to banking as well as non-banking intermediaries for finance to agriculture, SSIs and housing sector, respectively
- sector-specific / specialised institutions (EXIM Bank, TFCI Ltd., REC Ltd., HUDCO Ltd., IREDA Ltd., PFC Ltd., IRFC Ltd.)
- investment institutions (LIC, UTI, GIC, IFCI Venture Capital Funds Ltd., ICICI Venture Funds Management Co Ltd.). State / regional level institutions are various SFCs, SIDCs etc.

Historically, low-cost funds were made available to DFIs to ensure that the spread on their lending operations did not come under pressure. DFIs had access to soft window of Long Term Operation (LTO) funds from RBI at concessional rates.

(Industrial Development Bank of India (IDBI), IFCI Ltd., Industrial Investment Bank of India Ltd. (IIBI), Small Industries Development Bank of India (SIDBI), National Housing Bank (NHB), National Bank for Agriculture and Rural Development (NABARD), Export Import Bank of India (EXIM Bank), Tourism Finance Corporation of India Ltd. (TFCI), Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC); Infrastructure Development Finance Company of India Ltd. (IDFC). All these institutions operate on all-India basis. Other institutions comprise Export Credit and Guarantee Corporation (ECGC) and Deposit Insurance and Credit Guarantee Corporation (DICGC). The state level institutions consist of state financial corporations (SFCs) and state industrial development corporations (SIDCs))

Merchant Banks / Investment Banks

MBs are those who manage and underwrite (Underwriting an issue means to guarantee to purchase any shares in a new issue(IPO) or rights issue not fully subscribed by the public.) new public issues floated by companies to raise funds from public. They advise corporate clients on fund raising. They are also called investment banks (I banks) .They deal only with corporates and not general public, essentially.

Lehman Brothers was a global financial services firm. Before declaring bankruptcy in 2008, Lehman was the fourth-largest investment bank in the US (behind Goldman Sachs, Morgan Stanley, and Merrill Lynch), doing business in investment banking, equity, trading (especially U.S. Treasury securities), research, investment management, private equity and private banking.

On September 15, 2008, the firm filed for bankruptcy protection following the massive exodus of most of its clients, drastic losses in its stock, and devaluation of its assets by credit rating agencies.

Collective Investment Schemes (CIS)

According to the Securities Laws (Amendment) Act 2014, a CIS is any scheme or arrangement which pools funds from investors and involves a corpus amount of ₹ 100crore or more. It is an arrangement where investors pool in their funds to derive some return on investment. The pool of funds is, in turn, used for purposes of the scheme or arrangement.CIS is governed by the Securities and Exchange Board of India (SEBI) Regulations.

While they are useful for the unbanked people, many CISs emerged as Ponzi schemes(fraud).

Alternative Investment Funds

AIFs is a newly created class of pooled-in investment vehicles for real estate, private equity and hedge funds. Angels are the new category introduced in 2013. AIFs are basically funds established or incorporated in India for the purpose of pooling in capital from Indian and foreign investors for investing as per a pre-decided policy. Sebi regulates them. It excludes Mutual funds or collective investment Schemes, family trusts, Employee Stock Option etc.

REITs

Securities and Exchange Board of India (SEBI) regulates Real Estate Investment Trusts (REITs). Like mutual funds, REITs will pool in money from investors and issue units in exchange.

Most of the money so collected is invested in commercial properties which are completed and generate income. The REIT will have to first get registered and raise funds through an initial public offer or IPO. Units of REITs will have to be compulsorily listed on exchanges and will be traded like securities. The minimum requirement for asset sizes permitted to be listed in India is Rs 500 crore. The minimum issue size of the initial public offer shouldn't be less than Rs 250 crore. Therefore, like stocks, investors will be able to buy units of REITs from both primary and secondary markets which are based on commercial real estate without actually having to buy those assets.

Mutual Funds

Mutual funds raise money from public and invest them in stock market securities; bonds etc. SEBI regulates mutual funds.

Hedge Fund

A hedge fund is like a mutual fund (MFs): both are investment vehicles which pool investors' money which invested as per the fund's mandate and returns are distributed among unit holders for a commission. However, hedge funds use strategies far more complex than a typical MF which mostly focuses on generating returns through simple asset allocation. Hedge funds use various strategies such as long-short, derivatives, leverage and so on and aim to give return with minimum risk.SEBI (Securities and Exchange Board of India) regulates them under alternative investment fund (AIF) .

Venture Capital

Venture capital is money provided by financial institutions who invest in startups generally that have the potential to develop into significant economic contributors.

Angel Investors

An angel investor or angel (also known as a business angel or informal investor) is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. They invest their own money unlike a venture capitalist who invests public money. They became popular after the web-based enterprises came up in the 1990's.With an aim to encourage entrepreneurship in the country by financing small start-ups, market regulator SEBI in 2013 notified norms for angel investors, who provide funding to companies at their initial stages. Angel investors are allowed to be registered as Alternative Investment Funds (AIFs) - a newly created class of pooled-in investment vehicles for real estate, private equity and hedge funds.

In order to ensure investment by angel funds is genuine, the Securities and Exchange Board of India (Sebi) has restricted investment by such funds between Rs. 50 lakh and Rs 5 crore. Among other norms included, angel funds can make investments only in those companies which are incorporated in India. These funds need to be invested in a firm for at least three years, can invest in companies not older than 3 years.Angel funds are required to have a corpus of at least Rs 10 crore and minimum investment by an investor should be Rs 25 lakh. The regulator also stipulated that the fund must not have any family connection with the investee company.

The new norms would help in encouraging entrepreneurship in the country by financing small start-ups at a stage where such start-up finds it difficult to obtain funds from traditional sources of funding such as banks, financial institutions among others.

In 2016, GOI introduced a start-up policy which can get a stimulus from the angels.

Private Equity

A company can sell some of its shares- in significant quantity, to a PE firm which obliges the PE to be a part of the management and make the company profitable in a few years or so after which the PE firm exits. The company may be listed or not. The placement of equity is private and not through an IPO. It generally has a lock in period during which they are not publicly traded on a stock exchange. Capital for private equity is raised primarily from institutional investors.

Hundi

Hundis were legal financial instruments that evolved in India. These were used in trade and credit transactions; they were used as remittance instruments for the purpose of transfer of funds from one place to another. In the pre-modern era, Hundis served as travellers cheques. They were also used as credit instruments for borrowing and as bills of exchange for trade transactions. Technically, a Hundi is an unconditional order in writing made by a person directing another to pay a certain sum of money to a person named in the order. Being a part of an informal system, hundis now have no legal status and were not covered under the Negotiable Instruments Act, 1881.

Chit Funds

A chit fund is an arrangement that a group of people arrive at to contribute money in a defined manner at periodic intervals into a pool. It is a kind of savings scheme.Such chit fund schemes may be conducted by organised financial institutions, or may be unorganised schemes conducted between friends or relatives. Chit funds played an important role in the financial development of people of south Indian state of Kerala, by providing easier access to credit. In Kerala, chitty (chit fund) is a common phenomenon practiced by all sections of the society. A company named Kerala State Financial Enterprise exists under the Kerala State Government, whose main business activity is the chitty. During the process of collection, any member can draw a lump sum through various ways like a lucky draw, an auction or a member can even fix a payout date based on a known expenditure. These schemes are very popular in tier II and III towns in India and even in rural India, because under-penetration of banking services, as they are a way of raising quick money or catering for sudden liquidity needs or even a planned expenditure. They thrive as bank loans are very cumbersome and many are not eligible. Chit funds are governed by state or central laws. There is a central Chit Funds Act of 1982, apart from a number of state chit fund Acts. There is an office of "Registrar of Chit Funds" in every state that monitors operations which are quite stringent.

Securities Laws (Amendment) Act, 2014 provides Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, (ponzi schemes) and gives guidelines for the formation of special fast trial courts.

QIPs

QIPs are eligible under "Qualified Institutional Placement "(which includes public financial institutions, mutual funds, foreign institutional investors, venture capital funds and foreign venture capital funds registered with the SEBI) to be sold shares/ fully convertible debentures/ partly convertible debentures or any securities which are convertible into or exchangeable with equity shares at a later date. Since the beginning of 2009, Indian companies are raising billions of dollars from the QIP route.

NBFC

NBFC means Non-banking financial company. A non-banking financial company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, housing finance, acquisition of shares/stock/bonds/debentures/securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business, but does not include any institution whose principal business is that of agriculture activity, industrial activity, ale/purchase/construction of immovable property. NBFCs are similar to banks; however they do not accept demand deposits.

Some microfinance companies are registered as NBFCs and are regulated by the RBI while other MFIs are either registered as money lenders or Societies. An RBI-appointed panel headed by Y H Malegam had recommended setting up of a special category of NBFCs operating in the micro finance sector in 2011.These are called Non Banking Financial Company-Micro Finance Institution (NBFC-MFI).

The Reserve Bank of India (RBI) introduced a new category called Non-Banking Financial Company-Factors. Factoring is the business of selling invoices (receivables) to a factoring company (Factor) at a discount. Consequently, the selling corporate can get cash quickly and avoid

risk of collecting debt. Factoring can be of two types: domestic and export oriented, the latter being called forfaiting. Forfaiting is the purchasing of an exporter's receivables (the amount importers owe the exporter) at a discount by paying cash. The forfaiter, the purchaser of the receivables, becomes the entity to whom the importer is obliged to pay its debt.The factoring mechanism mostly assists smaller companies, which run relatively shorter fund flow cycle. Factoring bails them out by supporting their fund system instantly.

ECBs

ECB (External Commercial Borrowings) is an instrument used to facilitate the access to foreign money by Indian corporations and PSUs (Public Sector Undertakings). ECBs include commercial bank loans, buyers' credit, credit from official export credit agencies and commercial borrowings from the private sector window of Multilateral Financial Institutions such as International Finance Corporation (Washington), ADB and Investment by Foreign Institutional Investors (FIIs) in dedicated debt funds. ECBs cannot be used for investment in stock market or speculation in real estate. The DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates ECB guidelines and policies. External Commercial Borrowings provide an additional source of funds to Indian corporates and PSUs for financing expansion of existing capacity and as well as for fresh investment, to augment the resources available domestically. ECBs can be used for any purpose (rupee-related expenditure as well as imports) except for investment in stock market and speculation in real estate.Applicants are free to raise ECB from any internationally recognised source like banks, export credit agencies, suppliers of equipment, international capital markets etc. ECBs help diversify risk for the companies. Also, the interest rates are softer abroad. They help Indian companies with foreign funds.Country benefits as it has access to forex.

ECBs can be raised through two routes: Automatic Route and the Approval Route. The former does not require permit from the Regulator whereas the latter requires. RBI policy allows corporates registered under the Companies Act, 1956, except financial intermediaries such as banks, financial institutions (FIs), housing finance companies and Non-Banking Finance Companies (NBFCs) to access ECBs. NGOs engaged in micro-finance activities have been permitted to raise ECB up to certain limits. Financial institutions dealing exclusively with infrastructure or export finance such as IDFC, IL&FS, Power Finance Corporation, Power Trading Corporation, IRCON and EXIM Bank are considered on a case-by-case basis.

The priority end use of ECBs includes investment (such as import of capital goods, new projects, modernization/expansion of existing production units) in real sector - industrial sector including small and medium enterprises (SME) and infrastructure sector, power exploration, telecom, railways, roads & bridges, ports and exports.ECB Policy helps source loans cheap; domestic liquidity constraints are eased; country gets forex; rupee slide could be contained; infrastructure benefits.

Euro Issues

Indian companies are permitted to raise foreign currency resources through issue of Foreign Currency Convertible Bonds (FCCBs), ordinary equity shares through Global Depository Receipts (GDRs) to foreign investors i.e. institutional investors or individuals (including NRIs) residing abroad. That is, Euro-issues include Euro-convertible bonds and GDRs.

Stock Market

(Given as a separate chapter)

Credit Default Swap

It is a form of insurance against debt default. When an investor buys corporate (or government) bonds he/she faces the risks of default on the part of the issuing agent. The investor can insure its investment in such bonds against default through a third party. The investor pays a premium to the party providing insurance. In the event of default by the bond issuer, the insurer would step in and pay the investor. A CDS is just like insurance, which is bought by those who fear default.

Corporate Debt

Corporate debt is necessary for their investment, acquisitions etc.
The following are some of the different types of corporate debt securities issued:

- Non-Convertible Debentures
- Partly- Convertible Debentures
- Fully-Convertible Debentures (Convertible into Equity shares)
- Bonds

Infrastructure Debt Funds (IDFs)

IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, specially insurance and pension funds can invest through units and bonds issued by the IDFs. They can be set up either as a Trust or as a Company. A trust based IDF would normally be a Mutual Fund (MF), regulated by SEBI, while a company based IDF would normally be a NBFC regulated by the Reserve Bank. IDF-MFs can be sponsored by banks and NBFCs. Only banks and Infrastructure Finance companies can sponsor IDF-NBFCs. By 2017, while all IDF-NBFCs have asset base of over ₹ 9,000 crore, IDFs under the MF route (IIFCL, ILFS,) have assets of t about ₹ 2,000 crore.

FIIs Investment in Debt

FIIs can invest in government and corporate debt- primary and secondary market. These limits and the rules are relaxed from time to time depending on the needs of the economy. FII debt is rupee debt.

Take-out Financing

It came into effect in 2010. It is a method of providing finance for longer duration projects (for example, 15 years) by banks by sanctioning medium term loans (like 5-7 years). It is the understanding that the loan will be taken out of books of the financing bank within pre-fixed period, by another institution thus preventing any possible asset-liability mismatch.

Under this process, the institutions engaged in long term financing such as IDFC, agree to take out the loan from books of the banks financing such projects after the fixed time period when the project reaches certain previously defined milestones. On the basis of such understanding, the bank

concerned agrees to provide a medium term loan- 5-7 years. At the end of the period, the bank could sell the loans to the institution and get it off its books. This ensures that the project gets long-term funding through various participants. Banks otherwise cannot lend for infrastructure as their deposits are for a short period and the loans are for a long period- asset liability mismatch.

External Sources of Finance For India

- Stock market(partly touched above under Euro issues) like ADRs and GDRs
- ECB(see above)
- IBRD and IFC
- Private equity
- Bilateral loans by Governments abroad
- Masala bonds(in rupee)

International Finance Corporation's (IFC) and Masala Bond

IFC floated the first ever global rupee bond in 2013. The first tranche of International Finance Corporation's (IFC) rupee bond saw unprecedented demand from global pension funds, banks, asset management companies and central banks. It paved the way for Indian corporates to raise cheaper funds as the currency risk will be borne by the investor.

New Delhi

STOCK MARKET- INDIA AND GENERAL

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A stock exchange is an organization which provides a platform for trading shares- either physical or virtual. The origin of the stock market dates back to the year 1494, when the Amsterdam Stock Exchange was first set up. In a stock exchange, investors through stock brokers buy and sell shares and other financial products in a wide range of listed companies. A given company may list in one or more exchanges by meeting and maintaining the listing requirements of the stock exchange.

In financial terminology, stock is the capital raised by a corporation, through the sale of shares. In common parlance, stocks and shares are used interchangeably .A shareholder is any person or organization which owns one or more shares issued by a corporation. The aggregate value of a corporation's issued shares, at current market prices, is its market capitalization. Stock broker buys and sells for an investor as no one but the broker can do it.

Importance of Stock Exchanges

- For efficient working of the economy and for the smooth functioning of the corporate form of organization, the stock exchange is an essential institution.
- an efficient medium for raising long term resources for business
- Help raise savings from the general public by the way of issue of equity / debt capital
- attract foreign currency
- exercise discipline on companies and make them profitable
- investment in backward regions for job generation
- another vehicle for investors' savings

Stock Exchanges in India

The first company that issued shares was the VOC or Dutch East India Company in the early 17th century (1602). India has over 25m shareholders today. Over 9,000 companies are listed on the stock exchanges, which are serviced by approximately 7,500 stockbrokers. The Indian capital market is significant in terms of the degree of development, volume of trading and its tremendous growth potential.

Stock exchanges provide an organised market for transactions in securities and other securities. There were more than 20 regional stock exchanges till recently but all of them shut down from 2012 when 012, when SEBI brought out new norms for RSEs, under which they needed to own a platform, with an annual trading of not less than ₹ 1,000 crore, to continue.Net worth of the exchange should not be less than ₹ 100 crore.

There are 5 stock exchanges in the country: BSE, National Stock Exchange (NSE), United Stock Exchange (USE), MCX Stock Exchange Ltd (MCX-SX) and India International Exchange (INX).

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Bombay Stock Exchange (BSE)

BSE is Asia's first stock exchange is the world's 11th largest stock exchange with an overall market capitalization of $1.8 trillion (2017) More than 5500 companies are listed on the BSE.

BSE's popular equity index - the S&P BSE SENSEX (Formerly SENSEX) - is India's most widely tracked stock market benchmark index. It is traded internationally on the EUREX as well as leading exchanges of the BRICS nations (Brazil, Russia, China and South Africa).

One of the unique features in the BSE includes the automatic online trading system known as BOLT that ensures an efficient and transparent market for trading in equity, debt instruments and derivatives. In 2005, the status of the exchange changed from an Association of Persons (AoP) to a full fledged corporation under the BSE (Corporatization and Demutualization) Scheme, 2005 and its name was changed to The Bombay Stock Exchange Limited. It went for an IPO in 2017 and got listed on NSE.

National Stock Exchange (NSE)

It is stock exchange located in Mumbai, India. National Stock Exchange (NSE) was established in 1992 and started trading in 1994. It was recognised as a stock exchange in 1993. NSE has played a critical role in reforming the Indian securities market and in bringing transparency, efficiency and market integrity. NSE has a market capitalization of more than US$1.5 trillion, making it the world's 12th-largest stock exchange (2017). About 1600 companies are listed on it (2017).

NSE was set up by a group of leading Indian financial institutions at the behest of the government of India to bring transparency to the Indian capital market NSE was established with a diversified shareholding comprising domestic and global investors. The key domestic investors include Life Insurance Corporation of India, State Bank of India, IFCI Limited IDFC Limited and Stock Holding Corporation of India Limited. There are many domestic and global institutions and companies that hold stake in the exchange. Some of the domestic investors include LIC, GIC, State Bank of India and IDFC Ltd. Foreign investors include Citigroup.

The Standard & Poor's CRISIL NSE Index 50 or S&P CNX Nifty -Nifty 50 or simply Nifty is the leading index for large companies on the National Stock Exchange of India. The Nifty is a well diversified 50 stock index accounting for leading sectors of the economy .

The CNX Nifty Junior is an index for companies on the National Stock Exchange of India. It consists of 50 companies on the National Stock Exchange of India. It has the second tier of stocks in terms of market cap and don't make it into Nifty

Though a number of other exchanges exist, NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India, and between them are responsible for the vast majority of share transactions. NSE's flagship index, the CNX NIFTY 50, is used extensively by investors in India and around the world to take exposure to the Indian equities market.

Metropolitan Stock Exchange of India (MSE)

It was earlier known as MCX-SX. It commenced operations in 2008.But became a full-fledged exchange with equity trading in 2013. It went for an IPO in 2012.

United Stock Exchange of India (USE)

The United Stock Exchange of India (USE) is an Indian stock exchange. It is the 4th pan India exchange launched for trading financial instruments in India. USE represents the commitment of 21 Indian public sector banks, private banks, international banks (Standard Chartered) and corporate houses to build an institution of repute.USE launched its operations in 2010 and deals in currency futures.

INX 2017

India International Exchange (INX) is India's first international stock exchange, opened in 2017. It is located at the International Financial Services Centre (IFSC), GIFT City in Gujarat. It is a wholly owned subsidiary of the Bombay Stock Exchange (BSE).

India INX is one of the world's most advanced technology platforms with a turn-around-time of 4 micro seconds which will operate for 22 hours a day, allowing international investors and NRIs to trade from anywhere across the globe. India INX offers equity, currency, commodity and interest rate derivatives and proposes to offer depository receipts and bonds once the infrastructure is in place.

Classification of companies listed in BSE

Group	Classification
A	Companies with large capital base, large shareholder base, and good growth record with regular dividends & greater volumes in secondary market.
B1	Relatively liquid scrips with good management & satisfactory growth prospects & volumes
F	Segment for Non-convertible debentures
G	Central and State Government Securities
Z	It comprises of companies not complying with clauses of the listing agreement and are not redressing the grievances of the investor.

Sensex

Sensex or Sensitive Index is a value-weighted index composed of 30 companies with the base 1978-1979 = 100. It consists of the 30 largest and most actively traded blue chip stocks (profit making), representative of various sectors, on the Bombay Stock Exchange. Inclusion of the company is basically on the basis of market capitalization. The 30 companies in the index are revised periodically- some are replaced by others and new sectors may find representation as the economy evolves. The Sensex is generally regarded a mirror or barometer of the Indian stock markets and economy.

Demutualization

Mutualization refers to ownership and management of the exchange being combined in the same hands- brokers elected by the broker community from among themselves. Brokers are the owners of the BSE. Demutualization is when management and ownership are separated. Ownership

is divested from the brokers and the company becomes a public company. All stock exchanges are to be demutualised according to the Government law made in 2004. Demutualization, thus means that ownership, management and trading rights are separated in a stock exchange.

BSE SME and NSE Emerge

BSE and NSE in 2012 launched their SME exchange platforms to enable small and medium enterprises to raise funds and get listed as public entities. While BSE started its SME platform under the brand name of BSE SME Exchange NSE followed suit by announcing the launch its own platform 'Emerge'.The exchange provides an opportunity to small entrepreneurs to raise equity capital for growth and expansion. It will also provide immense opportunity for investors to identify and invest in good SMEs at early stage. The government has been taking a number of steps for SMEs to address challenges of globalisation, higher cost of funds, IT upgrade, infrastructure nstraints faced by SMEs.

SMEs have huge listing potential but so far there have been only debt-financing options, without any access to alternative equity options. There is a general lack of awareness among SMEs about equity capital, stock markets and funding options, other than banks.

Securities and Exchange Board of India (SEBI)

The capital markets in India are regulated by the Securities and Exchange Board of India. (SEBI) It was established in 1988 and given a statutory basis in 1992 on the basis of the Parliamentary Act-SEBI Act 1992 to regulate and develop capital market. SEBI regulates the working of stock exchanges and intermediaries such as stock brokers and merchant bankers, accords approval for mutual funds, and registers Foreign Institutional Investors who wish to trade in Indian stocks. Section 11(1) of the Sebi Act says that it shall be the duty of the Board to protect the interests of investors in securities.

SEBI promotes investor's education and training of intermediaries of securities markets. It prohibits fraudulent and unfair trade practices relating to securities markets, and insider trading in securities, with the imposition of monetary penalties, on erring market intermediaries. It also regulates substantial acquisition of shares and takeover of companies and calling for information from, carrying out inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self regulatory organizations in the securities market. SEBI has its head office in Mumbai and its three regional offices in New Delhi, Calcutta and Chennai.

SEBI's powers were enhanced in 2002 - strengthen the SEBI's board, enlarge it to nine from six and appoint three full-time directors; given enhanced powers to conduct search and seizure etc.

SEBI and the Reforms

The Stock Exchange Scam of 1992 (Harshad Mehta) and the scam in 2000 (Ketan Parekh) led to led to various measures by the Government to protect the interests of the small investors. SEBI introduced reforms like improved transparency, computerisation, enactment against insider trading, restrictions on forward trading, introduction of T + 2 system of settlement etc. The restriction and elimination of forward or Contango trading, referred to in India as 'Badla' is a bold step to check speculation and manipulation of the market. Some more steps taken by SEBI to strengthen markets are:

- SEBI reconstituted governing boards of the stock exchanges, introduced capital adequacy norms for brokers, and makes rules for making client/broker relationship more transparent
- SEBI enforces corporate disclosures
- Enforces ban on insider trading
- Protects retail investors
- SEBI is empowered to register and regulate mutual funds.
- introducing a code of conduct for all credit rating agencies operating in India.
- Clause 49 of the listing agreement that SEBI introduced mandates that all listed companies should have half the Directors on the Board as Independent Directors
- Making it mandatory to have anchor investors

Securities Laws (Amendment) Act 2014

Securities Laws (Amendment) Act 2014 is a legislation in India which provided the securiti: market regulator Securities and Exchange Board of India (SEBI) with new powers to effectively pursue fraudulent investment schemes, especially ponzi schemes. It also provides guidelines for the formation of special fast trial courts.

SEBI's Role As Protector of Investors

Investors are the pillar of the financial and securities market. They determine the level of activity in the market. They put the money in funds, stocks, etc. to help grow the market and thus, the economy. It thus very important to protect the interests of the investors. Investor protection involves prevention of malpractices. Securities and Exchange Board of India (SEBI) is responsible for regulations of the Mutual Funds and safeguard the interests of the investors.

SEBI has taken measures to ensure the investor protection from time to time. It has published various directives, conducted many investor awareness programmes, set up Investor Protection Fund (IPF) to compensate the investors. Other measures are as follows:

- Stock Exchange and other securities market business regulation.
- Registering and regulating the intermediaries of the business like brokers, portfolio managers, merchant bankers, etc.
- Recording and monitoring the work of credit rating agencies, etc.
- Registering investment schemes like Mutual fund & venture capital funds, and regulating their functioning.
- Keeping a check on frauds and unfair trading methods related to the securities market.
- Observing and regulating major transactions and take-over of the companies.
- Carry out investor awareness and education programme.
- Inspecting and auditing the exchanges (SEs)
- Assessment of fees and other charges.
- Banning insider trading
- Strengthening of corporate governance in the listed companies

Investor protection measures by SEBI follows the slogan 'An informed investor is a safe investor'. SEBI launched the Securities Market Awareness Campaign which covers major subjects like portfolio management, Mutual Funds, tax provisions, Investor Protection Fund, Investors' Grievance Redressal.

Capital Market Reforms

Since 1991 when the Government launched economic reforms, the following measures were taken

- SEBI given statutory status- that is Act of Parliament
- Electronic trade
- Rolling settlement to reduce speculation
- FIIs are permitted since 1992
- setting up of clearing houses
- settlement guarantee funds at all stock exchanges
- compulsory dematerialization of share certificates so as to remove problems associated with paper trading; and speed up the transfer
- clause 49 of the listing agreement for corporate governance
- restrictions on PNs
- platform for msme
- law in 2014 strengthen SEBI
- merger of FMC with SEBI

Essentially, the government is involved in providing the regulator, SEBI, with more teeth to prevent and take action against market frauds, take steps to boost retail participation into equities and provide for a viable fund-raising option for SME s – as also provide short-term gains by tweaking tax structures in favour of the asset class.

Primary Market

The primary market is that part of the capital markets that deals with the issuance of new securities directly by the company to the investors. Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. In the case of a new stock issue, this sale is called an initial public offering (IPO). If the company already issued shares and is going to the market again with a new issue, it is called Follow on Public Offer (FPO).

Sebi made some far reaching reforms in favour of the retail investor in August 2012- allowed electronic bidding (e-IPO) for cost effective bidding; and made the rule that retail applicant will be allotted some shares compulsorily.

Secondary Market

The secondary market is the financial market for trading of securities that have already been issued in an initial public offering. Once a newly issued stock is listed on a stock exchange, investors and speculators can trade on the exchange as there are buyers and sellers.

Types of Shares

There are essentially two types of shares: common stock and preferred stock.

Preferred stock is generally issued to banks by the companies though retail investors are also eligible for them. They are preferred for the following reasons:

- In terms of dividend payment, generally, they are given dividends even if the common stock holders are not
- When the company is to be closed, preference stock holders are given money first from the proceeds of the sale of the assets of the companies.
- They may have enhanced voting rights such as the ability to veto mergers or acquisitions or the right of first refusal when new shares are issued (i.e. the holder of the preferred stock can buy as much as they want before the stock is offered to others).

Derivatives

Derivative is a financial instrument. It derives from an underlying asset- securities, shares, debt instruments, commodities etc.. The price of the derivative is directly dependent upon the value of the underlying asset in the present and the projected future trends. Futures and options are the two classes of derivatives.

Futures

Futures are financial instruments based on a physical underlying (commodity, equities etc.). A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future for a certain price.

Futures are part of a class of securities called derivatives, so named because such securities derive their value from the worth of an underlying investment. Futures are different from forwards as the former are traded on exchange while the later may be merely a signed contract between two parties.

New Delhi

Options are a class of futures where the buyer or seller has the option whether to buy or not – put option is the right but not the obligation to sell. Call option is right but not the obligation to buy.

Buyback of Shares

Buyback of shares is the process of a company's repurchase of stock it has issued at a price that is usually higher than the market price. In the case of stocks, this reduces the number of shares outstanding, giving each remaining shareholder a larger percentage ownership of the company. This is usually considered a sign that the company's management is optimistic about the future and believes that the current share price is undervalued. The company also should have reserves to do so.

Reasons for buybacks include

- putting unused cash to use
- raising earnings per share
- reducing the number of shareholders to reduce the cost for servicing them, etc.

Shares bought back need to be cancelled and thus the total equity shrinks and the shareholders benefit. Buyback price is more than the market prices. Companies can buy back with the reserves but can not borrow to buyback. It is allowed in India since 1998. The government has encouraged cash—surplus PSUs to go for share buybacks to meet its disinvestment target. For the current 2017—18 fiscal, it has set a target of raising Rs 72,500 crore through minority sales, strategic

disinvestments as well as through listing of state—owned insurance companies. GOI benefited from the buyback operations of Coal India Ltd (CIL) and Engineers India Ltd in 2017.

Anchor Investor

Anchor investors or cornerstone investors (as they are called globally) are institutional investors like sovereign wealth funds, mutual funds and pension funds that are invited to subscribe for shares ahead of the IPO to boost the popularity of the issue and provide confidence to potential IPO investors. The benefit for institutional investors applying in anchor quota is that they get guaranteed allotment. Allotment to investors applying in an IPO depends on the number of times the issue gets subscribed. Anchor investors, however, cannot sell their shares for a period of 30 days from the date of allotment as against IPO investors who are allowed to sell on listing day.

Commodity Exchanges

Commodity exchanges are institutions which provide a platform for trading in 'commodity futures' just as how stock markets provide space for trading in equities and their derivatives. They thus play a critical role in price discovery where several buyers and sellers interact and determine the most efficient price for the product. Indian commodity exchanges offer trading in 'commodity futures' in a number of commodities. Presently, the regulator, SEBI allows futures trading in over 120 commodities.

Currently 6 national exchanges, viz. Multi Commodity Exchange, Mumbai (MCX), National Commodity and Derivatives Exchange, Mumbai (NCDEX), National Multi Commodity Exchange, Ahmedabad (NMCE), Indian Commodity Exchange Ltd., Mumbai (ICEX), ACE Derivatives and Commodity Exchange, Mumbai (ACE) and Universal Commodity Exchange Ltd., Navi Mumbai (UCX), operate forward trading in 113 commodities. Besides, there are 11 Commodity specific exchanges recognized for regulating trading in various commodities approved by the Commission under the Forward Contracts (Regulation) Act, 1952.

The commodities traded at these Exchanges comprise the following:

- Edible oilseeds complexes like Mustardseed, Cottonseed, Soybean oil etc.
- Food grains – Wheat, Gram, Bajra, Maize etc.
- Metals – Gold, Silver, Copper, Zinc etc.
- Spices – Turmeric, Pepper, Jeera etc.
- Fibres – Cotton, Jute etc.
- Others – Sugar, Gur, Rubber, Natural Gas, Crude Oil etc.

Out of 17 recognized Exchanges, MCX, NCDEX, NMCE, ACE, UCX and ICEX, contribute 99% of the total value of the commodities traded. Out of the 113 commodities, regulated by the FMC, in terms of value of trade, Gold, Crude oil, Silver, Copper, Natural Gas, Lead, Soy Oil, Zinc, Soybean and Castorseed are the prominently traded commodities.

FMC Was Merged Into SEBI 2015

Forward Markets Commission (FMC) that was headquartered at Mumbai was a regulatory authority, which was overseen by the Ministry of Consumer Affairs and Public Distribution, Govt. of India. It was merged with the Securities and Exchange Board of in 2015. The Forward Contracts Regulation Act (FCRA) stands repealed, and the regulation of the commodity derivatives market

shifts to Sebi under the Securities Contracts Regulation Act (SCRA), 1956. SCRA is a stronger law, and gives more powers to Sebi than FCRA offered to FMC. It means that commodity markets will now be better regulated, with more stringent processes — and will thus evoke greater confidence after the NSEL crisis. The FMC only regulated the exchanges and had no direct control over brokers. SEBI has a far superior surveillance, risk-monitoring and enforcement mechanism that will give more confidence to investors, and may help businesses grow.

Mutual Fund

Mutual fund – a financial intermediary that mops up money from a group of investors, to invest in capital market so as to generate returns for the investors. Mutual fund does it for a fees. There are two types of MFs.

Open-ended Funds

Open-ended or open mutual funds issue shares (units) to the investors directly at any time. The price of share is based on the fund's net asset value. Open funds have no time duration, and can be purchased or redeemed at any time on demand, but not on the stock market.

Closed-ended Fund

It is a collective investment scheme issued by a fund. Only a fixed number of shares (units) are issued in an initial public offering which may be called New Fund Offering (NFO). They trade on an exchange. Share prices are determined not by the total net asset value (NAV), but by investor demand. Once the offering closes, new shares are rarely issued. They can be traded only on the secondary market (stock exchanges). Shares are not normally redeemable until the fund liquidates. On the other hand, an open-end fund where the fund company creates new shares and can redeem existing shares.

New Delhi

Foreign Portfolio Investor (FPI)

In 2012, SEBI had constituted a "Committee on Rationalization of Investment Routes and Monitoring of Foreign Portfolio Investments" under the chairmanship of Shri K. M. Chandrasekhar with a view to rationalize/harmonize various foreign portfolio investment routes and to establish a unified, simple regulatory framework. Based on the committee report, in 2014, new FPI Regime came into effect from.

Highlights are:

- Portfolio Investment by any single investor or investor group cannot exceed 10% of the equity of an Indian company, beyond which it will now be treated as FDI.
- FIIs, Sub-Accounts and QFIs are merged together to form the new investor class, namely Foreign Portfolio Investors, with an aggregate investment limit of 24% which can be raised by the Company up to the applicable sectoral cap.
- Non-Resident Indians (NRIs) and Foreign Venture Capital Investors (FVCI) are excluded from the purview of this definition.
- FPIs are not allowed to invest in unlisted shares. However, all existing investments made by the FIIs/Sub-accounts/QFIs are grandfathered (Classroom).
- FPIs are permitted to invest in Government Securities with a minimum residual maturity of one year. It means, FPIs have been prohibited from investing in T-Bills.

FIIs

Foreign Institutional Investor (FII) means an institution established or incorporated outside India which proposes to make investment in securities in India. They are registered as FIIs with the SEBI (FII). FIIs are allowed to subscribe to new securities or trade in already issued securities FII are a part of "Foreign Portfolio Investor" (FPI) along with the other two: Sub Accounts and Qualified Foreign Investors.

FIIs invest huge sums of money in financial assets - debt and shares- of companies and in other countries- a country different from the one where they are incorporated. They include banks, insurance companies, retirement or pension funds, hedge funds and mutual funds.FIIs are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS). The ceiling for overall investment for FIIs varies from company to company. Besides buying equities from the market, FIIs have participated in Qualified Institutional Placements (QIPs), directly from the promoters requiring huge capital. SEBI prescribes norms to register FIIs and also to regulate FII investments.

Reasons for FIIs having India as a favourite destination

- growing economy
- corporate profits are high
- government policies are encouraging
- compared to other countries, India has brighter prospects

FII investment is referred to as hot money for the reason that it can leave the country at the same speed at which it comes in.

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QFIs

A QFI is an individual, group or association resident in a foreign country that is compliant with Financial Action Task Force (FATF) standards. Till 2012, they were investing in India through the FIIs registered with the SEBI. From 2012, they are allowed to invest in India directly for which Sebi and RBI have made the necessary rules.They are a part of FPI from 2014.They can invest in corporate debt, equities and mutual funds.Its aim is to widen the class of investors, attract more foreign funds and reduce market volatility and deepen the Indian capital market.

Government relaxed the eligibility condition to allow investors from Gulf Cooperation Council (GCC) and also the European Commission to invest in Indian debt if they meet the local rules. A resident of IOSCO can also be a QFI.

Difference Between FDI and FII

FDI invest in setting up firms to produce goods and services. That is why it is called "direct" institution. FII on the other hand buys financial assets for profits. In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), it was decided to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI.

IOSCO

The International Organization of Securities Commissions (IOSCO) is an association c organisations that regulate the world's securities and futures markets.

Members are typically the Securities Commission or the main financial regulator from each country. IOSCO has members from over 100 different countries, who regulate more than 90 percent of the world's securities markets. The organisations role is to assist its members to promote high standards of regulation and act as a forum for national regulators to cooperate with each other and other international organisations. India is a member.

IOSCO is has a permanent secretariat based in Madrid.

Sustainable Stock Exchanges (SSE)

The Sustainable Stock Exchanges (SSE) initiative is a project of the United Nations (UN) co-organized by the United Nations Conference on Trade and Development (UNCTAD), the United Nations Global Compact, the United Nations Environment Programme Finance Initiative (UNEP-FI) and the UN supported Principles for Responsible Investment (PRI).

Other key stakeholders include the World Federation of Exchanges (WFE), and the International Organization of Securities Commissions (IOSCO). The SSE provides a multi-stakeholder learning platform for stock exchanges, investors, regulators, and companies to adopt best practices in promoting corporate sustainability. In collaboration with investors, regulators, and companies, they strive to encourage sustainable investment.

FATF

The Financial Action Task Force (on Money Laundering) (FATF) is an intergovernmental organization founded in 1989.The purpose of the FATF is to develop policies to combat money laundering and terrorism financing. The FATF Secretariat is housed at the headquarters of the OECD in Paris.FATF is responsible for setting global standards on anti-money laundering (AML) and combating financing of terrorism (CFT).

Following its inclusion in 2010, India and its tax enforcement authorities — the Financial Intelligence Unit, the Enforcement Directorate, the Central Economic Intelligence Bureau and the Directorate of Revenue Intelligence — would be able to exchange vital information from member-countries on money laundering and terrorist financing activities.

Global Depository Receipts (GDR)

Indian companies are allowed to raise equity capital in the international market through the issue of Global Depository Receipt (GDRs). GDRs are designated in dollars/euros or any other foreign currency.

The proceeds of the GDRs can be used for financing capital goods imports, capital expenditure including domestic purchase/installation of plant, equipment and building and investment in software development, prepayment or scheduled repayment of earlier external borrowings, and

equity investment in JVs in India. GDRs are listed on London SE or Louxembourg or elsewhere. They are also called euroissues in a general sense.

ADRs

American depository receipts are like shares. They are issued to US retail and institutional investors. They are entitled like the shares to bonus, stock split and dividend. They are listed either on Nasdaq or NYSE.Like GDRs, they help raise equity capital in forex for various benefits like expansion, acquisition etc.ADR route is taken as non-USA companies are not allowed to list on the US stock exchanges by issuing shares.

Similarly with Indian Depository Receipts (IDRs).

Participatory Notes

Participatory notes are instruments used by foreign investors for making investments in the stock markets. In India, foreign institutional investors (FIIs) who are Sebi-registered use these instruments for facilitating the participation of overseas funds like hedge funds and others who are not registered with the Sebi and thus are not directly eligible for investing in Indian stocks.

Any entity investing in participatory notes is not required to register with SEBI (Securities and Exchange Board of India), whereas all FIIs have to compulsorily get registered. Participatory notes are popular because they provide a high degree of anonymity, which enables large hedge funds to carry out their operations without disclosing their identity and the source of funds. KYC (know your customer norms are not applied here).

Since the source of funds is not revealed, the PNs are potentially unsafe. Therefore, SEBI in 2007 October imposed certain conditions like limits on the PNs that a single FII can issue etc. SEBI wants the PN holders to register with the SEBI and invest directly as India is a long term growth story. Sebi policy paid off with the number of FIIs registering with the regulator going over time to about 2000(2017) .

The SEBI action aims at ensuring that the quality of flows into stock markets and Indian forex market is clean.

Clearing House

An organisation which registers, monitors, matches and guarantees the trades of its members and carries out the final settlement of all futures transactions. The National Securities Clearing Corporation is the clearing house for the NSE.

Equity

Common stock and preferred stock that is, shares issued by the company.Also, funds provided to a business by the sale of stock.

Share

Share is a certificate representing ownership of the company that issued it. Shares can yield dividends and entitle the holder to vote at general meetings. The company may be listed on a stock exchange. Shares are also known as stock or equity.

Bond

A debt instrument issued for a period of more than one year with the purpose of raising capital by borrowing.

Debenture

Debt not secured by a specific asset of the corporation, but issued against the issuer's general credit- that is, it is unsecured debt. Investment earns an interest for the debenture holder. The following are various types of debentures

- convertible debentures can be converted into equity at a future date
- Non-convertible debentures will not be converted
- Partly convertible debentures will have some part converted into shares.

Bear

Bear is an investor who believes that market will go down.

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Bull

Bull is an investor who believes that the market will go up optimistic

Bear Market

A sustained period falling stock prices usually preceding or accompanied by a period of poor economic performance known as a recession. of

Bull Market

A stock market that is characterized by rising prices over a long period of time. The time span is not precise, but it represents a period of investor optimism, lower interest rates and economic growth. The opposite of a bear market.

Gilt

Gilt is a bond issued by the government. It is issued by the Central Bank of a country on behalf of the government. In India, Reserve Bank of India issues the treasury bills or gilts. Gilt Edged Market is the market for government securities.

Blue Chip

Blue chip shares are the shares of the companies that are the most valuable. Companies that are profit making; usually dividend –paying and are liquid in the market- that is there is almost always in demand on the market.

Midcap Company

Generally, companies with a market capitalization that is very high are called large caps and the next rung below is mid cap and the bottom one is small cap companies. Limits are not statutorily laid dwn and vary from institution to institution.

Retail Investor

A retail investor is in the Indian securities is one whose subscription to securities is of a value less than Rs. 2 lakh regardless of individual's existing shareholding in the market or what his present networth is. Sebi allows price discount for retail investors and company discount participating in initial public offers and follow-on offers. This discount is offered to attract retail investors into the market and broad base ownership.

Negotiated Dealing System

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments.

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Short Selling

The sale of a security made by an investor who does not own the security. The short sale is made in expectation of a decline in the price of a security, which would allow the investor to then purchase the shares at a lower price in order to deliver the securities earlier sold short.

Market Capitalization

Price per share multiplied by the total number of shares outstanding; also the market's total valuation of a public company.

Insider Trading

Insider trading occurs when any one with information related to strategic and price-influencing information purchases or sells stocks so as to make speculative profits. SEBI is formulating rules which are tougher for the insider trading.

Depository

A depository holds securities (like shares, debentures, bonds, Government Securities, units etc.) of investors in electronic form. Besides holding securities, a depository also provides services related to transactions in securities. Benefits of a depository are reduction in paperwork involved in transfer of securities; reduction in transaction cost.

National Securities Depository Limited (NSDL)

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. The enactment of Depositories Act in 1996 paved the way for establishment of NSDL, the first depository in India.

NSDL offers facilities like dematerialisation i.e., converting physical share certificates to electronic form; rematerialisation i.e., conversion of securities in demat form into physical certificates etc.

Nasdaq

Nasdaq stands for the National Association of Securities Dealers Automated Quotation System. Unlike the New York Stock Exchange where trades take place on an exchange, Nasdaq is an electronic stock market that uses a computerized system to provide brokers and dealers with price quotes. It is an electronic stock market- first in the world- run by the National Association of Securities Dealers. Many of the stocks traded through Nasdaq are in the technology sector.

Dow Jones Index

The New York Stock Exchange (NYSE) index, which reflects the movement of the world's first stock market. It is composed of the 32 most traded stocks of the NYSE. Currently there are three Dow Jones Indices: The Dow Jones Industrial Average (DJIA). The Dow Jones Transport Average (DJTA) and finally DJUA (Dow Jones Utility Average).

In recent years, broader indices such as the Standard & Poor's 500 (for large companies), the Russell 2000 (for smaller companies) and the Wilshire 5000 (for an especially broad measure) have gained currency, in part due to the rising popularity of index investing.

Important Indices In The World

Market index is a number to indicate the average movement of prices of a securities market. It usually tracks select stocks.

- American Dow Jones Industrial Average and S&P 500 Index
- British FTSE 100: It is a share index of the 100 most highly capitalised companies listed on the London Stock Exchange. The index began in 1984 with a base level of 1000.The index is maintained by the FTSE Group, an independent company which originated as a joint venture between the Financial Times and the London Stock Exchange.
- French CAC 40
- German DAX
- Ibex for Spain
- Japanese Nikkei
- Australian All Ordinaries

- Hong Kong Hang Seng Index
- South Korea's Kospi
- Straits Times Index (STI) of Singapore.
- Bovespa Index
- RTS Index (RTSI) is an index of 50 Russian stocks that trade on the RTS Stock Exchange in Moscow
- SSE (Shenzhen Stock Exchange) Composite Index- China
- SSE (Shanghai Stock Exchange) Composite index-China

Ponzi Scheme Or Pyramid Scheme

A Ponzi scheme is a fraudulent investment operation that pays high returns to investors and promises higher returns to those who join the scheme later. The payments are done from investors own money or money paid by subsequent investors rather than from any actual profit earned. The scheme is named after Charles Ponzi, who became notorious for using the technique after emigrating from Italy to the United States in 1903.

Decoupling

It means that a nation's economy may have an autonomous logic and need not be entirely dependent on the global economy. For example, if the world goes into a recession, all counties need not have their stock markets collapse beyond a point. India, for example grew at 6.7% (2008-09) while the USA and the west were contracting. Reflecting the economic realities, equity markets also perform autonomously after a point. It is called decoupling- that is, isolation from the rest.China is more integrated with the world as its economy is driven by exports. However, even China is decoupled as it has a lot of domestic consumption driving its growth.

Clause 49

Clause 49 of the Listing Agreement to the Indian stock exchange came into effect in 2005. It has been formulated for the improvement of corporate governance in all listed companies as it mandates that there should be certain independent directors on the Board of a Company.

Shariah Index

Asia's oldest stock exchange, the Bombay Stock Exchange (BSE), launched its Shariah index in December 2010. The index has 50 stocks selected from the BSE-500 bracket. Infrastructure, capital goods, IT, telecom and pharmaceuticals shares will form a large chunk of the 'BSE Tasis Shariah-50 Index', as the new index is known.

The new index attracts investments from Arab and European countries, where Shariah funds are already popular. Shariah, the religious law of the followers of Islam, has strictures regarding finance and commercial activities permitted for believers. Arab investors only invest in a portfolio of 'clean' stocks. They do not invest in stocks of companies dealing in alcohol, conventional financial services (banking and insurance), entertainment (cinemas and hotels), tobacco, pork meat, defence and weapons.

BRICS Cooperation Among Exchanges

In 2011 seven major stock exchanges in Brazil, Russia, India, China and South Africa announced plans to cross-list derivatives on their benchmark indexes. The five founding members of the BRICS Exchanges Alliance began cross-listing benchmark equity index derivatives on each others trading platforms from 2012. The five exchanges, BOVESPA from Brazil, MICEX from Russia, BSE from India, Hong Kong Exchanges and Clearing Limited (HKEx) from China, and JSE Limited from South Africa, announced the formation of the alliance In this initial stage of implementation, the exchanges aim to expand their product offerings beyond their home markets and give investors of each exchange exposure to the dynamic, emerging, and increasingly important BRICS economies.

Power Exchanges

A power exchange created within the regulatory framework is an institution that is responsible for conducting auctions in a non-discriminatory fashion to sell power at competitive market prices. CERC has permitted trading of Electricity through Power Exchange with effect from June 2008. Currently, two exchanges viz. Indian Energy Exchange (IEX) and Power Exchange of India Limited (PXIL) are in operation in India which facilitate an automated on-line platform for physical day-ahead contracts. It is the core of an electricity market which is a system for effecting purchases, through bids to buy and sell. It would bring about efficiency as well as liquidity as power companies bought and sold electricity.

Why Is The Indian Stock Market Doing So Well (2017)

The Nifty rose to a historic high of 10,425, while the S&P BSE Sensex hit a lifetime high of 33,530 on November 1st, 2017 posting the highest returns in the calendar year till then. The reasons are: loose monetary policy of foreign countries like Japan, EU that makes money cheap for the FPIs to invest abroad. Domestic savings are flowing to mutual funds. It is happening because the macro economic data is encouraging. The current account deficit and fiscal deficit are under control. Retail inflation is low. The government is focusing on ease of doing business and implementing crucial reforms such as the Goods and Services Tax (GST); RERA etc. These factors could boost growth. India jumped 30 places to 100 in the World Bank's ease of doing business rankings 2018, driven by reforms in access to credit, power supplies and protection of minority investors. It augurs very well for investment.

TAXATION

Tax is a payment compulsorily collected from individuals or firms by government. A direct tax is levied on the income or profits of an individual or a company respectively. The word 'direct' is used to denote the fact that the burden of tax falls on the individual or the company paying the tax and can not be passed on to anybody else. For example, income tax, corporate tax, wealth tax etc. An 'indirect' tax is levied on manufacturing and sale of goods or services. It is called 'indirect' because the real burden of such a tax is not borne by the individual or firm paying it but is passed on to the consumer. Excise duty, customs duty, sales tax etc. are the examples.

Importance of taxation for the Government, economy and society

Taxation has revenue and non-revenue aims. The revenue it fetches helps government in meeting its growth goals through investment. Taxes provide funds that can accomplish

- Provision of public goods
- national defense
- enforcement of law and order
- redistribution of wealth through progressive taxation system
- economic infrastructure — roads, ports etc
- social welfare
- social infrastructure like education, health etc
- social security measures like pensions for the elderly, unemployment benefits
- To modernize the economic system like GST
- Promote savings
- Promote small scale industries
- Boost exports by making exports free of the GST burden
- Enforce good civic fiscal behavior through carrots and sticks as in the Income Declaration Scheme (IDS) 2016 and Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

Taxation in India

India has an elaborate federal Constitutional scheme for imposition, collection and appropriation of taxes. The central government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like customs and excise duties and service tax. In 2017, however, excise duties and service tax were integrated into the Goods and Services Tax (GST) for most products. States are a part of GST though they have some residuary power to levy Value added tax (VAT) on goods like petroleum products, tax on liquor etc. States also have the power to levy direct taxes like tax on agricultural income.

Since 1991, the tax system in India has undergone substantial rationalization- reduced rates and slabs and better administration. Tax system has been simplified also to boost "Ease of doing business."

Some of the tax reforms made till 2017 are:

- Broadening the tax base to include services, fringe benefits, stock market transactions etc
- Reduction in customs and excise duties. Peak customs rate is today 10% which is imposed on 90 per cent of non-agricultural industrial goods

- Lowering of corporate tax rates to 25% over a four year period from 2015
- Wealth tax was abolished in the Union Budget (2016-2017) and integrated into the income tax of the Rs.1 cr slab
- Rationalizing the personal income tax rates and slabs starting from 1997 'dream budget'
- GST from 2017
- Use of technology for quicker processes
- Simpler procedures for greater compliance
- Safe harbor rules on transfer pricing
- Revamping the double tax avoidance treaties with many countries like Mauritius to prevent Base erosion and profit shifting (BEPS)
- Clear General anti-avoidance rules (GAAR)
- Stringent action against black money holders through disclosure schemes which have very little amnesty component(Income Disclosure Scheme (IDS) 2016 and severe monetary penalty as in Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) so that they pay adequate tax

Direct and Indirect Tax Ratio

Total tax revenue of the Government of India includes both direct & indirect taxes. Direct taxes include personal income tax and corporation tax mainly while indirect taxes comprise of GST and Customs duties. Direct taxes come from the well-off as it is a progressive tax where the richer a person/firm, the more it has to pay. It has equity built into it. Direct taxes like income tax are also 'automatic stabilisers' – when the economy grows, there is inflation, wages rice, people move into higher tax brackets and pay more taxes which reduces their spend on goods and services thus stabilizing prices. They help in stabilising economic cycles without explicit government action.

Indirect taxes on the other hand largely do not differentiate between the rich and the poor though there is a progressive element there as well as there are exemptions and there is a hierarchy of slabs. But on most essential goods, there is tax and the poor pay it. Indirect taxes also contribute to inflation and may dent savings and demand. Thus, they are relatively anti growth. In India, the relative contribution has been evolving as follows as mentioned in the Reserve Bank of India (RBI) Handbook of Statistics on Indian Economy released in September 2017:

In 1985-86, the indirect tax revenue was more than 4 times that of the direct tax revenue. The share of indirect taxes in the total tax revenue was 83% compared to the 17% share of direct taxes in 1985-86. In 30 years since then, the share of both has more or less become equal. In 2016-17, share of direct taxes was 48% in the total tax revenue compared to the 52% share of indirect taxes. In the 8 years between 2007-08 and 2014-15, the share of direct taxes in the total tax revenue was more than the share of indirect taxes. In 2009-10, the share of direct taxes was close to 60%, the highest ever till date. Starting again in 2015-16, the share of indirect taxes has overtaken the share of direct taxes.

In this context, it should be noted that when the overall tax collections of both the Centre and the States are taken into account, nearly two-third of total tax collected is accounted for by indirect taxes, implying that the tax structure in the country continues to be regressive.

While collections from direct taxes have risen in absolute terms, their contribution to India's total tax revenue has fallen in percentage terms. Also, direct taxes have been growing at a slower pace than indirect taxes.

The reason for the surge in indirect taxes is two fold: service tax base increased and also the rate-being 18% under the GST regime since 2017. Also, with the dramatic drop in the international crude prices since 2015, GOI found an opportunity and need to increase the excise duties on petroleum products steeply.

Tax to GDP ratio

When the economy grows, there is greater personal prosperity, corporate profits and consumption of goods and services. All of them add to tax collections and thus the Tax: GDP ratio increases. GOI's gross tax collections (total amount that it collects which includes the share of States and UTs) are estimated at 11.3% of GDP for FY2018. When we add the taxes and duties of States and local bodies, India's tax-to-GDP ratio becomes 16.6%. Gross tax collections will statistically come down from 2017-18 as states are collecting their own GST. In 2015, tax revenue (including social contributions) in the EU-28 stood at 40.0 % of GDP, and accounted for around 89 % of total government revenue. In comparison, the combined tax to GDP ratio in other BRICS countries was higher - Brazil (35.6%), South Africa (28.8%), Russia (23%), and China (19.4%).Some countries, like Sweden, have a high tax-to-GDP ratio (as high as 54%). USA's is 25.4%. France has a tax to GDP ratio of 45% while Denmark as is pegged at 48.6%. Among the BRIC countries, Brazil has a tax to GDP ratio of 33.4% while Russia is at 34.8%. But experts say that most developed countries have a higher per capita income and therefore the ability to pay higher taxes.

The relatively low ratio in India is because we are a developing country; there is a large informal sector; agricultural income is exempt; there are so many other tax exemptions (tax expenditure); parallel economy; and also, tax machinery is not sufficiently capacity-built.

Low ratio handicaps the state from spending on social social sector and infrastructure. India spends on an average about 3.4 percentage points less vis-a-vis comparable countries on health and education Economic Survey 2015-16 said that India needs to increase its tax-GDP ratio, and spend more on health and education. When tax revenues grow at a slower rate than the GDP of a country, the tax-to-GDP ratio drops.

Since 2016-17, formalization of economy has become the focus with demonetization and GST. There are more people filing tax returns; more digital payments; those evading tax earlier can not do so any more as the government relies on big data garnered from demonetization. GST makes compliance higher due to input tax set off.

Due to demonetization, as many as 1.26 crore new taxpayers were added in 2016-17. The I-T department launched Operation Clean Money to clamp down on unaccounted money funnelled into bank accounts, post-demonetisation.

Number of Tax Payers 2017

In India a large section of people come from agriculture, BPL and small enterprises who are not liable to pay tax as their income falls below the exemption limit. Due to Tax Deduction at Source

(TDS), many more people are paying tax even though many of them may not be filing their tax returns. That is, not everyone who pays tax files returns. The government added 9.1 million new taxpayers in 2016-17.This is expected to significantly boost the government's tax revenue. India had only 55.9 million individual return filers at the end of 2015-16.

Not everyone who pays files returns pays tax. Many file returns to show that they have no taxable income.

Broadening Tax Base

Tax base encompasses all that is taxed- incomes, profits, manufacture, sale, import etc. While vertical equity demands that rich are taxed harder and luxury goods as well, horizontal equity demands that all transactions except the very essential ones be taxed. The more the actions that are taxed, the larger the base. Since 1991, government has been broadening the base starting from 1994 when the service tax was introduced. Following have been the steps

- STT
- CTT
- Fringe benefit tax
- MAT
- GAAR
- Limitation of benefit clause in the DTAAs
- Demonetization
- Transfer pricing and APAs
- GST
- Expanding the coverage of provisions relating to Tax Deduction at Source (TDS) to more transactions
- Quoting of permanent account number made compulsory for many transactions so more people can be brought into tax net

Tax Amnesty Schemes

There may be people who do not comply with the tax laws. That is they evade taxes. Governments make amnesty schemes for them come clean by paying taxes at the current rates or any other rate which is beneficial to the assesse even as the government collects tax revenue that can be used for the socio-economic development of the country. It is called tax amnesty scheme. Those who comply with such a scheme are not taken up criminally. Dome schemes do not have any penalty. Some have it, the latter being disclosure schemes essentially where the amnesty part if minimal (not being criminally proceeded against). The schemes that were launched in 2016 are mainly disclosure schemes: IDS 2016 and PMGKY.

IDS 2016

Income Declaration Scheme, 2016 was an amnesty scheme that was as a part of the 2016 Union budget to unearth black money and bring it back into the system. Lasting from 1 June to 30 September, the scheme provided an opportunity to income tax and wealth tax defaulters to avoid litigation and become compliant by declaring their assets, paying the tax on them and a penalty of 45% thereafter.

Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY)

It is an amnesty scheme launched by the Government of India in December 2016 on the lines of the Income declaration scheme, 2016 (IDS) launched earlier in the year. A part of the Taxation Laws (Second Amendment) Act, 2016, the scheme provides an opportunity to declare unaccounted wealth and black money in a confidential manner and avoid prosecution after paying tax, interest and a fine of 50% on the undisclosed income. An additional 25% of the undisclosed income is invested in the scheme which can be refunded after four years, without any interest.Valid from December 16, 2016 to May, 2017, the scheme can only be availed to declare income in the form of cash or bank deposits in Indian bank accounts and not in the form of jewellery, stock, immovable property, or deposits in overseas accounts.

While the rationale is appealing for the amnesty schemes, they carry a moral hazard: those who do not pay continue not to pay and those who did, may be de-motivated.

Operation Clean Money 1 and 2

Income Tax Department (ITD) initiated Operation Clean Money in January 2017. Initial phase of the operation involves e-verification of large cash deposits made during 9th November to 30th December 2016. Data analytics were used for comparing the demonetisation data with information in ITD databases. In the first batch, around 18 lakh persons have been identified in whose case, cash transactions do not appear to be in line with the tax payer's profile. Operation Clean Money 1 began on January 31 and ended on February 15.As part of the first phase of Operation Clean Money, the CBDT had identified 17.92 lakh persons for e-verification of large cash deposits.

In the second phase of 'Operation Clean Money' launched in April 2017 with an aim to detect black money generation post demonetisation, the I-T department used information received under the Statement of Financial Transactions (SFT) from banks to identify additional cases: persons whose tax profiles were found to be inconsistent with the cash deposits made by them during the demonetisation period.

Direct Taxes Code (DTC)

The Direct Taxes Code (DTC) is a proposal by the Government of India (GOI) to simplify the direct tax laws in India. DTC aims to introduce new provisions and revise, consolidate and simplify the structure of direct tax laws in India into a single legislation. DTC will l replace the Income-tax Act, 1961 and other direct tax legislations. DTC 2010 was introduced in the Indian Parliament in 2010 but it lapsed with the dissolution of the 15th Lok Sabha in 2014. However, without the DTC, many changes have been brought about in the direct tax regime in the country in the three years till 2017:

1. Wealth tax was abolished
2. Union Budget 16-17, GOI presented a plan to reduce the corporate tax rate from 30% to 25% in four years to make India's tax rates globally competitive
3. Reduction in corporate tax rate for MSMEs to 25% from 30% to make them competitive
4. General Anti Avoidance Rules (GAAR)
5. Place of Effective Management (POEM) rule as a test to determine residency for tax purposes
6. Changes in DTAAs

In the 2017 Rajaswa Gyan Sangam, PM mentioned the need to overhaul the direct taxes framework.

Inverted Duty Structure

Normally, there should be lower tax on raw material so that it can be imported and value added to produce the final product that can be sold at home or exported. That helps "Make in India". It also promotes exports. On the other hand, higher import duty on the raw materials and intermediates than on the finished product is called inverted duty structure. It puts the domestic manufacturers at a disadvantage making them uncompetitive within the domestic market and in global markets.

India levies one of the highest duties on import of raw materials and one of the lowest duties on import of finished rubber goods.This inverted duty structure is leading to a surge in import of finished goods. Of the total import of finished goods, 80-90 per cent is avoidable as domestic rubber manufacturing units have the capability to meet the demand, but low import duties on rubber products especially under FTAs (free trade agreements) have led to indiscriminate imports in the country.

Reducing the customs duty on raw material for the pharmaceutical, electronic and automobile sectors is important for the same reason.

Such anomalies discourage value-addition by domestic manufacturers and encouraged imports.

FTAs may lead to inverted duty structure with duties for final products being lower from FTA partners compared to duties for the raw materials imported from non-FTA countries. This acts as a disincentive to local manufacturing which is not competitive against FTA imports because of the inverted duty structure phenomenon.

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Tax Expenditure

Tax expenditure refers to revenue forgone as a result of exemptions and concessions (direct and indirect tax). It was introduced for the first time in 2006-07 Union Budget. The revenue foregone due to tax incentives in 2015-16 is estimated at nearly 6 lakh crore. Such exemptions have been justified for promoting balanced regional growth; dispersal of industries; neutralisation of disadvantages on account of location; and incentives to priority sectors, including infrastructure. They are also given to the middle class to build houses; senior citizens for their relief; women for buying houses etc.

Since the amount is large and so many of the incentives may have lost their utility and need, it is suggested that some should be dropped. They should be subject to a sunset clause, as tax exemptions often create pressure groups for their perpetuation. While some may be justified as they enhance investment and generate more taxes for the government, others are not.

Such exemptions and concessions can distort resource allocation and stunt productivity. They also result in a multiplicity of rates, legal complexities, classification disputes, litigation etc. If these exemptions are rationalized, they can help the government spend more on social and infrastructure and help reduce the fiscal deficit.

However, some such incentives are necessary. For example, the 2016 Start Up policy that gives breaks for such firms.

Tax Havens

A tax haven is a country or territory where certain taxes are levied at a low rate or not at all. Individuals and/or corporate entities can find it attractive to move themselves to areas with reduced or nil taxation levels. This creates a situation of tax competition among governments. The important features of a tax haven arte:

- nil or nominal taxes;
- lack of effective exchange of tax information with foreign tax authorities, that is, personal finance information is not shared with other countries
- no requirement for a substantive local presence; and

Bermuda, Panama, Ireland, Singapore, the Cayman Islands, Monaco, Luxembourg and Hong Kong are among 45 territories blacklisted by the Organisation for Economic Co-operation and Development and threatened with punitive financial retaliation for being tax havens.

Panama and Pradise Papers

The Panama Papers are 11.5 million leaked documents that detail financial and attorney–client information for more than 214,488 offshore entities that contain personal financial information about wealthy individuals and public officials dealing in shell corporations that were used for illegal purposes, including fraud, tax evasion, and evading international sanctions.

The Paradise Papers is a set of 13.4 million confidential electronic documents relating to offshore investment. The documents originate from the offshore law firm Appleby. They contain the names of more than 120,000 people and companies who put their legal and illegal money in funds based in Cayman Islands and Bermuda - tax havens.

Tobin Tax

James Tobin, an economist, proposed in 1972 a worldwide tax on all foreign exchange transactions- when foreign capital enters a country and when it leaves. The aim is to check speculative flows. Long term investment – generally FDI, will not suffer as it does not invest for speculative (short term) reasons like FIIs.

Tobin justified the tax on two grounds: First, it would reduce exchange rate volatility and improve macroeconomic performance. Second, the tax could bring in revenue to support for development efforts or exchange rate stabilization.

The defining characteristic of a Tobin tax is that the tax is levied twice- once when one acquires foreign exchange, and again when one sells the foreign exchange.

The south East Asian currency crisis (1997) is partly attributed to the 'dynamics of hot money'(portfolio investments or FII flows). That gave further justification for the Tobin tax.

Tobin tax can be imposed only if all the countries accept the proposition. Otherwise, FIIs can go to countries where the tax is not imposed.

India does not prefer it as we need foreign inflows as we are a CAD country and don't have surplus.

In the EMU, there is a proposal to see a microtax levied at 0.1% on share and bond transactions, and 0.01% on deals involving complex securities such as derivatives. It is called the Financial Transaction Tax. The FTT, or "Tobin tax" as it is also known is a "Robin Hood tax", - collected from speculators and used for rescuing the financial system when there is such a need. India has a similar tax though not for the same purpose- securities transaction tax (STT) and commodities transaction tax (2015)

Due to currency volatility and stock market stocks in China in 2015-16, there is a proposal that Tobin tax be imposed. China may be able to afford such a tax as FII exposure is limited in China and it has huge surpluses of forex reserves.

India can not afford Tobin tax as we need foreign currency. We need to contain volatility by other means encouraging FDI and relatively limiting FPI though FPI is also very important for liquidity in capital market.

Pigovian Tax

The Pigovian tax is imposed on transactions that have a negative externality. For example, pollution. Externality means impact of one person's actions on the well being of an outsider (bystander or third party). For example, the seller and consumer of cigarettes together will harm the third person with pollution. Also, exhaust fumes from automobiles. Positive externality refers to a good effect on the third party. For example, restoration of historic buildings, research into new technologies, libraries etc. Carbon tax is one example in the context of the need to discourage fossil fuels and encourage renewable sources due to climate change threat. Supreme Court in 2015 imposed an 'Environment Compensation Charge' (ECC) on commercial vehicles entering Delhi.

NOT FOR SALE

Carbon tax (called Clean Environment Cess from 2017) is levied in India since 2010 at the rate which is Rs.400 per tonne on Coal, Lignite and Peat in order to finance and promote clean environment initiatives, funding research in the area of clean environment or for any such related purposes.It is imposed on coal produced in India or imported into India. This is in line with the principle of "polluter pays".

In many countries carbon taxes are levied also on other fossil fuels like petroleum, natural gas etc.

Base Erosion and Profit Shifting (BEPS)

BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. It means, a company shifts its headquarters to a jurisdiction like Mauritius or Ireland where tax rates are low only to avoid taxes. Although some of the schemes used are illegal, most are not. It is a huge loss of tax revenue to the governments of the countries where these companies actually carry out their economic activity. This undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

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BEPS is of major significance for developing countries like India due to their significant reliance on corporate income tax, particularly from multinational enterprises. India suffers from BEPS due to double taxation avoidance agreements (DTAA) being misused, transfer pricing issues etc. India modified its DTAA with Mauritius to tackle the BEPS issues.

Tax abuse not only weakens efforts to fight poverty but also weakens the fiscal base needed for sustainable economic development.

OECD has a BEPS inclusive framework in which many countries are participants including India. It consists of measures ranging from common approaches which will facilitate the convergence of national practices, and best practices.The Inclusive Framework on BEPS brings together over 100 countries and jurisdictions to collaborate on the implementation of the OECD/ G20 Base Erosion and Profit Shifting (BEPS) Package.

United States Foreign Account Tax Compliance Act (FATCA) is a similar example. The Foreign Account Tax Compliance Act (FATCA) is a 2010 United States federal law requiring all non-U.S. ('foreign') financial institutions (FFIs) to search their records for customers from U.S. and to report the assets and identities of such persons to the U.S. government. India agrees with it.

Transfer Pricing and APA

Transfer pricing is the setting of the price for goods and services sold between related legal entities within an enterprise. For example, if a subsidiary company sells goods to a parent company or vice versa , the price of those goods paid by the parent to the subsidiary or the opposite is the transfer price.The Indian Transfer Pricing Code prescribes that income arising from international transactions or specified domestic transactions between associated enterprises should be computed having regard to the arm's-length price. An arm's-length price for a transaction is what the price of that transaction would be on the open market. The need for the Code is because of the profit shifting practices followed by the MNCs. For example, an MNC has a subsidiary in India and elsewhere. It sources from and supplies to the subsidiaries in all the countries. The goods and services are same but the prices are shown differently depending upon the tax rates in the countries. The corporate tax rates are high in India. Therefore, the price of goods sold by the MNC to Indian subsidiary is shown higher in India to show less profit and thus less tax outgo. Thus, transfer pricing is generally done in a way as to show high profit in countries where the corporate tax rate is low and low profits/losses where the rate is high. Therefore, transfer pricing norms existing today need to be rationalised so that the tax revenues that are due to the government are not eroded. Tax evasion and money laundering has to be checked by tightening the transfer pricing regime.The solution is advance pricing agreements (APA).

An APA refers to an agreement between the taxpayer and the tax authorities on the pricing of an existing or proposed transaction between related parties. Any taxpayer can file an application for an APA, along with details of the transaction and the proposed pricing for such transaction. The APA programme enables the taxpayers and the revenue authorities to interact, negotiate and come to a conclusion on the pricing of the transaction in question. If the taxpayer and the revenue authorities agree to a particular price, they may enter into an agreement, which would be valid for a period of five years. If, however, for some reason, they do not reach a consensus, they may not sign the agreement.It helps avoid disputes with the tax authorities over transfer pricing. The APA scheme, which was introduced in 2012, tries to provide certainty to taxpayers in transfer pricing by specifying the method of pricing and setting the prices of international transactions in advance. It applies to foreign MNCs and Indian MNCs.

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Double Taxation Avoidance Agreement (DTAA)

Double taxation is the levying of tax by two or more jurisdictions on the same declared income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes). Double taxation is avoided by DTAAs where countries affected enter into a tax treaty which sets out rules to avoid double taxation.

A DTAA is a tax treaty signed between two or more countries. Its objective is that tax-payers in these countries can avoid being taxed twice for the same income. A DTAA applies in cases where a tax-payer resides in one country and earns income in another. It is both fair as well boosts investment and growth.DTAAs also provide for concessional rates of tax in some cases.

For instance, interest on NRI bank deposits attract 30 per cent TDS (tax deduction at source) normally. But under the DTAAs that India has signed with several countries, tax is deducted at only 10 to 15 per cent. Many of India's DTAAs also have lower tax rates for royalty, fee for technical services, etc.

Favourable tax treatment for capital gains under certain DTAAs such as the one with Mauritius have encouraged a lot of foreign investment into India. Mauritius accounted for $93.65 billion or one-third of the total FDI flows into India between 2000 and 2016. It has also remained a favoured route for foreign portfolio investors. But the problem is DTAAs led to round tripping: India money goes out to come back through the DTAA countries to avoid paying taxes. Even foreign companies which are not DTAA companies route their investments through the DTAA jurisdictions only for tax avoidance purposes. They are called "mailbox companies." This leads to loss of tax revenue for the country.

2016 India-Mauritius Protocol

New Delhi

In 2016, India and Mauritius signed a Protocol to amend the 1982 India-Mauritius Double Taxation Avoidance Agreement (DTAA) It will have an impact on the India-Singapore DTAA as the capital gains tax exemption provided therein is linked to the benefits available under the 1982 IndiaMauritius DTAA. The 2016 protocol says that India has the right to tax the capital gains in India for investments coming from Mauritius from 2017. Investments made before 1 April 2017 have been grandfathered (continue to enjoy the benefits) and will not be subject to capital gains taxation in India. Where such capital gains arise during the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50% of the domestic tax rate of India. However, the benefit of 50% reduction in tax rate during the transition period shall be subject to the Limitation of Benefits Article. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.

Limitation of benefits

DTAAs may contain an article intended to prevent "treaty shopping," which is the inappropriate use of tax treaties by residents of third states. These limitation on benefits articles deny the benefits of the tax treaty to residents that do not meet certain tests.

They are aimed against any attempts of round-tripping and money laundering activities.The LOB clause limits treaty benefits to those who meet certain conditions including those related to

business, residency and investment commitments of the entity seeking benefit of a Double Taxation Avoidance Agreement (DTAA).

India-Mauritius Limitation of Benefits (LOB): The benefit of 50% reduction in tax rate during the transition period from 1st April, 2017 to 31st March, 2019 shall be subject to LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test. A resident is deemed to be a shell / conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 in the immediately preceding 12 months.

This LOB clause will have the effect of bringing substance to companies which want to be tax resident in Mauritius.

POEM

To determine the residential status of foreign companies, the Finance Act 2015 introduced the concept of place of effective management or POEM. If a company's place of effective management is India, it will be treated as an Indian resident and its global income will be taxable in India. The aim of POEM is not to attack Indian multi-nationals which are doing business outside India. But it is to target shell companies set up for retaining income outside India although effective control and management of affairs is located in India.

General Anti Avoidance Rules (GAAR)

General anti-avoidance rule (GAAR) is an anti-tax avoidance Rule of India. It came into operation from 1 April 2017- assessment year 2018-19. It allows tax officials to deny tax benefits, if a deal is found without any commercial purpose other than tax avoidance. Thus, it seeks to prevent tax evasion in the guise of tax planning. There are firms and individuals who either minimize tax payment or completely avoid it by taking advantage of the rules in the book. But government says that it is not acceptable as the entire event is planned only to avoid taxes as was done by the Vodafone when it signed the deal outside the country with Hutch and put up a corporate veil for the operation just to avoid paying taxes. Even while on the face of it, it is legal, GOI applied the doctrine of "look through" and not "look at" and ordered them to pay tax as tax avoidance in this case is tax evasion. There were no clear rules for the GOI order and there was a demand that there be clear GAAR rules. As a result GOI made the rules framed by the Department of Revenue under the Ministry of Finance. It applies to transactions made specifically to avoid taxes as detailed above. Investments made up to March 31, 2017 shall not be subjected to GAAR. It is to be applied on those claiming tax benefit of over Rs 3 crore.

GAAR was first proposed in 2010, targeting transactions made specifically to avoid taxes by companies such as Vodafone and Hutchison Essar. It applies to a company in case of abuse of treaty for gaining undue tax benefit.The rules are aimed at improving transparency in tax matters and help curb tax evasion.

The proposal to apply GAAR will be vetted first by the Principal Commissioner/Commissioner of I-T and at the second stage by an Approving Panel headed by a judge of High Court.

Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner.

Tax Information Exchange Agreements (TIEA)

The purpose of Tax Information Exchange Agreements (TIEA) is to promote international co-operation in tax matters through exchange of information.

They provide for the exchange of information relating to a specific criminal or civil tax matter under investigation.In simple terms, the tax departments of one State may assist that of the other State, with information which may be utilized in collecting the due share of taxes of the latter State, as per its laws and procedure, India has TIEAs with many countries.

The objective of agreement is to promote international cooperation in tax matters through exchange of information. The nature of information varies from agreement to agreement. In 2016, after the Panama Papers' expose, Panama had said that it was ready to share information with India on tax evaders named in the Panama Papers, but this was possible only after the two countries signed a TIEA.The Indian government is now strongly pursuing a tax information exchange agreement (TIEA) with Panama, official sources said.

According to the Panama Papers' expose in April 2016, at least 500 Indians are reportedly said to have held offshore accounts/equity interest in offshore entities in tax havens.

In 2016, Panama signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC), which is now seen as "gold standard" for co-operation in tax administration. However, under the MAC, Panama is not taking up information exchange obligations automatically, but on request. The commitment to automatic exchange remains only with those countries with which Panama decides to do so bilaterally, Panama Government had said in 2016.

The MAC is the most comprehensive multilateral instrument available for all forms of tax co-operation to tackle tax evasion and avoidance, and guarantees extensive safeguards for the protection of taxpayers' rights. Already 98 other countries, including India, and jurisdictions have joined the Convention.

Panama has been the one of the most popular domicile for the anonymous shell companies controlled by the powerful.

Service Tax

Service tax was first imposed in 1994. In the Seventh Schedule to the Constitution, under Article 246, the item relating to "taxes on services" was not specifically mentioned in any entry either in the Union List or in the State List. However, Entry 97 of the Union List empowers Parliament to make laws in respect of any other matter not enumerated in List II (State List) or List III (Concurrent List), including any tax not mentioned in either of those lists. Since "taxes on services" is not there in any of the lists, service tax was levied by the Central Government in exercise of the powers under Entry 97 of the Union List.

The 88th amendment to the Constitution (2004) inserted in the Union List (List I) entry No. 92C — 'taxes on services'. The amendment was never notified and so it never came into effect. 101st Constitution Amendment Act 2016 that introduced GST deleted Art.92C as services are a part of GST for which there is an entirely new regime put in place from 2017.

Goods and Services Tax (GST)

Goods and Services Tax is a comprehensive, multi-stage, destination-based tax that will be levied on every value addition. It absorbs many indirect taxes and duties into a single consolidated tax. It is levied on the supply of goods and services. It provides set off for tax paid on inputs which removes cascading (tax on tax) effect as there is deduction or credit mechanism for taxes paid for the inputs. The tax is levied on the value added and on consumption only. Total burden of the tax is exclusively borne by the domestic consumer. Exports are not subject to GST.

The term multi stage requires elaboration. Each final commodity is the result of value addition from raw material stage to the final sale to the consumer which goes through many stages which also involve not only physical value addition but also by way of storage, distribution and sale. At every stage tax is paid and under GST that is returned (credited) when it is shown that value is further added and the good resold.

Destination based means that goods are taxed where they are sold to the consumer and not where they are made. That is, if goods are made in Gujarat and sold in Telangana, they are taxed in Telangana where the consumer pays it. The manufacturing state gains by its prosperity which creates creates a big market for its own goods and services within its geography. Its apprehensions about losses are take care of by the central government commitment to compensate and also by a portion of the IGST that the centre levies and shares with it.
Both Centre and States will simultaneously levy GST across the value chain. Centre would levy and collect Central Goods and Services Tax (CGST), and States would levy and collect the State Goods and Services Tax (SGST) on all transactions within a State.

The Centre would levy and collect the Integrated Goods and Services Tax (IGST) on all inter-State supply of goods and services. There will be seamless flow of input tax credit from one State to another. Proceeds of IGST will be apportioned among the States.

With the 101 CAA 2016 being in place, the centre passed laws to levy CGST and IGST. Similarly, all states will have to pass a simple law on SGST. These laws will specify the rates of the GST to be levied, the goods and services that will be included, the threshold of the turnover of businesses to be included, etc.

India introduced VAT (earlier name was sales tax) at the state level in 2005. In 2002 union excise duties were renamed Central Vat (Cenvat). But when states called their sales tax Vat, centre reverted to the earlier name of excise duty to prevent confusion. The earliest form of Vat was however taken in 1986 in the form of Modvat- modified VAT that included set off for a few commodities only and was confined to excise duties only.

Need for GST

Pre-GST, India had a plethora of taxes at the central and state level making it a cumbersome system. States had different rates. Lack of uniformity of rates created confusion and deterred investment. Apart from the cumbersomeness, it lacked rationality. Tax is collected by the government in general to continue to provide public and special goods. Where there is value addition, there should be tax. But when there is tax on tax, it violates rationality of taxation and also is against growth, price stability, allocative efficiency of financial resources etc. It is called cascading effect as the tax base for further taxation is irrationally higher.

Thus, GST is needed to forge a common domestic market, removing multiplicity of taxes, eliminating the cascading effect of tax on tax, making the prices of the Indian products competitive and, above all, benefiting the end consumers by attracting investment of scale.

Eliminating a multiplicity of existing indirect taxes would simplify the tax structure, broaden the tax base as there is incentive to pay taxes due to the attraction of input tax credits and thus create tax buoyancy to enable government to consolidate the fiscal system and provide for greater resources for social sector.

By lowering business costs and transaction costs, it would boost economic growth and increase exports and bring India in line with practices in many developed economies.
Reducing production costs would make exporters more competitive.

Black money and evasion will reduce as GST is transparent. Also because all taxable businesses have to register with the government and thus become formal. Alcohol, petroleum,real estate and electricity do not come under GST.

GST and Revenue Neutral Rate

An important issue in the Goods and Services Tax was the rates of central and state GSTs to be levied. Tax rates should be "revenue neutral". This implies that the rates set under the new GST regime are such that they get the same revenue as the pre-GST regime. That is, the rates are not meant to lead to revenue loss or gain. However, over time the revenue productivity is expected to increase due to better compliance; higher levels of administrative efficiency; and increased productivity of the economy due to its rationality and transparency.

Estimation of revenue-neutral rate requires consensus on the exemption list, number of tax rates to be levied and the list of goods and services to be included in different rate categories.

There are three terms in this filed: Standard rate is what applies to most goods and services. Fitment rate is the rate that applies to a class of goods and services which is the tax bracket in which they fall. Revenue neutral rate is the rate that brings the same revenue as the pre-GST regime.

GST and Fiscal Autonomy Issues

Constitutional amendments are required to enable the Centre and the states to impose tax on the same base of goods and services. Currently, the states cannot impose tax on services. They also can not impose tax on manufacturing of goods. Centre cannot levy tax sales tax.

States feel that their fiscal autonomy is being eroded for the following reasons:

- they are surrendering the power to tax sales
- they can not change rates according to their fiscal needs
- all states can not have the same rates as it violates respect for federal diversity
- centre may not compensate the states fully

The position of states is rejected on the other points for the following reasons

- centre is also surrendering and sharing its powers regarding service tax and union excise duties

- states are free to tax sin goods like liquor and also the petroleum products

It is said that like VAT, GST would also increase the revenue of the states as they will have powers to impose tax on services which are growing at a rapid pace.

Thus, there is mutual surrender of powers to a uniform national taxation system where both gain. Apprehensions of loss of fiscal autonomy by states and central dominance is misplaced. This is a quintessential case of cooperative federalism and is an example of pooled sovereignty.

Constitution (101st) Amendment Act, 2016

The Act seeks to amend the Constitution to introduce the goods and services tax (GST). Consequently, the GST subsumes various central indirect taxes including the Central excise duty, additional excise duties, service tax, additional customs duty (CVD) and special additional duty of customs (SAD), etc. It also subsumes state Value Added Tax (VAT)/sales tax, central sales tax, entertainment tax, octroi and entry tax, purchase tax and luxury tax, etc.

Central and State government powers for GST: It inserts a new Article 246A in the Constitution to give the central and state governments parallel power to make laws on the taxation of goods and services.

Integrated GST (IGST): However, only the centre may levy and collect GST on supplies in the course of inter-state trade or commerce and imports. The tax collected would be divided between the centre and the states in a manner to be provided by Parliament, by law, on the recommendations of the GST Council.

GST Council: The President must constitute a Goods and Services Tax Council within sixty days of this Act coming into force. GST council examines issues relating to goods, services tax and make recommendations to the Union and the States on parameters like rates, exemption list and threshold limits. The Council shall function under the Chairmanship of the Union Finance Minister and will have the Union Minister of State in charge of Revenue or Finance as member, along with the Minister in-charge of Finance or Taxation or any other Minister nominated by each State Government.

Composition of the GST Council

The GST Council is to consist of the following three members:

(a) the Union Finance Minister (as Chairman),
(b) the Union Minister of State in charge of Revenue or Finance, and
(c) the Minister in charge of Finance or Taxation or any other, nominated by each state government.

Functions of the GST Council

These include making recommendations on:

- taxes, cess and surcharges levied by the centre, states and local bodies which may be subsumed in the GST;
- goods and services which may be subjected to or exempted from GST;
- model GST laws, principles of levy, apportionment of IGST and principles that govern the place of supply;

- the threshold limit of turnover below which goods and services may be exempted from GST;
- rates including floor rates with bands of GST;
- special rates to raise additional resources during any natural calamity;
- special provision with respect to Arunachal Pradesh, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand; and
- Any other matters relating to the goods and services tax, as the Council may decide.

The Goods and Service Tax Council shall recommend the date on which the goods and service tax be levied on petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas and aviation turbine fuel.

Resolution of disputes: The GST Council may decide upon the modalities for the resolution of disputes arising out of its recommendations.

Compensation to states: Parliament shall, by law, provide for compensation to states for any loss of revenues, for a period which may extend to five years. This would be based on the recommendations of the GST Council. This implies that (i) Parliament must provide compensation; and (ii) compensation cannot be provided for more than five years, but allows Parliament to decide a shorter time period.

Goods And Services Tax (GST) And The Changes It Makes In The Fiscal Federal Scheme of Division Of Powers

GST shows the Centre and States working together on a sustained basis to incrementally but irreversibly transforming the domestic indirect tax landscape in a manner to make the country a common market for more investment and prosperity. Both the centre and states had to forego some of their earlier constitutional powers for the historic compromise: The Centre left its exclusive power to tax manufacture of goods (i.e. Excise) and provision of services (i.e. Service Tax), and the States gave up their exclusive power to tax sale of goods (sales tax / VAT). Both the Centre and the States agreed to share their powers to achieve uniformity.

The Constitution of India has been amended accordingly- 101 CAA 2016. In the early part of the last decade, initially Empowered Committee of State Finance Ministers and later the GST Council became useful. Under the GST regime, the Centre & States will act on the recommendations of the GST Council. The participation of all States and Centre in the framing of GST laws has led to Harmonisation of GST laws across the country.

Main Constitutional changes

1. Art.246A *(explained separately)*
2. GST Constitution Amendment Act omits Entry 92 and 92C from the Union List and Entry 52 and 55 of the State List of the Seventh Schedule.
   - 92 of Union list – Taxes on the sale or purchase of newspapers and on advertisements published therein.
   - 92C of Union List – Taxes on services
   - 52 of State List – Taxes on the entry of goods into a local area

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- 55 of State List – Taxes on advertisements other than advertisements published in the newspapers and advertisements broadcast by radio or television.

Rationale for Art.246A

The Seventh Schedule to the Constitution classifies all areas under three lists for the purpose of making laws: the Union List, which enumerates subjects under the sole purview of Parliament; the State List, which has items to be legislated by state legislatures; and the Concurrent List, which has subjects that can be legislated upon by both Parliament and state legislatures. In case of Concurrent List subjects, if there is a contradiction on any specific provision in laws made by Parliament and a state legislature, the central law will override the state law.

Currently, the power to impose some of the taxes is distributed among the three Lists: Union list of the Constitution (e.g., excise duty) while that for some others are in the State List (e.g., sale tax). Therefore, the Constitution needs to be amended to enable the enactment of a uniform law. When we consider the amendments possible, many ways may be suggested. We need to see each one of them and see why they are not acceptable. One simple method is to move the power to impose all these taxes to the Union List. The Centre can then levy the tax, and a method of redistributing the tax to states can be formulated, by the FC. This is the process used in the case of central taxes such as income tax, which are then pooled and redistributed according to the recommendation of the Finance Commission. However, this methodology has some major drawbacks. States have no say in the rate of tax that is levied under this process, and may be unwilling to give up this power. Also, there is a risk that the state in which the transactions occur and where tax is collected may not get their proportional share of the tax pool at the time of redistribution. This will reduce the incentive for states to formulate policies that lead to higher economic activity as they might not benefit from the potential increase in tax revenue. Another choice would be to move the power to impose GST to the Concurrent List.

New Delhi

However, this move would have the same drawbacks discussed above because Parliament will have the power to make laws that override any law made by state legislatures. A third approach was adopted in the 101 CAA 2017 after extensive consultation with the Empowered Committee of State Finance Ministers. The Act removes several of these taxes from the three Lists and creates a new Article (Art.246A) of the Constitution to deal with GST. Both Parliament and state legislatures will have the power to make law, but unlike the Concurrent List items, Parliament will not have the power to make a law that overrides a state law. This applies to all goods and services other than six items: petroleum crude, diesel, petrol, natural gas, aviation turbine fuel and alcohol for human consumption. In case of inter-state commerce, Parliament will make law, the central government will collect the tax, and the tax collected will be apportioned between the centre and states according to law made by Parliament.

This formulation could lead to non-uniform taxes across states defeating a key objective of a national GST. In order to address this possibility, the Bill creates a GST Council composed of the union finance minister and the minister of state in charge of revenue, and finance ministers of all states which will determine the GST rates by consensus.

How GST scores over the pre-GST regime

Multiplicity of Taxes: Presently, the Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State

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Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter-State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas. Taxes by Union Government, State Governments and the local governments have resulted in difficulties and harassment to the tax payer. He has to contact several authorities and maintain separate records for each of them.

Complex: The taxes are levied by central government as well as state government. So, a person has to maintain accounts which will comply all the applicable laws. This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry.

Cascading effects of taxes: In current indirect tax structure in India, there is cascading of taxes due to 'tax on tax'. No credit of excise duty and service tax paid at the stage of manufacture is available to the traders while paying the State level sales tax or VAT, and vice versa. Further, no credit of State taxes paid in one State can be availed in other States. Hence, the prices of goods and services get artificially inflated to the extent of this 'tax on tax'.

Multiple Compliance: A business person might have to comply with multiple compliance in terms of indirect taxes in India.

IGST

IGST is a part of Goods and Service Tax (GST)

IGST means Integrated Goods and Service Tax. IGST is charged when movement of goods and services from one state to another. For example, if goods are moved from Tamil Nadu to Telangana, IGST is levied on such goods. Under the GST regime, an Integrated GST (IGST) would be levied and collected by the Centre on inter-State supply of goods and services. Under Article 269A of the Constitution, the GST on supplies in the course of inter State trade or commerce shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council.

Dual GST

India adopted a dual GST model, meaning that taxation is administered by both the Union and State Governments. India is a federal country where both the Centre and the States have been assigned the powers to levy and collect taxes through appropriate legislation. Both the levels of Government have distinct responsibilities to perform according to the division of powers prescribed in the Constitution for which they need to raise resources. A dual GST will, therefore, be in keeping with the Constitutional requirement of fiscal federalism. It satisfies the urge for autonomy by both the Centre and States. Dual GST threw up the challenge of taxpayers interface with tax administration and thus cross-empowerment was worked out.

GST and Cross-empowerment

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The cross-empowerment model allows taxpayers to restrict their interaction to a single tax authority for central GST, state GST and integrated or IGST. Central and state GST are two components of a single GST levied on intra-state sales, while IGST will apply to inter-state sales. The division of GST taxpayers between the centre and states will be done horizontally with states getting to administer and control 90% of the asseesses below Rs 1.5 crore annual turnover, and the remaining 10% coming under the Centre. The Centre and states will share control of assessees with annual turnover of over Rs 1.5 crore in 50:50 ratio and thus each tax payer will be assessed only once and by only one authority.

Anti-profiteering clause of GST

Section 171 of the CGST Act (and the corresponding provisions of the state GST Acts) creates the obligation on businesses to pass on to the recipients any reduction in the rate of tax or the benefit of input tax credit by way of a commensurate reduction in prices. For example, in November 2017, the 23rd meeting of the GST Council reduced rates on many goods and services. If the firms do not pass it on, they are liable for penal action.

These rules prevent entities from making excessive profits by not passing such reliefs. Since the GST, along with the input tax credit, is eventually expected to bring down prices, a National Anti-profiteering Authority (NAA) is to be set up to ensure that the benefits that accrue to entities due to reduction in costs is passed on to the consumers. Also, entities that hike rates inordinately, citing GST as the reason, will be checked by this body.

NAA will investigate the complaints, the procedure to be followed in investigations and the powers given to the authority.

Once the registered entity, which has profiteered illegally, is identified, it can be asked to — one, reduce prices if it has hiked prices too much and, two, if price reduction due to GST rate relief has not been passed on to customers, to return to the customer the sum equivalent to the price reduction along with 18 per cent interest from the date the higher sum was collected. The authority can impose penalty on the profiteer or cancel its registration.

The rules however do not lay down the formula based on which the extent of profiteering can be determined. This task has been left to the NAA.

Many countries that have adopted GST such as Singapore and Australia witnessed a spurt in inflation after implementation. This clause is relevant thus.

GSTN

Goods and Services Tax Network, (GSTN) is a Section 8 (under new companies Act, not for profit companies are governed under section 8), non-Government, private limited company. It was incorporated in 2013. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions. The Company has been set up primarily to provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of the Goods and Services Tax (GST). The Authorised Capital of the company is Rs. Ten crore.

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Besides, GST being a destination based tax, the inter- state trade of goods and services (IGST) would need a robust settlement mechanism amongst the States and the Centre. This is possible only when there is a strong IT Infrastructure and Service backbone which enables capture, processing and exchange of information amongst the stakeholders (including taxpayers, States and Central Governments, Accounting Offices, Banks and RBI).

GST And Petro-Products

Petroleum products are not included in the GST. That is taxes paid on them are not returned eventually. They are not eligible for set off. States have refused the central government's appeal to bring petroleum products under the ambit of Goods and Services Tax (GST).

Taxes constitute more than 50% of the price consumers pay for petrol and diesel. States, which charge VAT are reluctant to move away from the present tax regime unless the Centre promises special annual grants. Different states have different rates of VAT.It's the GST Council, the highest decision-making body of the indirect tax regime, that has the final word on the inclusion of petroleum productsFor the states, moving to the GST for petroleum products could amount to a "loss" in revenue. While the Centre collects Rs.21.48 as excise duty, states charge value added tax (or VAT, which varies from state to state, ranging between 25% and 48%) along with 25p as pollution cess with a surcharge. In 2016-17, the combined revenue collected from the petroleum sector was Rs.463,089 crore, according to figures available with the ministry of petroleum and natural gas. Of this, states' share was Rs.189,587 crore.

Under GST, even if petrol and diesel are charged at the highest slab of 28%, states, which get a substantial chunk of their revenue from the sector, will stand to lose considering they will only get 14% of it — much lower than the present rate of VAT. States say that taking the autonomy of taxing petroleum products away from the states will hurt their exchequer. States have freedom to change the VAT on petrol and diesel. But under the GST this flexibility will go.

With highest VAT and the surcharge in the country, Maharashtra government earns over Rs.20,000 crore a year from taxes on petrol and diesel. Centre also does not want to integrate petroproducts into GST as that will erode its fiscal resources. The Centre has been under pressure from the opposition as well as consumers for the steady surge in fuel prices.

Jammu and Kashmir and GST

Unlike in the case of the rest of India, the power to levy state taxes in J&K are not part of the Constitution of India's 7th schedule. Instead, it is part of the J&K Constitution.

Hence, the 101st Constitution amendment, laying the GST framework, is not applicable to the Himalayan state. It applies to J and K only when their legislature passes it. The resolution passed by the state assembly recently adopting GST was to address this issue and facilitate adoption of GST.

It will be very beneficial for state of Jammu and Kashmir and the estimate is that tax revenue will increase .Importing states like J&K stand to benefit from the GST as there will be no cascading effect of taxes, resulting in fall in prices of commodities. It will also benefit as its goods will be cheaper for trade in Indian market due to the input tax credit they enjoy like others. The entire market of India can be tapped. In case of revenue loss, there is compensation for 5 years also.

GST Benefits Small Entrepreneurs And Small Traders

The pre-GST threshold prescribed in different State VAT Acts below which VAT is not applicable varies from State to State. It was Rs. 5 lakhs for a majority of bigger States and a lower threshold for others. A uniform State GST threshold across States is desirable. Under the provisions of the GST, traders with an annual turnover less than 20 lakh are exempt for the Goods and Services Tax. This raising of threshold will protect the interest of small traders. A Composition scheme for small traders and businesses has also been introduced under GST. Both these features of GST will adequately protect the interests of small traders and small scale industries.

Threshold exemption is built into a tax regime to keep small traders out of tax net. This has three-fold objectives:

a. It is difficult to administer small traders and cost of administering of such traders is very high in comparison to the tax paid by them.

b. The compliance cost and compliance effort would be saved for such small traders.

c. Small traders get relative advantage over large enterprises on account of lower tax incidence.

In its working however, the GST troubled the small businessmen for which remedies were announced in October and November 2017. Composition Scheme is an important feature of GST to protect the interests of small traders and small scale industries. Small and new taxpayers generally find it difficult to comply with so many rules. Hence, the government has introduced the concept of Composition Scheme. Now there is an option for small and new taxpayer to opt for Composition scheme and have lesser compliance burden. Also, a taxpayer opting for composition scheme has to pay tax at a nominal rate. A taxpayer whose turnover is below Rs 1 crore can opt for Composition Scheme. In case of North-Eastern states and Himachal Pradesh, the limit is now Rs 75 lakh.

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HSN Code in GST

Harmonized System of Nomenclature, or HSN, was conceived and developed by the World Customs Organization (WCO) with the vision of classifying goods from all over the World in a systematic and logical manner. It is a six digit uniform code that classifies more than 5,000 products and is accepted worldwide. These set of defined rules is used for taxation purposes in identifying the rate of tax applicable to a product in a country. It is also used to determine the quantum of product exported or imported in and out of a country. It is a crucial feature to analyze the movement of goods across the World. It is a combination of different sections, further drilled down to chapters, which are further classified into headings and sub-headings. The resultant figure is the six-digit code. HSN is widespread and is adopted in more than 200 countries, covering a 98% of goods in the World. It is by far, the best logical system of classification and identification adopted in International Trade. It has helped in reducing efforts and costs related to complex procedures of International Trade. HSN (Harmonized System of Nomenclature) is a 6-digit code for identifying the applicable rate of GST on different products as per GST rules.

Components of GST

There are 3 types of taxes under GST: CGST, SGST & IGST.

- **CGST:** Collected by the Central Government on an intra-state sale (Eg: Within Andhra Pradesh)
- **SGST:** Collected by the State Government on an intra-state sale (Eg: Within Andhra Pradesh)
- **IGST:** Collected by the Central Government for inter-state sale (Eg: Andhra Pradesh to Kerala)

Tax slabs under the GST 2017

The government has categorised items in five major slabs for different goods and services - 0%, 5%, 12%, 18% and 28%.

Goods and Services Tax (Compensation to States) Act, 2017

The Goods and Services Tax (GST) is a transformational and historic reform whose effects are exppected to be positive but it is untested and so has generated anxieties among the states that they may incur losses. That made them bargain hard for compensation from centre in case of losses. It is a destination-based tax, so is viewed as being to the advantage of the consuming states and to the detriment of the producing states like Maharashtra, Tamil Nadu, Gujarat, Haryana, and Karnataka. These latter wanted a suitable compensation formula.States demanded full compensation for five years and the Centre agreed.

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Government needs extra revenue to compensate the states, and so the GST Council decided to impose additional cesses for five years on certain goods over and above the highest tax bracket of 28%. These goods on which cess will be levied include tobacco products, coal, motor vehicles, which include all types of cars, personal aircraft, and yachts.

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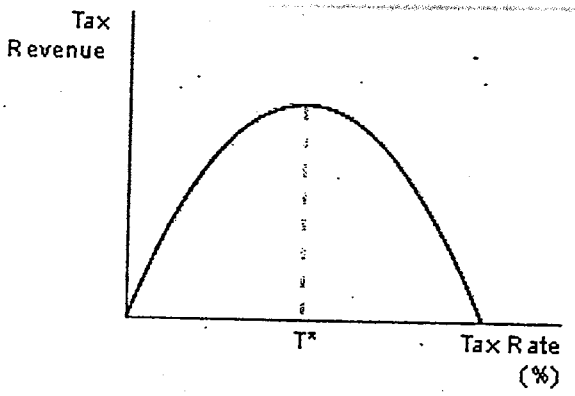
These additional cesses, however, will be removed after five years and the states incurring losses would have to find alternative sources of revenue.

The percentage of the additional cess changes from good to good.Both intra-state and inter-state supplies of goods or services would attract GST cess over and above the applicable CGST, SGST, and IGST rates.

Clean Environment Cess of GOI , India's carbon tax which was a source of funding clean energy projects and to combat climate change and which was collected -Rs. 400 a tonne on domestic and imported coal- to make up the National Clean Energy Fund, will go into the GST Compensation Fund, according to Goods & Services (Compensation to States) Act, 2017, in a schedule.

Laffer Curve

Developed by Arthur Laffer, this curve shows the relationship between tax rates and tax revenue collected by governments. The chart below shows the Laffer Curve:



The Laffer curve has been debated in the country since 1997-1998 Budget reduced rates and slabs in the income tax regime in the country.

Source and spend of rupee

Where does the rupee come from?

- **19%** of the rupee comes from corporation tax
- **16%** from Income Tax
- **9%** from Customs duty
- **14%** from Excise duty
- **10%** from Service tax and other taxes
- **10%** Non-tax revenue
- **3%** Non-debt capital receipts
- **19%** from borrowing and other liabilities

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How is the rupee spent?

- **11%** of the rupee goes to Central plan
- **18%** on Interest
- **9%** on Defence
- **10%** on Subsidies
- **5%** on other Non-Plan Expenditure
- **24%** on States' shares
- **13%** on Non Plan Grants
- **10%** Plan assistance to state and Union territories

Minimum Alternative Tax (MAT)

Normally, a company is liable to pay tax on the income computed in accordance with the provisions of the Income Tax Act, but the profit and loss account of the company is prepared as per provisions of the Companies Act. There were large number of companies who show book profits as per their profit and loss account (according to the Companies Act) but do not pay any tax by showing no taxable income as per provisions of the Income Tax act. Although the companies show book profits and may even declare dividends to the shareholders, they do not pay any income tax. These companies are popularly known as Zero Tax companies. In order to bring such companies under the income tax act net, MAT was introduced in 1996. They are required to pay MAT at 18.5% of the book profit.

Book profit is profit which is notional: when assets appreciate, their value in the book goes up but the same is not realized as they are not sold. It is also called unrealized gain or unrealized profit or paper gain or paper profit.

Rajaswa Gyan Sangam

The Central Board of Direct Taxes (CBDT) and the Central Board of Excise & Customs (CBEC) have been holding annual Conferences of senior officers for a number of years. In 2016, for the first time, a joint Conference of the two Boards was held under the umbrella of "Rajaswa Gyan Sangam" which was inaugurated by the Hon'ble Prime Minister. Same was held in 2017 too.

The objective of the Conference is to enable a two-way communication between the policy-makers and the senior officers in the field offices with a view to increase revenue collection and facilitate effective implementation of law and policies. Issues arising in implementation of policies and strategies to achieve targets in core functional areas are discussed. Such issues *inter alia* include HR issues, Litigation Management, Strategies for Revenue Maximisation, Tax Evasion, Taxpayer Services, GST and Reforms and Modernisation.

Tax Reforms in India

Since the beginning of the last decade as a part of the economic reforms programme, the taxation system in the country has been subjected to consistent and comprehensive reform.

The need for the tax reforms arises from the fact that

- tax resources must maximised
- international competitiveness must be imparted to the Indian economy
- transaction costs must be reduced
- the high-cost nature of Indian economy needs to be corrected so that compliance increases,equity improves and investment flows

On the direct tax front, the reforms are the following:

- Reduction and rationalization of rates
- Simplification of procedures
- Strengthening of e-administration
- Widening of the tax base
- Exemptions are gradually being withdrawn.
- Corporate tax reforms since 2015
- Wealth tax abolished in 2015 and many more as seen above

Indirect Taxes

- Reduction in the peak tariff rates- 10% is the peak customs duty today
- The number of slabs has come down drastically
- GST etc

Some Terms

Dividend Distribution tax

Companies giving dividend have to pay tax on the amount distributed as dividend.

Withholding tax

It means withholding of tax from certain payments including interest, salaries paid to employees, professional fee, payments to contractors etc at the time of making the payment. It is the same as TDS.

Capital gains tax

It is the tax on the gains made from buying and selling assets like land, shares etc.

If the gain is made in the assets held for over three year (one year for shares) , it is called long term capital gain and taxed. For shares, there is no long term capital gains tax. Short term capital gains tax is always more to encourage investment as distinct from speculation.

Presumptive Tax

Presumptive tax the estimated income method of assessment for certain categories of businesses is prevalent in several countries. Presumptive taxation involves the use of indirect means to ascertain tax liability which differs from the usual rules based on the taxpayer's accounts. It is used to indicate that there is a legal presumption that the taxpayer's income taxable to a certain extent.

The reason for the presumptive tax may be that in a number of businesses the assessees do not maintain books of accounts or the books of accounts maintained are irregular and incomplete. It was introduced in India in the early nineties for traders but was withdrawn as the success rate was low.

Wealth Tax

When income accumulates into wealth, it gets taxed after a point. Wealth tax is levied only in respect of specified non-productive assets such as residential houses, urban land, jewellery, bullion, motor cars etc. Union Budget 2015-16 abolished wealth tax and instead levied an additional surcharge of 2 per cent on individuals with taxable income of Rs 1 crore and above.

Securities Transaction Tax

Introduced in the Union Budget 2004-2005, it is a tax on the value of all the transactions of purchase of securities that take place in a recognised stock exchange of India. It is meant to make up revenue loss from the abolition of long term capital gains tax.

Commodities Transaction Tax

Commodities transaction tax (CTT) is a tax similar to Securities Transaction Tax (STT). CTT aims at discouraging excessive speculation

Fringe Benefit Tax (FBT)

Fringe benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees singly. They are taxed in the hands of the employer who may or not pass it on to the employee. Examples are transport services for workers and staff, gym, club, etc.

The rationale for levying a FBT on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. Consequent to abolition of fringe benefit tax in 2009, certain benefits taxed earlier as fringe benefits in the hands of the employer would now be taxable as perquisites in the hands of the employees.

Perquisites

Perquisites are benefits in addition to normal salary to which employee has a right by virtue of his employment. To put it simply or 'perks' as they are called colloquially, are benefits generally in cash/kind, received by an employee by virtue of his employment.

Perks are taxable as a part of salary as per the India income tax laws and includes:

- the value of rent-free accommodation
- the value of any concession in the matter of rent respecting any accommodation provided etc
- car
- club membership
- travel

Tax-incidence: It shows the entity on whom tax is imposed. It is different from the tax burden as the latter refers to the one who actually bears it- the consumer in the case of indirect taxes. For direct taxes, both fall on the same entity. Tax on petrol is paid by te consumer while the seller is officially responsible to deposit with the government.

Tax Base: The value of goods, services and incomes on which tax is imposed. When we speak of the tax base being broadened, they mean a wider range of goods, services, income, etc. has been made subject to a tax. In the case of income tax, the tax base is taxable income. Some kinds of income are excluded from the definition of taxable income, such as savings. For sales tax, the tax base is the value/volume of items that are subject to tax; essential goods, for example, are not part of the tax base.

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Tax Shelters: Any technique which allows one to legally reduce or avoid tax liabilities. It is a way in which the taxpayer can invest his income in a particular kind of investment that gives tax concessions.

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Tax planning, avoidance and tax evasion: There are provisions in the law that allows one to save and invest in a manner that leads to reduction in taxable income. If these provisions are used for reducing tax liability, it is called tax avoidance. It is lawful to take all available tax deductions. It is the same as tax planning for tax mitigation.

Tax evasion, on the other hand, is a punishable offence. Tax evasion involves failing to report income, or improperly claiming deductions that are not authorized. It creates black money.

But as mentioned earlier in the chapter, certain types of tax avoidance can be considered evasion as in the case of Vodafone.

Hidden taxes: are taxes that are concealed in the price of articles that one buys. Hidden taxes are also referred to as implicit taxes. The most well-known form of the hidden tax is the indirect tax. Examples of hidden taxes are import duties.

Consumption tax

A consumption tax is a tax on spending on goods and services. The tax base of such a tax is the money spent on consumption. Consumption taxes are indirect, such as a sales tax or a value added tax.

Proportional, progressive and regressive tax

An important feature of tax systems is whether they are proportional tax (the tax as a percentage of income is constant over all income levels), progressive tax (the tax as a percentage of income rises as income rises), or regressive tax (the tax as a percentage of income falls as income rises). Progressive taxes reduce the tax incidence on people with smaller incomes, as they shift the incidence disproportionately to those with higher incomes.

Specific duty: Weight or quantity or number is the basis for taxation.

Ad Valorem- A Latin term meaning "according to worth," referring to taxes levied on the basis of value. Taxes on real estate and personal property are ad valorem. Luxury goods are taxed higher even if they weigh the same or number the same as ordinary goods.

Compound duties are a combination of value and other factors based on which tax is imposed.
Excise Duty: Excise duty is a tax on manufacture and is levied on the manufacture of goods within the country.

Customs Duty: When goods are imported or exported, customs duty is imposed and collected by the Union Government. Peak customs duty today is 10%.

Negative income tax: Subsidy is a negative income tax. It is a taxation system where income subsidies are given to persons or families that are below the poverty line. The government sends financial aid to a person who files an income tax return reporting an income below a certain level. It is advocated by economist Milton Friedman in 1962.

Tax Buoyancy: It refers to the percentage change in tax revenue with the growth of national income. That is, growth-based increase in tax collections.

Tax Elasticity: Tax elasticity is defined as the percentage change in tax revenue in response to the change in tax rate and the extension of coverage. Buoyancy, on the other hand is the response to economic growth when the base increases but there is no change in the rate.

Tax Stability: It means no frequent changes and continuity of policy in a predictable and transparent manner. Although revenue from different taxes varies from year to year, revenue stability is desirable because it makes it easier for a government to build a credible spending and borrowing plan for the year ahead. Taxes whose revenue is relatively stable contribute to overall revenue stability. Market players also can plan better.

Receipt Budget, 2017-2018

1

ABSTRACT OF RECEIPTS

(In ₹ crores)

	2015-2016 Actuals	2016-2017 Budget Estimates	2016-2017 Revised Estimates	2017-2018 Budget Estimates
REVENUE RECEIPTS				
1. Tax Revenue				
Gross Tax Revenue				
Corporation Tax	1455648.11	1630887.81	1703242.94	1911579.46
Taxes on Income	453228.33	493923.55	493923.50	538744.73
Wealth Tax	287637.12	353173.68	353173.70	441255.27
Customs	1079.26	...	...	...
Union Excise Duties	210338.00	230000.00	217000.00	245000.00
Service Tax	288072.89	318669.50	387368.58	406900.00
Taxes on Union Territories	211414.25	231000.00	247500.00	275000.00
Less - NCCD transferred to the National Calamity Contigency Fund/National Disaster Response Fund	3878.26	4121.08	4277.16	4679.46
Less - State's share	6136.39	6450.00	6450.00	10000.00
Centre's Net Tax Revenue	506192.86	570336.59	608000.31	674565.45
	943318.76	1054101.22	1088792.63	1227014.01
2. Non-Tax Revenue				
Interest receipts	25378.32	29620.43	18149.03	19020.73
Dividend and Profits	112127.15	123780.05	153222.38	142430.49
Other Non Tax Revenue	112662.67	168181.29	161997.07	125788.20
Receipts of Union Territories	1538.27	1339.33	1401.81	1517.65
Total Non Tax Revenue	251706.41	322921.10	334770.29	288757.07
Total Revenue Receipts	1195025.17	1377022.32	1423562.92	1615771.08
3. Capital Receipts				
A. Non-debt Receipts				
1. Recoveries of loans and advances@	30834.75	10634.31	11070.86	11932.25
2. Miscellaneous Capital Receipts	42131.69	56500.00	45500.00	72500.00
Total	*72966.44*	*67134.31*	*56570.86*	*84432.25*
B. Debt Receipts*				
3. Market Loans	404049.95	425180.87	347218.54	348226.40
4. Short term borrowings	50692.71	16648.84	18629.59	2002.00
5. External Assistance (Net)	12748.34	19094.42	14873.00	15789.00
6. Securities issued against Small Savings	52464.96	22107.91	90376.57	100157.16
7. State Provident Fund (Net)	11858.33	12000.00	13000.00	14000.00
8. Switching/Buy Back of Securities	...	...	...	...
9. Other Receipts (Net)	-12201.90	25676.70	9648.40	53512.69
Total	519612.39	520708.74	494046.10	533687.25
Total Capital Receipts (A+B)	592578.83	587843.05	550616.96	618119.50
4. Draw-Down of Cash Balance	13170.07	13195.08	40227.10	12844.20
Total Receipts (1+2+3+4)	1774433.93	1951670.29	1933952.78	2121046.38
Receipts under MSS (Net)	...	20000.00	...	...
@ excludes recoveries of short-term loans and advances from States, loans to Government servants, etc.	11035.05	11861.04	50615.00	51375.01

* The receipts are net of payment

BANKING SYSTEM IN INDIA

A commercial bank is a type of financial intermediary as it mediates between the savers and borrowers. It does so by accepting deposits from the public and lending money to businesses and consumers. Its primary liabilities are deposits and primary assets are loans and bonds.

"Commercial bank" has to be distinguished from another type called "investment bank". Investment banks assist companies in raising funds in the capital markets (both equity and debt), as well as in providing strategic advisory services for mergers, acquisitions and other types of financial transactions. It is also called merchant bank.

The term commercial banks refers to both scheduled and non-scheduled commercial banks which are regulated under the Banking Regulation Act, 1949. The scheduled banks are those which are included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: Public sector, private sector domestic banks and foreign banks. Among the public sector banks, there are nationalized banks, State Bank of India and Regional Rural Banks (RRBs).

Scheduled banks are those banks which are included in the Second Schedule of the Reserve Bank Act, 1934. They satisfy two conditions under the Reserve Bank of India Act

- paid-up capital and reserves of an aggregate value of not less than Rs 5 lakh
- it must satisfy RBI that its affairs are not conducted in a manner detrimental to the depositors.

The scheduled banks enjoy certain privileges like approaching RBI for financial assistance; refinance etc and correspondingly, they have certain obligations like maintaining certain cash reserves as prescribed by the RBI etc. Non-scheduled banks are those banks which are not included in the second schedule of the RBI Act as they do not comply with the above criteria and so they do not enjoy the benefits either. There are only 3 non-scheduled commercial banks operating in the country with a total of 9 branches. **Local Area Banks** are **Non-scheduled commercial Banks** in India. Scheduled banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks.

Currently (2017), India has 21 public sector banks that include SBI and the IDBI Bank; there are private banks and foreign banks also. Public sector banks hold over 70 percent of total assets of the banking industry. Share of public sector banks in total deposits is at 76.6 per cent.

GOI nationalized the Imperial Bank Of India in 1955 and the new bank was named as the State Bank of India. The next major nationalisation of banks took place in 1969 when the government of India nationalised an additional 14 major banks. The next round of nationalisation took place in 1980. The government nationalised six banks. The objectives behind nationalisation were:

- To break the ownership and control of banks by a few business families and thus to prevent the concentration of wealth and economic power
- To make banks into a part of socio-economic planning
- To extend banks to rural and unbanked areas
- To mobilize savings from masses from all parts of the country,

- To cater to the needs of the priority sector like weaker sections and poverty alleviation, agriculture, MSMEs etc
- From class banking to mass banking

Private Sector Banks include domestic and foreign banks.

Domestic Private Sector Banks

There are about 23 such banks. The private sector banks are divided into old and new. The old private sector banks existed prior to the nationalisation in 1969 and retained their private status because they were either too small or specialist to be nationalised. The new private sector banks came up after the liberalisation in the 1991.

The Nedungadi Bank was the first private sector bank in India.

Foreign Banks

There are more than 40 such banks operating in India.

State Bank of India

Government of India took over the Imperial Bank of India in 1955 and renamed it the State Bank of India. They were the seven regional banks of former Indian princely states, all of them were renamed with the prefix 'State Bank'. These seven banks were State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Mysore (SBM), State Bank of Patiala (SBP), State Bank of Travancore (SBT),State Bank of Saurashtra (SBS) and State Bank of Indore (SBI - Indore). All these banks used the same logo as its parent bank.SBI acquired the control of seven associate banks in 1960.

The plans for making SBI a mega bank with trillion dollar business by merging associate banks started in 2008 when SBS merged with SBI. The next year, SBI-Indore merged. The process for merging of 5 associate banks (State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore) and Bharatiya Mahila Bank) started in 2016. The merger of these six subsidiaries was done in 2017. It makes SBI one of the top 50 banks in the world.

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), besides Bharatiya Mahila Bank (BMB), merged with SBI with effect from 1 April,2017.With this merger, the bank will join the league of top 50 banks globally in terms of assets.

The total customer base of the bank will reach 37 crores with a branch network of around 24,000 and nearly 59,000 ATMs across the country. The merged entity will have a deposit base of more than Rs.26 lakh crore and advances level of Rs18.50 lakh crore.

The combined entity will enhance the productivity, mitigate geographical risks, increase operational efficiency and drive synergies across multiple dimensions while ensuring increased customer satisfaction.

Post merger, the bank will rationalise its branch network by relocating some of the branches to maximise reach. This will help the bank optimise its operations and improve profitability. Integration of treasuries of the associate banks with the treasury of SBI will bring in substantial cost saving and synergy in treasury operations.

Lok Sabha passed the bill to repeal the SBI (Subsidiary Banks) Act 1959, State Bank of Hyderabad Act 1956 and to further amend the State Bank of India Act, 1955, following the merger of five associates with the parent SBI.

Development Banks

Development Banks are those financial institutions which provide long term capital for industries and agriculture: Industrial Finance Corporation of India (IFCI); Industrial Development Bank of India (IDBI) ; Industrial Credit and Investment Corporation of India (ICICI) that was merged with the ICICI Bank in 2000; Industrial Investment Bank of India (IIBI); Small Industries Development Bank of India (SIDBI); National Bank for Agriculture and Rural Development (NABARD); Export Import Bank of India; National Housing Bank(NHB).

The commercial banking network essentially catered to the needs of general banking and for meeting the short-term working capital requirements of industry and agriculture. Specialised development financial institutions (DFIs) such as the IDBI, NABARD, NHB and SIDBI, etc., with majority ownership of the Reserve Bank were set up to meet the long-term financing requirements of industry and agriculture. To facilitate the growth of these institutions, a mechanism to provide concessional finance to these institutions was also put in place by the Reserve Bank.

The first development bank in India- IFCI- was incorporated immediately after Independence in 1948 under the Industrial Finance Corporation Act as a statutory corporation to pioneer institutional credit to medium and large-scale. Then after in regular intervals the government started new and different development financial institutions to attain the different objectives and helpful to five-year plans.

Government utilized these institutions for the achievements in planning and development of the nation as a whole. The all India financial institutions can be classified under four heads according to their economic importance that are:

- All-India Development Banks
- Specialized Financial Institutions(SIDBI)
- Investment Institutions (The Industrial Reconstruction Corporation of India Ltd., set up in 1971 for rehabilitation of sick industrial companies)
- State-level institutions(SFC)

S.H. Khan committee appointed by RBI(1997) recommended to transform the DFI (development finance institution) into universal banks that can provide a menu of financial services and leverage on their assets and talent.

Cooperative Banks

Co-operative Banks are organised and managed on the principle of co-operation, self-help, and mutual help. They function with the rule of "one member, one vote" and on "no profit, no loss" basis. Co-operative banks, as a principle, do not pursue the goal of profit maximisation.

Co-operative bank performs all the main banking functions of deposit mobilisation, supply of credit and provision of remittance facilities.

Co-operative Banks provide limited banking products and are functionally specialists in agriculture related products. However, co-operative banks are now provide housing loans also.

Urban Co-operative Banks (UCBs) are located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. Earlier, they essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. Urban CBs provide working capital, loans and term loan as well.

Co-operative banks are the first government sponsored, government-supported, and government-subsidised financial agency in India. They get financial and other help from the Reserve Bank of India, NABARD, central government and state governments. RBI provides financial resources in the form of contribution to the initial capital (through state government), working capital, refinance.

Co-operative Banks belong to the money market as well as to the capital market- they offer short term and long term loans.

Primary agricultural credit societies provide short term and medium term loans. State Cooperative Banks (SCBs) and CCBs (Central Cooperative Banks at the district level) provide both short term and term loans. Land Development Banks (LDBs) provide long-term loans.

Long term cooperative credit structure comprises of state cooperative agriculture and rural development bank (SCARDB) at the state level and primary PCARDBs or branches of SCARDB at the decentralised district or block level providing typically medium and long term loans for making investments in agriculture, rural industries, and lately housing. The sources of their funds (resources) are ownership funds

- deposits or debenture issues.
- central and state government
- Reserve Bank of India
- NABARD
- other co-operative institutions

Some co-operative bank are scheduled banks, while others are non-scheduled banks. For instance, SCBs and some UCBs are scheduled banks (included in the Second Schedule of the Reserve Bank of India Act).

Co-operative Banks are subject to CRR and SLR requirements as other banks. However, their requirements are less than commercial banks.

Although the main aim of the co-operative bank is to provide cheaper credit to their members and not to maximize profits, they may access the money market to improve their income so as to remain viable.

Commercial Banks And Their Weaknesses By 1991

The major factors that contributed to deteriorating bank performance upto the end of eighties were

- lack of profitability
- high SLR and CRR
- no credit discipline as there were loan melas
- lack of competition
- directed and concessional lending for populist reasons
- administered interest rates and

The reforms to set the above problems right were

- Floor and cap on CRR were removed and floor on SLR was removed in 2006
- interest rates were deregulated to make banks respond dynamically to the market conditions. Even savings bank deposit rates were deregulated in 2011
- near level playing field for public, private and foreign banks in entry
- adoption of prudential norms- Reserve Bank of India issued guidelines for income recognition, asset classification and provisioning to make banks safer
- Basel norms adopted for safe banking
- VRS for better work culture and productivity
- FDI upto 74% is permitted in private banks
- Differentiated banking so as to cater to the unbanked and also leverage technology to reach the unreached- for the last mile access to the remotely located
- Bank consolidation
- Indradhanush comprising banking sector reforms for professionalization and strength

One of the sectors that has been subjected to reforms as a part of the new economic policy since 1991 consistently is the banking sector. The objectives of banking sector reforms have been:

- to make them competitive and profitable
- to strengthen the sector to face global challenges
- sound and safe banking
- to help them technologically modernize for customer benefit
- make available global expertise and capital by relaxing FDI norms
- inclusive banking

Narasimham Committee

Banking sector reforms in India were conducted on the basis of Narasimham Committee reports I and II (1991 and 1998 respectively), primarily the first report. The recommendations of Narasimham committee 1991 are:

- No more nationalization
- create a level playing field between the public sector, private sector and foreign sector banks
- select few banks like SBI for global operations
- reduce Statutory Liquidity Ratio(SLR) as that will leave more resources with banks for lending to businesses
- reduce Cash Reserve Ratio(CRR) to increase lendable resources of banks

- rationalize and better target priority sector lending as a sizeable portion of it is wasted and also much of it turning into non-performing asset
- introduce prudential norms for better risk management and transparency in operations
- deregulate interest rates
- Set up Asset Reconstruction Company (ARC) that can take over some of the bad debts of the banks and financial institutions and restructure them on profitable lines

Most of these reforms are implemented. SLR is 19.5% (2017) and CRR is 4%. Bank rate is aligned with MSF.Divestment in public sector banks led to their listing on the stock exchanges and their performance has improved.

Bank Loans: Good and Bad

All loans given by banks are classified as either standard or substandard loans.

Standard Assets

Standard assets are performing assets which are being serviced- repayment of principal at the interest rate that is agrred upon- as per the contract. Banks have to make a small amount of provisioning for these good loans also for security. For instance, provision for direct advance to agriculture or small and micro enterprise is 0.25% and for housing loan at teaser (low at the time of giving but sies soon) rates, it is 2%.

SRIRAM'S IAS

Substandard Assets or NPAs

When the borrower pays neither the interest nor the principal for a specified period of time, the loan is said to be non-performing. When a loan is classified as NPA it goes through several phrases as the repayment gets delayed. If the borrower does not pay dues for 90 days, the loan becomes an NPA and it is termed as "Special Mention Account". If this loan remains SMA for a period less than or equal to 12 months; it is termed as Sub-standard Asset.

A sub-standard Asset requires a provision of 15 per cent on secured portion and 25 per cent on the unsecured exposure. After 12 months as Sub-Standard Asset, it gets classified as Doubtful Asset 1(DA1) and requires a provision of 25 per cent on secured portion and 100 per cent on the unsecured portion.

Once the account crosses one year as DA1, it becomes Doubtful Asset 2 (DA2-1to 3 years) and requires a provision of 40 per cent on the Secured portion and 100 per cent on the unsecured portion.

Once it crosses three years, it becomes Doubtful Asset3 (DA3) and requires 100 per cent provision irrespective of the availability of security. It is a loss making asset, in other words. Unsecured loans such as clean loans, educational loans attract 100 per cent provision even at DA1 stage.

Accounts classified as fraud need not go through all these stages and will require 100 per cent provision as soon as it is classified as NPA. Such provisions have to be made out of the profits of the year thus, eroding the bottom line.

Stressed Assets

When an asset shows wekness and is likely to become an NPA, it is considered a stressed asset. RBI allows it to be prevented from becoming an NPA by restructuring: making terms of loan softer by rescheduling the repayment period, lower interest rate, pumping additional assistance etc. They are classified as standard assets. RBI mandated the banks to make additional disclosures regarding restructured loans, which includes the number of proposals received, and the amount involved etc.

AQR

In addition to the annual inspection of bank books of banks done by the Reserve Bank of India (RBI) a special inspection was conducted in 2015-16 called Asset Quality Review (AQR). It involves a small sample of loans being inspected to check if asset classification was in line with the loan repayment and if banks have made provisions adequately.Most of the large borrower accounts were inspected to check if classification was in line with prudential norms. The RBI believed that asset classification has to be done effectively and that banks should not resort to ever-greening of accounts, that is, lend to the loanees who are in in the NPA category to show them to be standard. Banks were postponing bad-loan classification Investors were also facing uncertainties as guidance by banks on bad loans was not proper. The impact of the AQR: banks have classified AQR-identified accounts (which were termed as stressed assets) as NPAs which resulted in an increase in provisioning to 15 per cent or more.

PAC

Prompt Corrective Action norms allow the regulator (RBI) to place certain restrictions such as halting branch expansion and stopping dividend payment on banks. It can even cap a bank's lending limit to one entity or sector. Other corrective action that can be imposed on banks include special audit, restructuring operations and activation of recovery plan. Banks' promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA. RBI revised the norms of PCA framework which came into effect in 2017.

The PCA is invoked when certain risk thresholds are breached. There are three risk thresholds which are based on certain levels of asset quality, profitability, capital and levels of NPA.

Stress Tests

Banks are exposed to a variety of risks- market, credit, liquidity etc- which need to be tested for their adequacy continuously. Its need was amply demonstrated when the great recession took place in 2008. A stress test is an analysis or simulation to determine the ability of a bank to deal with an economic or financial crisis. RBI undertakes such stress tests in India. Following tests are usual:

- If stock markets plunge by "x" %
- If rupee swings severely
- If inflation gallops
- If growth crashes
- If global commodity prices swing severely

Extent of The Problem

Total bad loans of India's 38 listed (on the stock exchange) commercial banks are about Rs 8 lakh crore by mid-2017 which accounts for nearly 11 percent of the total loans given by all the banks.Over 90 percent of these are of PSBs .The actual figure is around Rs 20 lakh crore if we include all troubled loans including reported bad loans, restructured assets, written off loans and bad loans that are not yet recognized.

NPAs can occur for a variety of reasons:

- Bad lending practices
- Slowdown in economy
- Discoms could not repay due to bad tariff policy .
- Steel companies are running losses due to competition from imports
- Infrastructure companies could not get clearances due to environmental reasons, natural calamities, business cycle
- willful defaulters due to crony capitalism

High levels of NPAs means

- banks' profitability diminishes
- precious capital is locked up
- cost of borrowing will rise as lendable assets shrink
- stock prices of banks will go down and investors will lose
- investment in economy suffers
- if banks have to close down, employees and despositors lose

What Is Being Done

- provisioning
- Capital adrquacy norms according to Basel 3
- securitization law
- ARCs
- foreclosure
- one time settlement
- interest waiver
- writeoffs/writdowns
- debt recovery tribunals
- CDR
- SDR
- S4A
- IBC
- Banking Regulation Act 2017
- Recapitalization bonds

Foreclosure means taking over by the lender of the mortgaged property if the borrower does not conform to the terms of mortgage.

Securitization is the process of pooling a group of assets, such as loans or mortgages, and selling securities backed by these assets.

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SARFAESI Act

To expedite recovery of loans and bring down the non-performing asset level of the Indian banking and financial sector, the government in 2002 made a new law that promises to make it much easier to recover bad loans from willful defaulters. Called the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI), the law has given unprecedented powers to banks, financial institutions and asset reconstruction/securitization companies to take over management control of a loan defaulter or even capture its assets. It was further amended in 2016 to speed up the process further.

Asset Reconstruction Company

Asset Reconstruction Companies (ARCs) have been created to bring about a system for recovering Non Performing Assets (NPAs) from the books of secured lenders and unlocking the value of Non-Performing Assets (NPA). Reserve Bank of India (RBI) provides license for ARCs and regulates them. ARCs are empowered by the SARFAESI Act. Securitisation Act (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002). It allowed selling of the assets held by banks as collalateral in case of NPAs building up. Prior to promulgation of the Securitisation Act, 2002, banks and financial institutions had no option but to enforce their security interests through the court process, which was extremely time consuming.After the enactment of the act many asset reconstruction companies (ARCs) were formed.

ARCs being the specialized agencies have NPA resolution as the core activity.

Narasimhan Committee on Banking Sector recommend them in the 1990' by way of creation of an "Asset Recovery Fund" to take the NPAs off the lender's books at a discount.SRFAESI Act, 2002 was made. ARC functions within the guidelines issued by RBI.

ARC has been set up to provide a focused approach to Non-Performing Loans resolution issue by:-

- isolating Non Performing Loans (NPLs) from the Financial System (FS),
- freeing the financial system to focus on their core activities and
- Facilitating development of market for distressed assets.

As per RBI, ARC performs the following functions:-

- Acquisition of financial assets
- Change or takeover of Management / Sale or Lease of Business of the Borrower
- Rescheduling of Debts
- Enforcement of Security Interest
- Settlement of dues payable by the borrower

Insolvency and Bankruptcy Code (IBC) 2016 provides opportunity for asset reconstruction companies. Non-performing assets (NPAs) were essentially productive assets which, if turned around, would not only create additional jobs but also contribute to national output.

For this to happen, timely interventions, transparent price discovery and right management were required. GOI made arious legislative and regulatory changes that have created an enabling and supportive operational environment for ARCs and for takeover of stressed assets. These include

higher ceiling of 100 per cent for FDI in ARCs, pass through status to ARC trusts for income tax, exemption from stamp duty, enabling trading of security receipts etc.

Resultant collaboration between banks, ARCs and resolution professionals could pave the way to a virtuous cycle of fresh investments, new jobs and additional demand. As a result, a number of new ARCs have sought and obtained registration during recent months. The increasing number of players in the market iss indicative of an increasing interest in the sector but also presented an opportunity for banks to offload stressed assets before fully provisioning for them.

Banking Regulation (Amendment) Act 2017

It amends the Banking Regulation Act, 1949 to allow the Reserve Bank of India (RBI) to issue directions to banks for initiating recovery proceedings against loan defaulters. These proceedings will be under the recently enacted Insolvency and Bankruptcy Code, 2016 (IBC). RBI has acted on these powers and directed banks to initiate recovery proceedings against 12 defaulters who are estimated to account for 25% of India's non-performing assets (NPAs). The RBI has also identified another 488 defaulters for which banks have been directed to finalise a resolution plan within six months.

TBS Challenge

The Economic Survey devotes considerable attention to what it terms India's Twin Balance Sheet (TBS) problem - companies overborrowed and became distressed as their investments did not yield and so could not repay to the banks who thus become mired in NPAs. Thus, the balance sheets of both the borrowing companies and lending banks are under pressure. The issue is important because it is holding up private investment in the country and therefore, growth in all sectors. Many measures are introduced by the government- from Sarfaesi Act, to Asset Reconstruction Companies, to Strategic Debt Restructuring (SDR) and the Sustainable Structuring of Stressed Assets. The steps taken so far as mentioned above did not pay off due to inherent difficulties. The Insolvency and Bankruptcy Code, 2016 (IBC).Is being put to use by the RBI in 2017 with promise of results. Recapitalisation bonds in 2017 October. The suggestion of the Economic Survey that a Public Sector Asset Reconstruction Company (PARA) be formed to buy the biggest, most complex NPAs and then dispose of them.

PARA

Economic Survey 2017 proposed that Public Sector Asset Rehabilitation Agency o(PARA) be set up to solve the NPA problem of PSBs. PARA is expected to be the special purpose vehicle that will raise money by issuing government bonds with which it will buy the big bad loans of the PSBs. The proposal has advantages of relieving the banks of NPAs; settling the issue faster than when each bank has to settle independently; get better bargain as there is only ne buyer etc. It is the 'bad bank' that the country has been debating for some years.

S4A

RBI took many steps in relation to NPAs. The S4A is one. The scheme seeks to solve the TBS challenge- rwin balance sheet, by converting a portion of large loan accounts into equity shares.For a distressed company to be eligible for S4A, the RBI has put down three conditions. The project must be operating and already generating cash. The total loans to the entity should be ₹500 crore

or more.The lending banks are required to engage an independent agency to evaluate how much of the debt is 'sustainable'. For the loan to be eligible for S4A, at least 50 per cent of it should be 'sustainable'.

Strategic Debt Restructuring

The RBI in its "Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)", in 2015 suggested change of management as a part of restructuring of stressed assets. RBI suggests that Joint Lenders' Forum (JLF) should actively consider such change in ownership and take necessary action.

Prudential Norms

For the safety of banking operations, they need to follow prudential norms.Prudential norms relate to

- income recognition
- asset classification
- provisioning for NPAs
- capital adequacy norms(capital to risk-weighted asset ratio, CRAR).

A proper definition of income is essential in order to ensure that banks take into account income that is actually realized (received). It helps in classifying an asset as NPA in certain cases. Once classified as NPA, funds must be set apart to balance the bank's operations so as to maintain safety of operations in case of non-recovery of NPAs. Thus, income recognition, asset classification and provisioning norms are inter-related.

Prudential norms make the operations transparent, accountable and safe.

Prudential norms serve two primary purposes: bring out the true position of a bank's loan portfolio and help in prevention of its deterioration.

Safety of Banks And Basel Norms

Banks lend to different types of borrowers and each carries its own risk. They lend the deposits of public as well as money raised from the market- equity and debt. The intermediation activity exposes the bank to a variety of risks. Cases of big banks collapsing due to their inability to withstand are many. Therefore, banks are recommended to to keep aside a certain percentage of capital as security against the risk of non-recovery. Basel committee provided the norms called Basel norms to tackle the risk.

Basel Norms

The Basel Accords is a set of recommendations for regulations for the banks. The **Basel Accords** —Basel I, Basel II and Basel III— are issued by the Basel Committee on Banking Supervision (BCBS). They are called the Basel Accords as the BCBS maintains its secretariat at the Bank for International Settlements in Basel, Switzerland and the committee normally meets there.

The aim of the Basel Accords is to ensure that banks and other financial institutions have enough capital to meet their obligations to depositors and other stakeholders and absorb unexpected losses.

Basel III

It is a global, voluntary regulatory framework on bank capital adequacy, stress testing, etc. It was agreed upon by the members of the Basel Committee on Banking Supervision in 2010–11, and was introduced in 2013 to be adopted till 31 March 2019. It was developed in response to the deficiencies in financial regulation revealed by the financial crisis of 2007–08. The major thrust area of Basel III is improvement of quantity and quality of capital of banks, with stronger supervision, risk management and disclosure standards.

Under Basel III norms, banks need to have a total capital adequacy ratio of 11.5% against 9% now.

Three Pillars

Apart from the risks which make up Pillar 1, there are two more Pillars of Basel regulations. Pillar 2 Enlarges the role of banking supervisors.Pillar 3 Defines the standards and requirements for higher disclosure by banks on capital adequacy, asset quality and other risk management processes.

Basel norms cover a variety of risks- **credit risk, market risk and operational risk.**

Credit risk: A bank always faces the risk that some of its borrowers may not repay loan, interest or both. This risk is called credit risk, which varies from borrower to borrower depending on their credit quality. Basel II requires banks to accurately measure credit risk to hold sufficient capital to cover it.

New Delhi

Market risk: As part of the statutory requirement, in the form of SLR (statutory liquidity ratio), banks are required to invest in liquid assets such as cash, gold, government and other approved securities. For instance, Indian banks are required to invest 19.5% of their net demand and term liabilities in cash, gold, government securities and other eligible securities to comply with SLR requirements (2017). Such investments except the government securities (which carry zero risk) are risky as prices fluctuate. It is known as the market risk as the value of the investments depends on market forces.

Operational risk :Several events that are neither due to default by third party nor because of the vagaries of the market make up the operation risk like fraud, security, privacy protection, legal risks, physical (e.g. infrastructure shutdown) or environmental risks.

Capital Adequacy Norms

Banks need to have adequate capital- profits or share capital and debt capital- to absorb a variety of risks. It is set at a certain level as Capital Adequacy Ratio (CAR) which is the same as Capital to Risk (Weighted) Assets Ratio (CRAR). It is expressed as a percentage of a bank's risk weighted credit exposures.Its purpose is to protect depositors and promote stability and efficiency of financial systems around the world.RBI mandated the CAR norms for Basel 3 for Indian banks. It is fixed at 9% which is higher than the international norm of 8%.Under Basel III norms, a

countercyclical capital buffer is prescribed: keep aside capital that can be used when the cycle turns down due to slowdown or recession and the loans may turn bad.

CAR

Banks lend to different sectors. Historically, each of these sectors- agriculture, students, exporters, infrastructure etc are calculated to have certain quantified level of risk. Banks need t keep aside capital as a security in case of non-recovery. That is, all bank loans are risk-weighted assets except bogernment bonds which carry zero risk. This type of asset calculation is used in determining the capital requirement or Capital Adequacy Ratio (CAR) for a bank. Government debt is allowed a 0% "risk weighting" that is, they are subtracted from total assets for purposes of calculating the CAR.

India and CAR

As per the Reserve Bank of India direction, the Basel III capital regulation is being implemented from April 1, 2013 in India in phases, and it will be fully adopted as on March 31, 2019. India witnessed three important structural reforms demonetisation, Goods and Services Tax (GST), Real Estate Regulatory Authority (RERA) which are impacting Indian economy and the banking sector.The country's banking sector, which is the key driver of Indian economy, is currently going through challenging times due to low credit growth, deterioration in asset quality and low profitability.

Basel III norms require Indian banks to mobilise up to Rs 4,20,000 crore by 2019. PSBs can not generate profits for the reasons cited above. To raise debt or equity from the market to this extent is also very difficult as investors confidence is low. Even if the PSBs can raise equity, it will mean that the government holding in them will fall closer to 50% and the government is not ready for it. Therefore, under Indradhanush initiative, GOI is taking up recapitalization of banks. In fact the earlier commitments of 2015 under the scheme are being scaled up significantly with the issue of recapitalization and the bonds that were announced in October 2017.

BIS

The Bank for International Settlements (BIS) is an international financial institution owned by central banks which "fosters international monetary and financial cooperation and serves as a bank for central banks". The BIS carries out its work through its meetings, programmes etc. It also provides banking services, but only to central banks and other international organizations. It is based in Basel, Switzerland. The mission of the BIS is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks. Sixty member central banks or monetary authorities are there in BIS including India.

Bank Run

There are times when people are not confident about their bank's capacity to honour its financial commitments. They fear its insolvency for any number of reasons When a large number of such customers of a bank want to withdraw their deposits at the same time due to such concerns , the bank's resources get even more depleted , the likelihood of default increases, thereby prompting more people to withdraw their deposits. It is known as a bank run.

Shadow Banks

There are many financial institutions that perform functions like banks- raise deposits and equity, float bonds and so on and lend them to investors and consumers – but are not covered by the stringent regulations like banks. Some of them are floated by the banks themselves like mutual funds, investment banks, housing finance bodies etc. They are refered to as shadow banking system. Because of their lax conduct, some say the sub-prime crisis of 2008 resulted.

Universal Banking in India

A **universal bank** is one that follows a " cafeteria" approach to financial services by offering all of them itself- retail, wholesale and investment banking services under one roof.It is both a commercial bank and an investment bank as well as providing other financial services such as insurance. Thus, it is a "full-service" bank providing wealth and asset management, housing and auto finance, trading, underwriting, consultancy, financial advisory etc. All commercial banks in India are universal banks. Reserve Bank of India appointed committee — Khan Working group — in 1998 recommended universal banking as was done earlier by the Narasimham Committee in 1988. It has advantages like better use of given human, financial and institutional resources. Disadvantage is that the regulatory norms not being strict for the non-banking activities, they can derail the entire bank as it happened in the sub-prime crisis in 2008 in the USA.

Writeoff, Writedown and Haircut

Hair cut in bank parlance is when an asset value is brought down as it can not be realized in full. For example, a loan that is given may not be recovered fully or at all. The first case is one of wtite down and the latter is writeoff. Both are examples of hair cut.

Insolvency and Bankruptcy Code 2016

Insolvency and Bankruptcy Code 2016 was passed in the Budget session of Parliamment in 2016 and came into effect.

Background

Till IBC came into effect, India did not have effective legal and institutional machinery for dealing with debt defaults as per the global standards. The recovery proceedings by creditors, either through the Contract Act or through special laws such as the Recovery of Debts due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, has not had desired outcomes. Similarly, action through the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) and the winding up provisions of the Companies Act, 1956 were ineffective. Laws dealing with individual insolvency, the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, were outdated. This has hampered the confidence of the lender. The new law aims to consolidate the laws relating to insolvency into a single legislation and provide for their reorganization and resolution in a time bound manner for maximization of value of their assets. This law will thus promote entrepreneurship, availability of credit and balance the interest of all stakeholders. The Code empowers the employees, suppliers etc. also to initiate the insolvency resolution process upon non-payment of dues. In order to develop the credit market in India, in case of liquidation, financial debts owed to unsecured creditors have been kept above the Government's dues in the list of priorities. Facilitating early resolution and exit is as important as facilitating investment. When

decisions are taken in a time-bound manner, there is a greater chance that the corporate entity can be saved as a going concern, and the productive resources of the economy (labour and capital) can be put to the best use. This is in complete departure from SICA regime where there were delays leading to destruction of the value of the firm.

The 2016 Code is systemic reform to address this problemand covers borrowing by firms and also by individuals.

The Code separates commercial aspects of the insolvency proceedings from judicial aspects. While Insolvency Professionals (IPs) will deal with commercial aspects such as management of the affairs of the corporate debtor, facilitating formation of committee of creditors, organising their meetings, examination of the resolution plan, etc., judicial issues will be handled by Adjudicating Authorities (National Company Law Tribunal / Debt Recovery Tribunal). One more important institution created under the Code is the 'Information Utility' which would store financial information and data and terms of lending in electronic databases. This would eliminate delays and disputes about facts when default does take place. The Code also addresses the important issue relating to cross border insolvency by providing the enabling mechanism on the subject. The Government, at an appropriate time, will come out with a detailed framework for cross border insolvency. The Code will give a big boost to ease of doing business in India.

Highlights of the Code

Insolvency is a situation when an individual/firm is unable to meet the financial obligations due to its creditors. Bankruptcy, on the other hand, is a legally-declared status that an individual/firm cannot repay debts.

The 2016 Code seeks to speed up the process of resolution and do justice to stake holders. The Code creates various institutions to facilitate resolution of insolvency. These are as follows:

- *Insolvency Professionals*: A specialised cadre of licensed professionals is proposed to be created. These professionals will administer the resolution process, manage the assets of the debtor, and provide information for creditors to assist them in decision making.
- *Insolvency Professional Agencies*: The insolvency professionals will be registered with insolvency professional agencies. The agencies conduct examinations to certify the insolvency professionals and enforce a code of conduct for their performance.
- *Information Utilities*: Creditors will report financial information of the debt owed to them by the debtor. Such system by creating a data base tracks serial defaulters.Such information will include records of debt, liabilities and defaults.
- *Adjudicating authorities*: The proceedings of the resolution process will be adjudicated by the National Companies Law Tribunal (NCLT), for companies; and the Debt Recovery Tribunal (DRT) for individuals. The duties of the authorities will include approval to initiate the resolution process, appoint the insolvency professional, and approve the final decision of creditors. The NCLT appoints an insolvency professional or 'Resolution Professional' to administer the IRP. The Resolution Professional's primary function is to take over the management of the corporate borrower and operate its business as a going concern under the broad directions of a committee of creditors. Therefore, the thrust of the Code is to allow a shift of control from the defaulting debtor's management to its creditors, where the creditors drive the business of the debtor with the Resolution Professional acting as their agent.

- *Insolvency and Bankruptcy Board*: The Board will regulate insolvency professionals, insolvency professional agencies and information utilities set up under the Code. The Board will consist of representatives of Reserve Bank of India, and the Ministries of Finance, Corporate Affairs and Law.

The Code Proposes The Following Steps To Resolve Insolvency:

Initiation: The Code makes a significant departure from the existing resolution regimen by shifting the responsibility on the creditor to initiate the insolvency resolution process against the corporate debtor. Any corporate debtor who commits a default, a financial creditor (banks and bond-holders), an operational creditor (trade creditors) or the corporate debtor or employees or shareholders may initiate corporate insolvency resolution process.

- The insolvency professional administers the process. The professional provides financial information of the debtor from the information utilities to the creditor and manage the debtor's assets. This process lasts for 180 days and any legal action against the debtor is prohibited during this period.
- *Decision to resolve insolvency*: A committee consisting of the financial creditors who lent money to the debtor will be formed by the insolvency professional. The creditors committee will take a decision regarding the future of the outstanding debt owed to them. They may choose to revive the debt owed to them by changing the repayment schedule, or sell (liquidate) the assets of the debtor to repay the debts owed to them. If a decision is not taken in 180 days, the debtor's assets go into liquidation. For firms with smaller operations, the code stipulates a fast-track IRP which will be completed within 90 days and may be extended if 75% of financial creditors consent to revival plans.
- *Liquidation*: If the debtor goes into liquidation, an insolvency professional administers the liquidation process. Proceeds from the sale of the debtor's assets are distributed in the following order of precedence: i) insolvency resolution costs, including the remuneration to the insolvency professional, ii) secured creditors, whose loans are backed by collateral, dues to workers, other employees, iii) unsecured creditors, iv) dues to government, v) priority shareholders and vi) equity shareholders.

Workers' salaries for up to 24 months will get first priority in case of liquidation of assets of a company, ahead of secured creditors.

Significance of The Code

- Speedier insolvency resolution
- More power to creditors
- Enhance ease of doing business
- Reduce bad loans
- India is a capital starved country and therefore it is essential that capital used productively. Quick resolution of bankruptcy can ensure this.

P. J. Nayak Committee

Committee for Review of Governance of Boards of Banks in India chaired by Mr. P. J. Nayak was constituted to examine the working of banks' boards, review RBI guidelines on bank ownership and representation in the board, and investigate possible conflicts of interest in board

representation. Its recommendations related to PSBs and private banks. Main recommendations of the Committee are:

Ownership of Public Sector Banks (PSBs): All PSBs should be incorporated under the Companies Act, 2013. The government should transfer its holdings in PSBs to a Bank Investment Company (BIC). Some of the constraints faced by PSBs could be removed if the government reduces its holding below 50%.

Board appointments in PSBs: The process of board appointments in PSBs needs to be professionalised in a three-phase process. In the first phase, a Banks Board Bureau should advise on all board appointments. In the second phase BIC should take over the process. In the third phase, BIC should delegate these powers to PSBs' boards.

It suggested a fixed term of 5 years for the chairman/managing director of a bank and a term of 3 years for a whole-time director.

Bank Consolidation

The consolidation of PSBs , which have a market share of about 70% and account for over 80% of the bad loans in the Indian banking system, is aimed at building scale , strengthening their risk-taking ability, operational efficiency, deal better with their credit portfolio, including stressed assets, prevent duplication of bank branches in the same area and strengthens banks to deal with shocks.

The government wants that this, along with measures such as capital infusions in weak banks, will cause a revival.The government is looking to reduce the number of staterun banks to 10-15 through mergers and acquisitions In case of consolidation, GOI factors in balance sheet, integration of technology and people.

GOI in October 2017 set up a ministerial panel, headed by Union Finance Minister Arun Jaitley, to consider and oversee mergers among the country's 21 state-run banks.

SBI has merged operations of five of its associate banks and Bharatiya Mahila Bank with itself earlier this year, marking the first consolidation move in the sector following the bad loan crisis. The merger has reduced the number of state-controlled banks to 21 from 26.The government announced infusing capital in excess of the ₹20,000 crore promised as part of the Indradhanush plan over this fiscal year and the next.Under the Indradhanush scheme introduced in 2015, the government had agreed to infuse ₹70,000 crore in state-run lenders over four years. In October 2.11 lakh crores of rupees is committed for rrecapitalisation.

Critics disagree. The objections are that it is a tactical decision to address the NPA issues and so will be damaging in the long run. Employee rationalization is also worrying some.

The idea of bank mergers has been around since at least 1991, when former Reserve Bank of India governor M. Narasimham recommended the government merge banks into a threetiered structure, with three large banks with an international presence at the top. In 2014, the P. J. Nayak panel suggested that the government either merge or privatize stateowned banks.

Indradhanush

To revive the NPA-burdened public sector banks, government introduced in 2015 a seven-point plan called 'Indradhanush.'

The Indradhanush strategy consists of

- Appointments
- Bank of Board Bureau
- Capitalization
- De-Stressing Public Sector Banks
- Empowerment
- Framework of accountability
- Governance Reforms

Details

- **Appointments:** Executives from the private sector have been engaged to head state-owned banks.
- **Bank Board Bureau (given ahead)**
- **Capitalization:** Over the next four years, the government plans to inject Rs 70,000 crore.
- **De-stressing:** Due to lending to large projects turning bad, NPAs has resulted and the GOI will de-stress the banks' bad loans by a variety of means like CDR, SDR, S4A etc.
- **Empowerment:** it is about Government's non-interference in the management of banks. The Government intends to provide greater flexibility in hiring manpower to Banks.
- **Framework of Accountability:** The government also announced a new framework of key performance indicators for state-run lenders to boost efficiency in functioning while assuring them of independence in decision making on purely commercial considerations.
- **Governance Reforms:** The process of governance reforms is centered around "Gyan Sangam" - a conclave of PSBs and FIs organized at the beginning since 2015 as a Retreat for Banks and Financial Institutions" to take forward the Government's commitment to reforms in the banking and financial Sector

Banks Board Bureau

The Bureau is an autonomous body, responsible for: (i) making recommendations on heads of public sector banks and financial institutions, and (ii) helping banks with developing strategies and raising capital. The Bureau is headed by Mr. Vinod Rai, former Comptroller and Auditor General of India and six other members. A committee set up by the RBI to review the governance of bank boards, headed by P.J. Nayak, in 2014 had suggested the formation of the bureau as a the first stage in a phaseed process to empower the boards of public sector banks. BBB aims to 'professionalize and depoliticize" the appointment process.The objective of BBB is to help prepare he banks in the public sector to take on the competition, have the ability to manage risk across usiness cycles. The Bureau is engages with the Public Sector Banks (PSBs) to help build capacity o attract, retain and nurture both talent and technology.

Differentiated Banking

In a dynamic growth-oriented economy, the financial sector needs to keep pace with the demands of the real sector. It is crucial that the financial system is flexible and competitive to cope with multiple objectives and demands made on it by various constituents of the economy. The financial sector catering to different segments, ranging from retail to wholesale, micro-finance, nurturing specific sectors and offering specialised services and tailor-made products to niche segments, is crucial for economic growth and financial inclusion.

There has been movement towards differentiated banking in the country since Nachiket Mor Committee in 2013. Differentiated banks are distinct from universal banks as they function in a niche segment. The differentiation could be on account of capital requirement, scope of activities or area of operations. As such, they offer a limited range of services / products or function under a different regulatory dispensation. The concept is not entirely new. In fact, and in a sense, the UCBs, the PACS, the RRBs and LABs could be considered as differentiated banks as they operate in localized areas.

Reserve Bank of India (RBI) in recent years has issued licences and debated upon the need for niche banks and put new lending systems in place as it seeks to widen sources of funding in the economy.For example, in 2016 RBI gave in-principle approval to 10 small finance banks and 11 payments banks. Wholesale and Long-Term Finance (WLTF) banks are under discussion.

The Reserve Bank of India released a Discussion Paper on 'Wholesale & Long-Term Finance Banks'.As envisaged in the discussion paper, the Wholesale and Long-Term Finance (WLTF) banks will focus primarily on lending to infrastructure sector and small, medium and corporate businesses. They may have negligible retail sector exposure on asset side.

Small Finance Banks

New Delhi

Small finance banks are a part of differentiated banking in India focused on basic banking service of acceptance of deposits andlending for financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities.

The Small Finance Bank (SFB) is a private financial institution that can operate without any restriction in the area unlike Regional Rural Banks or Local Area Banks.The minimum capital for SFBs is prescribed at Rs. 100 crore. Foreign Investment is permitted as in the case of other private sector commercial banks.

SFBs are full spectrum banks in contrast to payments banks. Hence, they are subject to all prudential norms and regulations of RBI as applicable to existing commercial banks like maintenance of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

SFBs are required to extend 75 per cent of credit to the sectors eligible for classification aspriority sector lending (PSL) by the Reserve Bank. At least 50 per cent of its loan portfolio should constitute loans and advances of upto Rs. 25 lakh.

SFBs can undertake other non-risk sharing financial services activities, not requiring any commitment of own fund, such as distribution of mutual fund units, insurance products, pension

products, etc. SFBs can set up dealership in foreign exchange business SFBs cannot set up subsidiaries to undertake non-banking financial services activities.

There will not be any restriction in the area of operations of small finance banks; however, preference will be given to those applicants who in the initial phase set up the bank in a cluster of under-banked States / districts. It is mandatory that at least 25 per cent of its branches shall be in unbanked rural centers.

Equitas Small Finance Bank Ltd and Ujjivan Small Finance Bank Ltd are listed entities.Mumbai-based Suryoday Small Finance Bank Ltd, Varanasi based Utkarsh Small Finance Bank and Kerala based ESAF Small Finance Bank Ltd started operations by 2016. North East Small Finance Bank Limited commenced operations from 2017.

Following are ligible to apply

- Existing Non-Banking Finance Companies (NBFCs),
- Micro Finance Institutions (MFIs), and
- Local Area Banks (LABs) that are owned and controlled by residents can also opt for conversion into small finance banks.

The concept of small finance banks was one of the recommendations in the 2009 Report - A Hundred Small Steps - of the Committee on Financial Sector Reforms headed by Dr. Raghu Ram Rajan.

Payments Banks

Payments banks are a new type of bank conceptualised by the Reserve Bank of India (RBI). These banks can accept a restricted deposit, which is currently limited to ₹1 lakh per customer and may be increased further. These banks cannot issue loans and credit cards. Both current account and savings accounts can be operated by such banks. Payments banks can issue services like ATM cards, debit cards, net-banking and mobile-banking.

The bank should be fully networked from the beginning. The bank can accept utility bills. It cannot form subsidiaries to undertake non-banking activities. The bank cannot undertake lending activities. 25% of its branches must be in the unbanked rural area. The bank must use the term "payments bank" in its name to differentiate it from other types of bank. The banks will be licensed as payments banks under Banking Regulation Act, 1949, and will be registered as public limited company under the Companies Act, 2013.

India has 4 payments banks by 2017: The first such bank was Airtel Payments Bank Ltd, followed by India Post Payments Bank Ltd , Paytm Payments Bank Ltd and ,Fino Payments Bank Ltd.

India Post Payments Bank (IPPB)

n 2014, a task force was formed by GOI to study ways in which the existing postal network ould be used more, headed by T. S. R. Subramanian. It said that more services should be provided n the field of banking, insurance and e-commerce. In 2015, during the presentation of the Budget, t was announced that India Post will use its large network to set up a payments bank. IPPB ecame operational from 2017. It is the third entity after Airtel and Paytm payments bank, to get ne central bank's approval and the second after Airtel Payment Bank to commence operations.

India Post Payments Bank (IPPB) is set up as a public limited company under the Department of Posts with 100 per cent government equity.

India Post has about 1,54,000 post offices, of them 90% are in rural areas. There is one post office for every 7176 people in India. India Post also has 2,96,000 agents in the rural area. About 2.2 crore people, already receive their National Rural Employment Guarantee Act (NREGA) payments by post offices. After State Bank of India, India Post has the largest deposits valued at ₹6 lakh crore.T. S. R. Subramanian Committee said that it could aid in the ongoing Pradhan Mantri Jan Dhan Yojana financial inclusion plan

D. IPPB will offer demand deposits such as savings and current accounts upto a balance of Rs 1 Lac, digitally enabled payments and remittance services of all kinds between entities and individuals and also provide access to third party financial services such as insurance, mutual funds, pension, credit products, forex, and more, in partnership with insurance companies, mutual fund houses, pension providers, banks, international money transfer organisations, etc.

The four key features of IPPB are:
Financial literacy: IPPB aims to make India prosperous by ensuring that everyone has equal access to financial information and services.

Streamlining payments: Beneficiaries can access income from government's DBT programs like MNREGA wages, Social Security Pensions and scholarships, directly from their IPPB bank account. They can also pay their utility bills, fees for educational institutions and many more from the same IPPB account.

Financial inlcusion: Hundreds of millions of Indians who don't have access to banking facilities cannot avail of government benefits, loans and insurance, and even interest on savings. IPPB will reach the un-banked and the under-banked across all cross sections of society and geographies.

Easy access: With over 1.54 lac post offices across the country, postal delivery system will make IPPB an accessible banking network. IPPB also offers services through internet and mobile banking, and prepaid instruments like mobile wallets, debit cards, ATMs, PoS and MPoS terminals etc.

MUDRA Bank

Micro Units Development Refinance Agency (MUDRA) Bank is a refinance institution for micro-finance institutions. It aims to provide the funding to the non corporate small business sector. MUDRA is conceived not only as a refinance institution and but also as a regulator for the micro finance institutions (MFIs).

The MUDRA Bank is primarily be responsible for

- Laying down policy guidelines for micro/small enterprise financing business
- Registration of MFI entities
- Regulation of MFI entities
- Accreditation /rating of MFI entities
- Promoting right technology solutions for the last mile
- Formulating and running a Credit Guarantee scheme for providing guarantees to the loans which are being extended to micro enterprises

- Creating a good architecture of Last Mile Credit Delivery to micro businesses under the scheme of Pradhan Mantri Mudra Yojana.

Union Budget 2015-16 proposed to create MUDRA with a corpus of Rs. 20,000 crore made available from the shortfalls of Priority Sector Lending. There is a credit guarantee corpus of Rs.3,000 crore for guaranteeing loans being provided to the micro enterprises. MUDRA Bank will refinance Micro-Finance Institutions through a Pradhan Mantri Mudra Yojana.

MUDRA Bank operates through regional level financing institutions who in turn connect with last mile lenders such as Micro Finance Institutions (MFIs), Small Banks, Primary Credit Cooperative Societies, Self Help Groups (SHGs), NBFC (other than MFI) and such other lending institutions.

In lending, MUDRA gives priority to enterprises set up by the under-privileged sections of the society particularly those from the scheduled caste / tribe (SC/ST) groups, first generation entrepreneurs and existing small businesses. There are estimated to be some 5.77 crore small business units in India, mostly individual proprietorship, which run small manufacturing, trading or service businesses. 62% of these are owned by SC/ST/OBC.

MUDRA Bank is proposed to be set up through an enactment of law and it will take some time. To begin with, the same is being operationalised as a subsidiary of Small Industries Development Bank of India (SIDBI). The micro finance institutions (MFIs) can become Member Lending Institutions (MLIs) with MUDRA (SIDBI) Bank for refinance and with National Credit Guarantee Trustee Company (NCGTC) for credit guarantee.

PMMY

The Pradhan Mantri MUDRA Yojana (PMMY) is a scheme launched by the Union Government in 2015 for providing loans upto Rs. 10 lakh to the non-corporate, non-farm small/micro enterprises. Under PMMY, all banks viz. Public Sector banks, Private Sector Banks, Regional Rural Banks (RRBs), State Co-operative Banks, Urban Co-operative Banks, Foreign Banks and Non-Banking Finance Companies (NBFCs)/Micro Finance Institutions (MFIs) - are required to lend to non-farm sector income generating activities below Rs.10 lakh. These loans are classified as **MUDRA loans** under PMMY.

For implementing the Scheme, government has set up a new institution named, MUDRA (Micro Units Development & Refinance Agency Ltd.), for development and refinancing activities relating to micro units, in addition to acting as a regulator for the micro finance sector, in general. MUDRA provides refinance to all banks seeking refinancing of small business loans given under PMMY. Thus, MUDRA refinances all *Last Mile Financiers* - Non-Banking Finance Companies of various types engaged in financing of small business, Societies, Trusts, Section 8 Companies [formerly section 25], Co-operative Societies, Small Banks, Scheduled Commercial Banks and Regional Rural Banks - which are in the business of lending to Micro/Small business entities engaged in manufacturing, trading and services activities.

The purpose of PMMY is to provide funding to the non-corporate small business sector. Non-Corporate Small Business Segment (NCSBS) consists of millions of proprietorship/ partnership firms running as small manufacturing units, service sector units, shopkeepers, fruits/ vegetable vendors, truck operators, food-service units, repair shops, machine operators, small industries, artisans, food processors and others, in rural and urban areas. One of the biggest hurdles to the growth of entrepreneurship in the Non-Corporate Small Business Sector (NCSBS) is lack of

financial support to this sector and a vast majority belonging to this sector do not have access to formal sources of finance.

Under the aegis of PMMY, the MUDRA created its initial set of products/ schemes. The interventions have been named 'Shishu' (meaning infant), 'Kishor' (meaning child) and 'Tarun' (meaning adolescent) to signify the state of growth/development and funding needs of the beneficiary micro unit/entrepreneur and also provide a reference point for the next phase of graduation / growth to look forward to:

- *Shishu:* covering loans upto Rs. 50,000/- provided with no collateral, @1% rate of interest/month repayable over a period of 5 years
- *Kishor:* covering loans above Rs.50,000/- and upto Rs. 5 lakh
- *Tarun:* covering loans above Rs. 5 lakh to Rs. 10 lakh

To begin with, MUDRA has enrolled 21 Public Sector Banks, many private sector banks, Regional Rural banks and Micro Finance Institutions as partner institutions for channelizing assistance to the ultimate borrower.

A minimum of 60% of support would flow to enterprises in the smallest segment. Partner intermediaries of MUDRA Bank have to endeavour to adhere to the following broad framework:

- First time entrepreneurs, youth entrepreneurs (i.e. entrepreneurs aged upto 30 years) and women entrepreneurs shall be encouraged and special schemes shall be designed for such entrepreneurs.
- Emphasis shall be on cash flow based lending and not security based lending. Collateral securities, etc. shall be avoided.
- Repayment obligations shall be flexible and shall be framed keeping in view the business cash flows of the entrepreneur.

Recapitalisation

New Delhi

It has been in news since many years as PSBs are in need of capital both the meet basel3 norms by 2019 and also to withstand the impat of NPAs. Indradhanush in 2015 commits the government to recapitalization. The October 2017 bonds take the process further. Banks like other corporate entities have equity and debt making up their capital in a certain ratio. Changing the ratio is called recapitalization. It can happen by infusion of fresh capital or conversion of debt into shares or vice versa.

In general, the aims of recapitalization may be:

- Desire of current shareholders to partially exit the investment
- Providing support of falling share price
- Protection from a hostile takeover

October 2017

2.11 lakh crores of bank recapitalisation plan spread over 2 years, announced for the PSBs in October 2017 seeks to bail out the NPA-inflicted entities to stimulate the flow of credit to spur private investment. Out of the total commitment, Rs1.35 lakh crores will come from the sale of recapitalisation bonds. The remaining Rs76,000 crore will be through budgetary allocation and fundraising from the markets. Banks will buy the bonds with their deposits. It fetches them

interest. GOI on its part will buy shares of the PSBs and infuse the equity capital into them. Today, PSBs do not have adequate capital to lend the deposits that they are sitting on. Recapitalisation will help them solve this problem. Interest will be paid from budget. Banks' health will improve as they start lending. Share prices of the banks will rise. GOI will sell these shares at a higher price to redeem the bonds. Thus, it is a win-win solution.

GOI did it in the early 1990s the PSBs saw a severe erosion in their profitability and capital base due to reckless lending to the priority sector in the preceding decade.

The advantages of the bonds are that the same money need not be raised by taxing the citizen; by borrowing directly from the banking system instead of the markets, the Centre can avoid crowding out private borrowings. Coupled with Bharatmala in 2017, it can aid "crowding in"; borrowing costs are lower for the GOI than the PSBs that are weak; banks will find the investment in these bonds safe and they just need to divert the SLR excess investment; But there are downsides too: will the banks lend again as they did, without due diligence; nation's debt-to-GDP ratio will rise; fiscal deficit calculation also matters.

It needs to he stressed that unless used to start a new chapter in PSB governance driven by recommendations selectively from PJ Nayak committee and BBB, this policy may not make much of a difference.

FDI In Banks

FDI in India banks is allowed. In PSBs, 20% of FDI is allowed and in private banks it is 74%- upto 49% it is automatic and beyond that it is on approval basis. However, voting rights are capped in national interest at 10%.

Foreign Banks: Subsidiary Vs Branch

Indian Government allows foreign banks to operate by registering as a branch office or by incorporating a subsidiary. A branch office is a considered an extension of the parent company and is not considered a separate legal entity. The assets and liabilities of branch office are considered as merged with the parent office. Subsidiary has a separate legal status; there is Indian investment; assets and liabilities are separate. It has to have a separate management in India. Any losses incurred by parent can not be offset by subsidiary's assets. This arrangement protects Indian capital and operations from external economic shocks as such outfits follow local guidelines. It can raise capital from Indian share market as a separate entity.

At present, most foreign banks operate as branches or representative offices of the parent.

BALANCE OF PAYMENTS

Balance of payments is an overall statement of a country's economic transactions with the rest of the world over some period- usually one year. It includes all outflows and inflows (payments and receipts). Countries have either balance of payment surplus or a balance of payment deficit. Balance of payments can be broken down into balance of trade (export & import of goods); balance of current account (includes the balance of trade, the balance of services and remittances; and capital account (investment and borrowing). Trade account is a part of the current account. Capital account deals with investment and borrowings and the rest of the BOP is the current account of which foreign trade is a part.

India's Balance of Payments (BOP) Crisis in 1991

The 1990s witnessed some major changes on India's balance of payments front. The decade began with a crisis caused both by the immediate Gulf war and the cumulative problems of the Indian economy. It led to an IMF-sponsored bail out.

The Gulf crisis of 1990-91 and the subsequent rise in crude prices rudely exposed the inadequacy of reserves. India has been dependent on crude imports. International crude pirces are very crucial for out BOP condition. When there was geopolitical disturbance due to Iraq crisis, crude prices shot up as our import bill. Tourism dropped. It depleted our foreign exchange reserves. International rating agencies downgraded India. This fuelled the crisis further as India's credit worthiness plunged. A substantial outflow of deposits held by Non-resident Indian during 1990-91 added to the crisis. Reserves declined to a low of $0.9 billion in January 1991. India had to pledge gold in May 1991 and again in July 1991 to avoid a default on its short term obligations. Further, in October 1991, India forex through India Development Bonds and Foreign Exchange Immunity Scheme.

New Delhi

Confidence building measures were taken up after the new Rao government was formed in June 1991. The rupee was devalued and brought closer to the market value as earlier it was artificially overvalued. International investors saw in this reform progress towards market orientation. Indian exporters felt encouraged as their earnings in foreign currency would fetch them more rupees.

Devaluation is a precursor to the beginning of rupee convertibility. We need to pause and get clear about a cluster of concepts- all being interrelated.

Devaluation And Depreciation

When the exchange rate of a country's currency is fixed, the central bank may choose to lower its value by its decision. That is called devaluation. The result is a new rate that is fixed by the central bank with respect to a foreign reference currency, for example, US dollar. Depreciation also has the same effect of lowering the value of the domestic currency but market forces are behind it and not the policy decision of the central bank. Market forces operate under a floating exchange rate.

When the central bank increases the value of the currency, it is called revaluation. Same increase in value taking place as a result of market forces of demand and supply makes it appreciation. The causes and effects of these changes on value will discussed ahead in the book. *Exchange rate* is the value (price) of one currency in terms of another.

Convertibility of Rupee

Convertible currencies give freedom to the holders of the currency to convert them freely into other currencies at the prevailing market rate. For example, one who has Indian rupees with him can convert them into foreign currencies if rupee is convertible. Balance of payments lists covers a vast number of transactions from trade, remittances by foreign workers to loans and investment. All these transactions of a country with the rest of the world are classified broadly into current and capital accounts. Current account includes foreign trade in physical goods(merchandise) and invisibles which are foreign trade in services like software, knowledge process outsourcing based earnings , consulting services, shipping services, tourism, and royalty on patents; and also movements of money without exchange for goods or services called 'remittances' and may include money sent from one country to another by an individual, business, government or non-governmental organisations (NGO) – like charities. India was the topmost country for remittances in 2016 at $62.7 billion sent by its diaspora. It includes what is sent as a part of what is earned as wage, interest, profit or rent.

In the BOP when one overlooks the current account part that is detailed above, the rest is loan and investment and that is called the capital account. The same information helps us to differentiate between balance of trade and the balance of payments. 'Balance of trade' is the foreign trade part of the overall balance. Trade is a part of current account. But current account also includes remittances. Thus, BOP is trade which is a part of current account; and capital account.

The larger the scope of convertibility that is permitted by a country, the stronger and the more resilient its economy is said to be, according to its proponents. No country grants full convertibility - restricts it for certain purposes and excluding certain other purposes. For example, the trade account convertibility is confined to exports and imports and certain associated aspects like remittances (what Indians living abroad send to their friends and relatives in India), tourism, etc. Even here, restrictions are imposed after a point. Convertibility for investment and borrowing abroad comes under capital account convertibility.

Rupee Convertibility

The rupee's external value was regulated by the Reserve Bank of India till 1992. Unlike in the developed countries where, where by and large, the market forces dictate the exchange rate of the currency, the rupee was artificially valued by the RBI because the country did not have a policy that is pro-exports or pro-FDI. The policy changed irreversibly sine 1991.

As an important part of the economic reforms since 1991, rupee was made convertible since 1992 in phases. Devalution was done by the RBI in 1991 to set the stage for convertibility. The rupee was made partially convertible in 1992, under which 40 per cent of the foreign exchange earnings were to be traded at the official exchange rate and the remaining 60 per cent could be converted at market determined exchange rates. This was known as partial convertibility of rupee(PCR) and was a part of Liberalised Exchange Rate Management System (LERMS) that was introduced, from March 1992: a dual exchange rate system of 40:60 as explained above. Rupee was made fully convertible on the trade account in 1993 and it was further extended to current account in 1994. Thus, India assumed obligations under Article VIII of the International Monetary Fund, as a result of which, India is committed to adopt current account convertibility.The measures helped in international investors reposing faith in India once again.

India's response to the crisis was essentially tailored to build confidence of the international investing community in India. Foreign institutional investments (investments into financial assets like shares, bonds etc) were permitted and Indian companies were permitted to raise resources in the international capital markets in the form of GDRs. Norms for foreign direct investments were liberalised and multinational companies were wooed by Central/state governments to invest in white goods (consumer durables),infrastructure and other projects. The dramatic change in the environment led to a surge in capital flows. Foreign investments into India shot up dramatically.

Balance of Payments and Invisibles

Invisibles in international trade, is used as a synonym for "service." Invisibles trade is trade in services. Visible, in referring to international trade, is used as a synonym for "goods." "Visibles trade" is trade in goods.

Invisibles are in three parts

- Services
- Transfers and
- Income.

Services include transportation, financial services, travel, telecommunications, computer services and professional services. India's export of services increased to well over $110 billion (2012)

Transfers include remittances from Indians working abroad.

Income receipts are the income earned (as profits, interest and dividends) from the ownership of overseas assets by Indian companies, government and individuals

The net inflow on invisible account has continued to be a major support to the balance of payments. Invisible receipts have shown robust growth, increase being spurred by increased private transfer receipts (remittances by Indian living and working abroad).Tourism receipts have been on the rise. Software exports continue to show exceptional growth rates.

Remittances

India became the largest remittances receiving country at $72 billion in 2015 followed by China at $64 billion. Kerala, Gujarat, Maharashtra, and Punjab are the maximum inward-remittance generating states, according to the RBI. The largest remittances came from the UAE and USA.

In recent months, the rupee has weakened considerably vis-à-vis the dollar, and a surge in remittances is expected as non-resident Indians take advantage of cheaper goods, services and assets in India, says the WB report. Indian Diaspora which is one of the most prosperous in the world is sending money home. Controls are lifted and so there are greater inflows. The government has progressively reduced the red tape. Interest rates are high. RBI increased the amount that can be remitted home.

Convertibility has four dimensions:

- Freedom to convert
- Convert at market rate and

- Removal of restrictions on convertibility on current and capital account. That is, liberalization of flows. It means convertibility for more purposes (like FDI in retail); higher or no caps on existing convertibility regime (49% FDI in insurance etc); more of automatic than approval route; and Indians being allowed greater freedom to take their money abroad.
- Liberalization of outflows from India

The fuller the convertibility, the more the above four items are relaxed.

Current Account Convertibility: It refers to freedom to convert domestic currency into foreign currency and vice versa for the following purposes:

1. exports and imports
2. payments due as interest on loans etc
3. remittances
4. travel
5. education etc

Capital Account: It covers investment and borrowings. For example, foreign investment in India; how much Indian companies can borrow. Similarly, Indians to open bank accounts in foreign countries; invest abroad; hold assets abroad etc.

Capital Account Convertibility

Full convertibility means freedom to convert rupee into foreign currency and vice versa for both current and capital account purposes with least restrictions. That means, in the capital account, there should be 100% FDI and FII allowed across all sectors, more or less (except security related areas). Similarly, there should be very liberal regime for outflows- that is, Indians can invest abroad and borrow from abroad. There should be no controls on current account transactions either.

Full convertibility was the goal in India since the reforms began. We have a large measure of capital account convertibility for foreigners and NRIs for investing in India and taking out profits relating to FDI, portfolio investment and NRI bank deposits in India. For Indian residents and corporates, some limits still exist on how much they can invest abroad. Indian companies also need RBI permission to borrow funds from abroad for some designated purposes. The controls are being relaxed.

Why do we need fuller capital account convertibility?

Advantages

- we get foreign capital for investment
- FII flows can increase liquidity and also modernize our financial sector
- Creates competition for our domestic players
- All advantages of FDI will be available-technology, investment and trade(TIT) accrue
- There will be macro economic discipline
- Indians have a wider range of choice for investment and borrowing.

Fears are

- As the global financial crisis shows, adoption of fuller convertibility should be calibrated or it can be quite destabilizing

- Domestic interests in retail are hurt as it can create unemployment
- Rupee still not being a hard currency, can be subject to volatility with serious effects
- FDI hike in defence also needs to be discussed well before being adopted

Prerequisites for fuller convertibility

- Fiscal deficit should be minimal
- Forex reserves should be adequate
- NPAs of banks should be minimal
- Inflation and interest rates should be moderate

Unless these conditions are met, great steps towards fuller convertibility should be kept on hold.

Benefits of fuller convertibility:

First, India needs huge resources, especially to upgrade its infrastructure. Domestic savings alone are not enough. More foreign funds would come in only if they are sure of free entry and exit.

Second, Indian businesses (especially, the established companies) would be able to access cheaper foreign funds that would improve their international cost competitiveness.

Third, unhindered access to foreign funds would facilitate Indian companies taking over firms abroad and developing more Indian MNCs in the process. For example, Tatas acquiring Jaguar , the international steel major.

Fourth, Indian banks would be able to borrow foreign funds at lower rates which would, in turn, enable them to lend at a lesser rate to Indian small and medium enterprises which may not otherwise be able to borrow directly from the international capital market.

Fifthly, it exerts macro-economic discipline.

Sixthly, outflows are necessary to balance the inflows or the problem of appreciation will plague the economy.

Finally, ordinary Indian investors would be able to further diversify their asset portfolios. Fears relate to Dutch disease. Netherlands experienced Dutch disease as a result of its discovery of oil and related fuels in 1960s. The foreign exchange inflows led to the Guilder appreciating so much that the imports shot up and the competitiveness of Dutch industry was affected adversely. Exports suffered and imports increased due to appreciation. Deindustrialization is the result. The Dutch disease is something similar to what the emerging market economies have experienced due to capital inflows, particularly of the portfolio variety.

Tarapore Committee on CAC

Tarapore Committee on CAC that was set up in 1997 and gave a road map for introduction of capital account convertibility. The objective of the committee was to study economies that had implemented capital account convertibility and understand the prerequisites for it. They had to make recommendations on the measures to be taken and the time frame to achieve full capital account convertibility.

The report noted that India had adopted current account convertibility in August 1994, in accordance to Article VIII of the Articles of Agreement of the International Monetary Fund (IMF). It also noted that capital account convertibility already existed for foreign investors, both direct and portfolio, non-resident depositors and Indian corporates which take external commercial borrowings (ECB). The report said that implementing capital account convertibility would increase capital inflows and bring in all the other advantages cited above. The report said that the time was appropriate for India to take some steps towards but it should be done only when the prerequisites are met otherwise the CAC is a double edged sword. The report said that the move should be made in three phase: Phase I (1997–98), Phase II (1998–99) and Phase III (1999-2000). The transition from one phase to the next should be made, only if certain preconditions are met. The preconditions were reduction of fiscal deficit, keeping the inflation in a 3-5% range and reforming the financial sector, including reduction of non-performing assets.

But it could not be implemented as East Asian currency crisis struck in 1997.

Capital Account Convertibility Relaxations So Far

Capital account transactions continue to be regulated under the FEMA which is a highly liberalized version of the earlier FERA.

Foreign direct investment, barring a few strategic industries is put on automatic route, with most of the sectors permitted to have ever increasing foreign equity participation.

- The foreign portfolio investment by FIIs is allowed liberally.
- The external commercial borrowings (ECB) no longer require the RBI or Ministry approval up to a value.
- Inflows are liberalized far more than outflows for obvious reasons of security. The relaxation on outflows to balance the inflows have been significantly undertaken.
- Overseas investment limit (total financial commitments) for Indian companies enhanced.
- Aggregate ceiling on overseas investment by mutual funds enhanced.
- Prepayment limit of external commercial borrowings (ECBs) without prior Reserve Bank approval increased.
- an *Indian* citizen *can invest* up to *$2,50,000* per *year* in foreign markets (2016)

Tarapore II On Fuller Rupee Convertibility 2006

Tarapore Committee on Fuller Convertibility that presented its report in 2006 recommended that India should make the rupee more freely convertible over the next five years to realize the country's "maximum" economic potential. Tarapore committee said that in view of the huge investment needs of the country and that domestic savings alone will not be adequate to meet this aim, inflows of foreign capital become imperative. The shift toward fuller convertibility should be phased over three phases starting in 2006-07. A "comprehensive review" should be undertaken in 2011 to chart the future path.But, before making the rupee more freely tradeable, India must "improve regulatory and supervisory standards across the banking system" and get its financial house in order, including taming its worsening deficit, said the committee.

The report sought a ban on participatory notes as a mode of investment in Indian equities and easing the direct investment routes for foreigners. It suggested that foreign individuals investors should be brought at par with non-resident Indian investors. The committee recommended the restrictions on overseas borrowings by Indian firms and banks be eased. It said that the limit on

outbound remittances by Indian citizens should be increased. It also recommended that the fiscal deficit be brought under control otherwise a large deficit will make India's economy vulnerable to shocks. It proposed the formation of a monetary policy committee (MPC) which has since been set up and operating (2017).

(Participatory Notes (P-Notes) are instruments issued by registered foreign institutional investors (FII) to overseas investors, who wish to invest in the Indian stock markets without registering themselves with the market regulator, the Securities and Exchange Board of India-SEBI. They prefer to buy PNs for a variety of reasons and not directly invest in India.Investing through P-Notes is popular amongst foreign institutional investors. Bu India's risks can be high if PNs invest heavily as they are very volatile.)

Internationalization of Rupee

The recent decision by the International Monetary Fund to include the Chinese renminbi in the Special Drawing Rights basket ; the issuance by International Finance Corporation (IFC) of the World Bank Group of rupee-denominated offshore masala bonds; and announcements by the Reserve Bank of India (RBI) allowing Indian companies to issue masala bonds started debate about 'internationalization' the rupee.

A currency is said to be internationalized when other countries' banks and firms and citizens hold its currency for financial security. It is associated with another feature: international currency markets trade actively in such a currency. It is accepted for international trade transactions. If rupee is internationalized, we can pay for our imports in rupees. Our firms can raise dollars in international markets and repay in rupees. Further, Rupee will be an international currency if non-residents are willing and able to trade in it and invest in rupee-denominated assets. For example, a Russian importer must be able to pay for her imports from South Africa in rupees. Similarly, a UK resident must be able to invest her savings in rupee-denominated bonds or shares. In these cases, non-residents take risks in the rupee as a currency.

These are the core features of an international currency. US dollar, Euro, Yen, Pound, and recently renminbi are some of the dominant international currencies.

To be an international currency is dependent on three prerequisites. First, the issuing country must have sufficient scale: there must be so much currency available for non-residents to hold it in terms of volume of international transactions. It is linked to macroeconomic fundamentals like strength of the economy, its exports, its resilience etc. Second, the value of the currency must be stable over time. Stability has multiple aspects: macroeconomic, financial and political. Third, the currency must be liquid. A currency is liquid if significant quantities of assets can be bought and sold in the currency, without noticeably affecting its price. This requires depth in financial markets, a large stock of domestic currency-denominated bonds .Scale, stability and liquidity can be achieved through strong economic fundamentals and once these are achieved, the rupee will come to be accepted as an international currency.

Internationalization of Rupee will facilitate greater degree of integration of Indian economy with rest of the world in terms of foreign trade and international capital flows. Key benefits of internationalization of Rupee include savings on foreign exchange transactions for Indian residents- we can pay in rupee for external transactions and need not route them through dollars etc. Reduced foreign exchange exposure for Indian corporates, reduction in dependence on foreign exchange reserves for balance of payment stability etc are other benefits.

One of the important drivers for internationalization of a currency is the country's share in global trade. India's percentage share in the global trade is still on the lower side and it limits the pricing ability of domestic businesses in Indian Rupee. Moreover, the share of Indian Rupee in the Global foreign exchange market turnover at present is also very low. Internationalization of Indian currency would also require full capital account convertibility. As a policy, we have followed a gradual and cautious approach in opening up the capital account. The capital account is being progressively liberalized in accordance with the evolving macro-economic conditions and requirements of the Indian industries, individuals and financial sectors. Government has been taking measures to promote the internationalization of the Indian Rupee. Recently, a framework was put in place for issuance of Rupee denominated masala bonds overseas by Indian corporate.

Capital Account Liberalization

Foreign Direct Investment (FDI) in India is subject to certain Rules and Regulations and is subject to predefined limits ('Limits') in various sectors which range from 20% to 100%. There are also some sectors in which FDI is prohibited. The FDI Limits are reviewed by the Government from time to time and as and when the need is felt and FDI is allowed in new sectors where the limits of investment in the existing sectors are modified accordingly. In order to revise the FDI Limits to attract more foreign investment in India, the Union Government constituted a committee named, Arvind Mayaram Committee. In 2013, the Government approved the recommendations given by the Arvind Mayaram Committee to increase FDI limits in 12 sectors.

Current Account Deficit

The current account of the balance of payments is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid). Both government and private payments are included in the calculation. The balance of trade is typically the most important part of the current account. This means that changes in the patterns of trade are key drivers of the current account.

CAD is said to be good upto a limit as the country uses foreign savings which are imports for its development. However, two points must be made to qualify the same. One, it should be financed from dependable inflows like FDI. Two, it should be within limits. Foreign investment inflows were encouraged into the country to finance the current account deficit (CAD). The steps include liberalizing long-term external commercial borrowings (ECBs), asking state-run companies to raise funds from overseas markets etc. The government also talked to sovereign wealth funds and pension funds to get them to invest in India. Promoting exports and measures to reduce imports, especially non-essential ones were taken up.

Deficit on the current account means a net outflow of foreign currency and depletion of forex reserves. In India's case, this means a dollar outgo.Therefore, a country with a current account deficit has to attract capital flows, which could be in the form of FDI/NRI deposits/FII etc to meet the shortfall. But when capital flows are insufficient to meet the deficit, the country's currency starts to depreciate as its capacity to defend its currency weakens. It has no forex to meet it debt servicing obligations. It runs into a sovereign debt crisis thus. This is why a current account deficit in excess of 2.5% of GDP is seen as worrisome in case of India. To act against CAD, India needs to promote exports and slow down consumption imports such as fuel and gold. Reduction of subsidies will also reduce the demand for imported fuel and thus balance trade.

Exchange Rate

Exchange rate is the price of one currency in terms of another currency. For example, approximately 66 India rupees are exchanged for 1 US dollar in 2017. That is the exchange rate. 25 years back it was 20 rupees. But that was artificially fixed by the RBI for the reasons stated above. Since the rupee exchange rate was deregulated- left to the market forces largely- rupee lost its value and came down to almost close to 70 rupees in late 2013 and since then recovered. The exchange rate depends upon many factors:

- Growth rate of the economy
- Future potential
- Foreign trade profile which includes import dependency
- Inflation
- Forex reserves with RBI
- Interest rates in the country and global majors like US
- Monetary policy of countries like USA
- International commodity prices
- External debt levels, particularly the short term commercial debt level
- The extent of convertibility of the currency
- Twin deficits – fiscal and external current account
- Political stability

Rupee is fully floated. RBI buys and sells foreign currency only to facilitate normal operations for foreign trade, debt servicing etc. That is, rupee exchange rate is not" managed" by the RBI. It is not even semi-managed (dirty float). RBI's significant marked forex market intervention is only when there is manipulation of forex market that can create instability internally and externally. The reason for $400 b is built up as the foreign currency reserve war chest is primarily for this reason.

New Delhi

Currency Mechanisms

There are many ways a currency's exchange rate is arrived at. Some are:

1. In floating rate , the forces of demand and supply determine the valuation and the role of monetary authority is nil or negligible except in indirect terms like buying and selling currency in the market, changes it makes in the interest rates , cash reserves ratio etc .

2. In dirty float the exchange rate is largely market determined but the central bank manages the rate in a specific band that suits certain national goals like export promotion etc. Management of the currency valuation is within a band called the target zone and it is declared by the central bank. The objective here is to make exchange rate conducive for certain macro economic goals like export promotion and balancing it with import liberalization; remittances etc. It is also called managed float.

3. In the fixed exchange rate, the Central Bank artificially and arbitrarily fixes the exchange rate which may not have any relation to market forces. India had the system till 1992 before trade account convertibility was introduced. India had the system as it did not need any FDI or exports.

4. In the pegged system the currency is pegged to the international hard currency like dollar so as to signal the commitment of the central bank to stability. Its movements may or may not be determined by the hard currency because the valuations that suit the local currency are independent of the hard currency. It is essentially meant for imparting stability and

credibility to the domestic currency in its exchange rate so as to invite investors. The stability, however, depends on the ability of the country to manage the rate that is necessary for its exports and gain other benefits. For that, the Central bank should have sufficient forex reserves to intervene whenever necessary. Otherwise, there will be speculative attacks and currency meltdowns. China is an example of currency peg. Crawling peg means, the Government accepts that the currency will crawl up or down gradually by a certain annual rate.

2013 And The Exchange Rate Of Rupee: Why Did The Rupee Slide To Historic Lows Of Nearly 69 In 2013

Rupee fell its lowest ever against the dollar culminating in 2013 - at little less than Rs.69 for which the external and internal reason are responsible

- Eurozone crisis
- Fed taper and rate hike
- Flight to safety
- Dollar is relatively strong as the US economy came out of recession and growth resurfaced
- Risk aversion for the foreign investor
- GAAR/retro taxation laws
- CAD widening
- Weakening capital inflows: The capital account (the net flow of funds through investments and borrowings) surplus has been used to finance the current account deficit for many years. Capital inflows have reduced due to the improving economic situation in the US and other developed countries. Investors are exiting developing markets in expectation of the US Federal Reserve increasing the interest rates, impacting the currencies of emerging markets, like India, Brazil, Russia, Indonesia, Turkey and South Africa.
- Inflation: part of the depreciation is attributable to the adjustment of the rupee exchange rate to the inflation differential, i.e. India's relatively high rate of inflation versus other economies.

Steps taken by the RBI and the government of India to stabilise the currency markets:

Issue	Details
Capital Outflow	The RBI reduced the limit for outbound investment and remittances from India.
Encouraging Capital Inflows	RBI has removed administrative restrictions on investment schemes offered by banks to non-resident Indians, and removed ceiling on interest rates on deposit accounts held by NRIs.The government liberalised the FDI limits for 12 sectors, including oil and gas.
Limiting Imports and encouraging exports	The Finance Ministry increased the customs duty on importing precious metals including gold and platinum.20% of every lot of import of gold must be exclusively made available for the purpose of export of gold-related items
Oil Import Needs	RBI decided to provide dollar liquidity to three public sector oil marketing companies (IOC, HPCL and BPCL) to help them meet their entire daily dollar requirements. Government also considered increasing

	its import of crude oil from Iran, and pay for it directly in Indian rupees.
Trade Deficit	Ministry of Commerce explored the possibility of using local currency for trade with major trading partners.RBI allowed exporters and importers more flexibility in management of their forward currency contracts.
Curbing Speculative in currency	RBI increased the short-term emergency borrowing rates for banks. The daily holding requirements under the Cash Reserve Ratio for banks have been modified. MSF was increased to curb borrowing for speculation
International Cooperation	Government increased its currency swap limit with Japan from USD15 billion to USD50 billion. The BRICS nations also agreed on a USD100 billion foreign currency reserve pool as part of their plan to create a BRICS -CRA

As is evident, some were related to capital account; some others were long term and confidence boosting measures; few are related to immediate relief.From the above sub topic where the reasons and remedies were given, it is clear as to how the currency moves and what policy levers are available to ensure order. The reason for giving in such detail the case of rupee in 2013 is it is a good case study.

Since then rupee recovered and fell again in 2016 November to close to Rs.69 levels.

What is the Real Value of the Rupee?

Since 1991 when dollar fetched 16 rupees, rupee has depreciated to Rs. 65 per dollar by 2017 October. Erosion is caused by the fact that unlike the arbitrary value fixed till 1991, the rupee is finding its market value according to demand and supply in the market. The factors that influence the value are:

- Demand and supply
- Net Capital flows
- Performance of economy and its prospects
- Forex reserves with the RBI
- Interest rates
- Short term debt and the Current Account Deficit(CAD) or CAS
- International prices of the commodities on whom the nation depends. For example, the crude prices in the international markets influence exchange rate of rupee as India depends for more than 80% of its requirements on imports
- speculators
- Political stability – current government has overwhelming majority in the Lok Sabha and gives an edge

The prevailing official exchange rate is called the nominal effective exchange rate (NEER) Adjustment –upward or downward –according to inflation shows real effective exchange rate (REER). REER is an inflation adjusted exchange rate – the differential between the inflation in India and India's trading partners is factored to arrive at the REER. NEER always tends towards REER even though there may be a time lag to suit the macro-requirements of the economy.

Forex Reserves

RBI holds foreign exchange reserves which are made up of

- foreign currency held in US Dollars, Euro, British Pound, Japanese Yen etc
- foreign bank deposits
- foreign government securities
- gold reserves
- Special Drawing Rights of IMF and International Monetary Fund reserve positions

Reasons For Accumulation of Forex

Today (2017) RBI has $400b of reserves. It is acquired by the RBI for the following reasons

- To gain external account security
- To defend the rupee when needed
- To import essentials for economic and social security
- To enable the country to globalise further
- To deter speculators
- To enjoy favourable rating by sovereign credit rating agencies which in turn will confer advantages like borrowing cheap from offshore currency market etc.

The foreign currency assets (FCAs), a major component of the overall reserves, were at $375 billion in September when RBI had $400 billion forex reserves for the first time.

Expressed in US dollar terms, FCAs include the effect of appreciation or depreciation of non-US dollar currencies, such as the euro, the pound and the yen held in the reserves.

Gold reserves were $21 billion.

The special drawing rights with the International Monetary Fund (IMF) were $1.5 billion.

The country's reserve position with the IMF was $2.3 billion.

These are reserves and not resources and can not be used for infrastructure etc as the investors want to see the country hold enough of these reserves to give them confidence to come and leave without uncertainties.

Adequacy or Otherwise of The Forex Reserves

Whether it is adequate or not is determined by the composition of our flows and external debt. NRI deposits and FII investment (hot money) are vulnerable. Global crude prices are also a factor in estimating the quantum of forex that is necessary. Drought and resulting food position is one more. Short term debt is another input. With all these factors, including the import cover required, we have to decide the extent of forex necessary.

RBI is diversifying the reserves into SDR and gold since 2008 and the US-centered global recession.

Problems of Plenty With Large Forex Reserves

But there are problems with huge forex reserves as to

- Cost of acquisition is high

- Sterilization costs are high, that is, when rupees are printed to buy dollars, the rupees that put into market have to be absorbed by floating government securities carrying significant interest cost through MSBs(discussed in the Monetary Policy Chapter)
- Market risks associated with their deployment in US securities are evident since 2008
- Returns on such deployment is also miniscule

RBI is diversifying the reserves into SDR and gold since 2008 and the US-centered global recession.

China, Japan, Switzerland, Saudi Arabia, Taiwan, Russia, Hong Kong and India are the top eight countries in terms of forex reserves- in the descending order.

Strong Rupee 2017: Causes And Effects

Indian rupee has turned out to be one of the best-performing currencies in the world with a gain of well over 6% against the U.S. dollar by August 2017. The rupee has been appreciating because of strong capital inflows. These include portfolio inflows into equities and, more importantly, debt markets. They also include higher levels of foreign direct investment and instruments such as masala bonds. These are driven partly by global liquidity and partly by the improving fundamentals of the Indian economy. The Reserve Bank of India's (RBI) relatively hawkish stance on the policy rate has attracted funds searching for yield.According to the Reserve Bank of India, foreign portfolio investors invested $15.2 billion in India's equity and debt markets this year until the end of July. In addition, foreign direct investment in April-May doubled compared to last year. Oil prices remaining stable at around the $50 mark too has helped as it helps reduce forex outgo on oil imports. This is reflected in the improved current account deficit, which stood at 0.7% of GDP in 2016-17 compared to almost 4.8% in 2012-13.

Foreign exchange reserves are at a record level of $393 billion.

However, strong rupee can cause concerns if our object is to stimulate investment, create employment and foster growth, it is a cause for serious concern.

The exchange rate is a determinant of the price competitiveness of exports in world markets and the price competitiveness of imports in the domestic market. Similarly, it exercises an important influence on the profitability of domestic firms that produce goods which are exported, or produce goods which compete with imports. The relative profitability of domestic firms is particularly important in a large economy such as India, because most exports are goods that can be sold either in the world market, or in the domestic market, while most imports are goods that can be bought either from abroad or at home.

It is possible that any currency is overvalued or undervalued. Overvaluation of the rupee means that its price in terms of foreign currencies is too high, compared to what it would be with a more appropriate exchange rate. This makes our exports expensive in foreign markets and our imports cheap in the home market. Undervaluation of the rupee means the opposite. Its price in terms of foreign currencies is too low, so that it discriminates against imports and in favour of exports.

In 2017, almost every currency appreciated against the dollar, but the rupee rose the most (along with the Korean won).

India's export performance in the past three years has seen setbacks. India's share in world exports, around 1.65%, was maintained but not increased. The slow growth in world trade does impose a demand constraint on total exports from developing countries taken together. But China, Korea and even Bangladesh, managed to increase their shares in world exports. Thus, it would be misleading to blame the world economy for India's dismal export performance. Some part of the explanation lies in domestic economic factors such as infrastructure or quality but these have been problems for a long time. The exchange rate of the rupee has been the main reason in recent years. Software exports, which have continued to grow—from $98 billion in 2014-15 to $108 billion in 2015-16 and $117 billion in 2016-17—appear to be an exception to the rule, but these would have done far better if the overvalued and appreciating rupee had not dented the profitability of domestic firms.

The essential underlying factor was the exchange rate of the rupee, which also made imports distinctly cheaper than home-produced goods, whether fruits, mobile phones, consumer electronics or household goods. Every consumer in India is familiar with the overwhelming presence of Chinese manufactured goods. The consequent switch in domestic expenditure from home-produced goods to imports did lead to a contraction in demand and jobs which in turn had a dampening impact on jobs and economic growth

High interest rates to sustain portfolio investment led to strong rupee as seen the first paragraph above. These capital inflows drive prices up in stock markets and add to foreign exchange reserves. But this solution can cause considerable collateral damage to the economy.

First, portfolio investment flows have a significant impact on the exchange rate. The appreciating overvalued rupee erodes the price competitiveness of exports and enhances the price competitiveness of imports, which hurts the profitability of domestic firms and is bound to enlarge the trade deficit. At a macro level, this also leads to a contraction in domestic demand so that economic growth is slower than it would have been in the absence of an appreciating rupee.

Interest rates have been kept at high levels, said to combat inflation—at its lowest in years—but substantively to ensure profitability of short-term foreign capital inflows and maintain confidence in international financial markets. As inflation rates have come down sharply while nominal interest rates have not, real interest rates have risen sharply in the past three years. This has tended to crowd out domestic investment in the real sector of the economy, whether agriculture, manufacturing or services. Such dampening of domestic investment also means that economic growth is slower than it would have been in the absence of high interest rates.

It is essential to recognize that the exchange rate is a price which matters for the economy in many spheres. It is far more important than portfolio investment inflows that can be volatile. The overvaluation of the rupee, which makes exports difficult and imports attractive, must be corrected. The time has come to let the rupee depreciate not just in nominal but in real terms. A more appropriate exchange rate would stimulate exports and dampen imports, just as it would help domestic manufacturing firms to be more competitive, both abroad and at home, to "Make in India" and combat the onset of deindustrialization.

The way forward, now, is to drop interest rates, which would also help the exchange rate depreciate. Together, these would stimulate investment and revive exports, which in turn will drive economic growth and employment creation from the demand side. The time is also most opportune as the consumer price annual inflation rate has dropped to 1.5% in June 2017.

Sovereign Wealth Fund

It is a fund of foreign currency that is meant to be invested in global assets. It is set up and managed by the central bank or a special body (special purpose vehicle) of the government. It is commonly seen in countries that have substantial foreign currency assets earned by them from exports or by foreign investors like MNCs. The fund is invested in shares, bonds, property or other areas of potential growth- like energy assets like oil and gas fields, uranium and agricultural fields. It may also be used to acquire foreign companies. The main reason for it s to earn more than making investments in government bonds of foreign central banks. It helps in energy and food security. Some of the countries that use sovereign wealth funds (SWFs) have economies that are rely on one source of income- oil revenues in Norway and the Middle East.

SWFs diversify their incomes and help them with external account security. India has not set up an SWF because our reserves are not adequate for our needs and contingencies. Besides, the forex held by the RBI is not earned through exports or FDI but is essentially borrowed resources. Our external debt is about $475 billion and our forex reserves are $ 400 billion.

Rupee Devaluation/Depreciation and Export Performance and Promotion

It is argued that when a currency depreciates due to market forces of supply and demand or is devalued by the Central bank, exports go up as in price terms as the country's goods and services will be cheaper especially in relation to similar goods and services from competitive countries. In fact, in the case of India, since the beginning of reforms in 1991 one of the reasons for the growth in exports in dollar terms was the depreciation of rupees. With depreciated rupee, FII will also flow in. Remittances will increase. Inessential imports will reduce. More money in rupee terms is realized for the loans in foreign currency that Indian firms take.

However, when rupee loses its value externally, debt servicing becomes costlier. Inflation will rise as imports will become costlier. Government's subsidy bill and fiscal deficit may rise as it will have to make imported goods like petroleum products and food affordable to the general public. At the same time, a cheaper rupee making the imports costly may drive the domestic import – dependent firms to become either import-substituting or cut corners and raise productivity. The result can be innovation and indigenous production.

To boost exports, pricing the external value of the rupee low is not the strategy beyond a point. Sclae, quality, reliability, packaging and so on matter. Price-elasticity of our exports is also to be considered before depreciation is advocated. That is, price may not boost consumption beyond a point. Further, competitive devaluation will harm the economy as elaborated above. Also, import elasticity of Indian exports- about 50% exports like engineering goods, gems and jewellery etc is high and thus depreciation hurts them.

J curve effect is a theory stating that a country's trade deficit will initially worsen after the depreciation of its currency. This is because higher prices on foreign imports will be greater than the reduced volume of imports and the growth in exports initially. When exports become price-competitive and imports are reduced due to high cost, the BOP turns positive.

Rupee Appreciation: Why And What It Does

Normally, currencies appreciate when the economies are doing well. An appreciating currency is the result of a booming economy. Performance of economy brings in FIIs; huge FII inflows into financial asset markets and an increasing reliance on low cost foreign loans (ECB) add to the foreign currency glut, and help power the rupee higher. NRI deposits also explain the appreciation.

The resentment is among exporters while importers, borrowers from abroad and the consumers are gainers. Borrowers gain as they can prepay at reduced cost. Importers are delighted with the rupee's appreciation to the dollar as most imports and external borrowings are denominated in dollars. Borrowings through Masala bond does not make the debtors relieved as the borrowing and repayment both are in rupees and so is the interest.

The Indian consumer is a beneficiary too, as costs of a host of imported goods — from petro products to electronic, electrical and consumer items — would be cheaper.

The effect on exporters too is not all negative. With increasing global integration an ever-increasing proportion of exports consist of imported raw materials and components. This is particularly true of the diamond, high-end textile and engineering industries that use a high proportion of imported goods in their exports.

The rupee's rise has helped these exporters to rein in their costs and increased their competitiveness in the global market place. However, exporters, in general, have seen their profit margins erode as a result of the rupee's unexpected appreciation.

Appreciation is suggested for the following reasons:-

- Helps manage inflation
- Puts pressure on export sector to scale up the value chain and export niche products
- Forces the industry to cut costs and be competitive on quality terms.

Currency Manipulation

A country depends on the price of its currency in overseas markets- the exchange rate, for a variety of its macroeconomic objectives. Some want it weak so as to export more etc and some want it balanced if they also have a need to import substantially. China is in the former category and India in the latter. China keeps its exchange rate weak by having the yuan (renminbi) fixed (pegged) to a basket of currecnies since 2015 and till then to the US dollar. By artificially keeping it devalued, it has posed a threat to other countries that also want to export but can not weaken the currency for the purpose. For example, India. When a country dmages its competitors through a weak currency, it is called a "beggar they neighbor policy." The decline of India's exports and the huge trade deficit that India runs with China (about $50 billion in 2017) may be cited as an example of such policies. It is the result of currency manipulation. The United States accused China of keeping the yuan, artificially low by massively accumulating foreign reserves, in order to give Chinese exports an advantage over competitors.

US wants to have Chinese yuan to move freely in foreign exchange markets and find its value.

A weak currency cheapens the price of a country's exports, making them more attractive to international buyers by undercutting competitors.

China's economy is primarily export-driven and international competition could be killed only by currency manipulation. Other countries can not join this currency war as they do not have such large scale manufacturing capacity nor the population to supply cheap labour skills nor the authoritarian government that can take decisions against popular will, for examples environmentally incompatible projects. Other countries lose by way of growth, jobs, fiscal receipts, competitiveness, welfare and so on as they lose their global and domestic markets.

Certain professional economists and policy makers are apprehensive that the devaluation driven growth could overheat the economy and hardland the country into a rapid slowdown hindering the world recovery.

Other countries also reacted in a similar manner. US started quantitative easing one of whose objectives was to oversupply dollar to weaken it to check imports and boost exports. President's Trump's "America First" is also a response to it. Protectionsim is spreading across the world as a result.

Currency War

In 2010 by Brazil's Finance Minister Guido Mantega coined the term while describing the competition between the United States and China to cheapen their currency- US having joined the war started by China by introducing the QE .As detailed in the note on currency manipulation, some nations deliberately weaken their currencies to gain in terms of exports etc. When the other nations join the race of devaluation, it is called a currency war. Currency cheapening is made possible by the central bank following an expansionary monetary policy to lower the value of its money. The central bank buys foreign currency and keeps a war chest of it like China with which it ensures that its domestic currency has a low valuation vis a vis other currencies to aid exports. That helps businesses and boosts economic growth.

New Delhi

Other countries may not be able to join as their currencies are not fixed but are floated; imports will be costlier; inflation will shoot up; growth will suffer; jobs will be lost and financial sector may be destabilized as banks may accumulate non-performing assets(NPA).

A central bank has many tools to lower the exchange rate: increase the money supply by expanding credit. It can lower interest rates. It can also add credit to a money supply through open market operations an extreme form of which is Quantitative Easing.

Governments can also aid in currency losing its value through expansionary fiscal policy: by spending more or cutting taxes. But its effects can be severely destabilizing and anti-growth unless the entire ecosystem is in place to take relative advantage of the weak currency from the global market.

Dollarization

When a country uses the currency of another country along with its own currency or by official substitution, it is called Dollarization. Currency substitution can be in complete replacement of domestic currency or along with it. Nepal and Bhutan people hold Indian rupee along with their own official currencies Nepalese rupee and Bhutanese Ngultrum respectively for financial security and for trade across the border. Similarly, residents of Zimbabwe hold British Pound or South African Rand along with Zimbabwe dollar.

Currency Board

In recent times, currency board came into international headlines in 2001-02when Argentina adopted it to flush out its extra currency that was losing its value due to fiscal profligacy. When foreign investors were leaving the country ad the exchange rate of peso was plunging, the decision was taken to adopt the currency board mechanism. It set a fixed exchange rate to US dollar. It ruled that the country should print so many pesos as it had dollars- the ratio between the two being fixed at a certain level. Thus the country retrieved its financial stabilityand FDI and FII resumed. Thus, like a central bank, a currency board is a country's monetary authority that issues notes and coins. That is its only function and is performed in line with the fixed currency exchange rate. In other words, CB, unlike a central bank, is not the lender of last resort, nor banker to government nor is it the bank's bank.

Global Reserve Currency

There are some national currencies that are held by central banks around the world as a part of their foreign exchange reserves as they are accepted in the international markets for all types of transactions like payment for imports, debt servicing etc. For example, US dollar, Japanese yen, Euro etc. It is held not only by the central banks but also firms and individuals as it is considered a hard currency or safe-haven currency. U.S. dollar is the most preferred and makes up 64 percent of all known central bank foreign exchange reserve. More than 85 percent of forex trading involves the U.S. dollar. 39 percent of the world's debt is issued in dollars. The reason for the dollar gaining the predominant position was that in 1944 the Bretton Woods Agreement assigned a unique status to the US dollar - it took the world off the gold standard and made the US dollar the basis for other counties printing their currencies. That is, US dollar ws made the global reserve currency. They could hold US dollars instead of gold. When they wanted to convert the dollars into gold, US would exchange. US dollar was printed on the basis of gold holding. It meant that all countries held dollar; dollar dominated the world; all others used the dollar to buy US goods; dollar was in huge demand; others were grossly undervalued. But they felt inflationary pressures. It worked well when the US held sway over the world- till the end of sixties. When Japan and Germany and others were coming up, they defied it and wanted their own currencies also to emerge as global reserve currencies. When they wanted gold for dollars, Richard Nixon changed the system and discontinued with the gold standard for the USA. That is, even the US dollar was not tied to the gold reserves. In other words, since 1971, the amount of currency that US printed is not linked to gold. Each country followed its own standard (gold standard is followed when a country promises the holders of its currency to redeem their currencies for their value in gold upon demand). The next most popular reserve currency is the euro. About 20% (2017) of known central bank foreign currency reserves were in euros.Most of the other currencies are only used inside their own countries. Whether a currency becomes a reserve currency or not does not depend on the size of the currency. Swiss economy is worth only $660 billion (2017) but has been one for many years. China was more than $5 trillion 10 years back and was not.

(Bretton Woods Agreement 1944 was decided upon at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire, in 1944. The creation of the International Monetary Fund (IMF) and World Bank Group and valuation of gold and foreign exchange rates was the contribution of 44 countries that met to create a new international monetary system. The main goals of the meeting of the 730 delegates were to ensure a foreign exchange rate system, prevent competitive devaluations and promote economic growth.)

The reasons for any national currency to emerge as a global currency are that it should have strength in the form of a large economy; it should have performed well for decades; it should be stable which the central bank should be able to ensure; there should be adequate amount of the currency in global markets to convert it into other currencies and vice versa. If a currency satisfies these features, it can be accepted across the world.

If a currency is held by others, it has a great advantage: other countries will hold it. They do not hold it as currency as it does not fetch returns. They buy government bonds with it. For example, US dollar is held, it is held as US government security which fetches some returns. It means, world will give USA the dollars that it holds and US will exchange it for US government securities. These securities are thus sold for an interest rate that is negligible-1% or so. It means, the rate at which US raises loans is very cheap. That reflects on the global trust in these bonds. US spends the money for its own growth and consumption.

Hard And Soft Currency

In line with the explanation of global reserve currency above, hard currency is any globally traded currency that is liquid(adequate supply) and stable (does not fluctuate much). Such currency is in global demand as a store of value. Long-term stability, fiscal and economic policies of the country, strength of the economy etc are the relevant factors behind the emergence as a hard currency.It becomes a safe haven currency.Soft currency exhibits opposite features.

Flight of Capital

When financial assets or money rapidly leave a country due to the understanding that the economy is not doing well, or is imposing controls that will mean losses, or is likely to makes policies that are inimical for investments, government facing sovereign debt crisis defaulting on its debt etc. Any of these events will cause loss of confidence in the economy. When flight of capital takes place, exchange rate drops thus causing even greater flight and harm to the economy. The country's currency will lose value and the purchasing power. High inflation will result .The problem is worse if the country is import dependent. In such a situation- either before after the capital flight, the country will resort to capital controls.

Capital Controls

In 2017, China imposed regulations targeting "irrational" overseas investments in the property, entertainment and sports sectors. In 2015, Greece imposed capital controls on foreign currency outflows. In India, in August 2013, the Reserve Bank of India (RBI) imposed partial capital restrictions on companies and individuals to stabilise the rapidly weakening rupee. Overseas direct investment by Indian companies was cut by three-fourths, making it more difficult for local corporate entities to buy overseas assets. RBI also lowered overseas remittances by locals to $75,000 a year from $200,000, and prohibited investments in overseas property. These measures were rolled back after the rupee stabilized.

These measures constitute 'capital controls': Any measure taken by a government, central bank or other regulatory body to limit the flow of foreign capital in and out of the domestic economy. These controls include taxes (Tobin tax), quantitative restrictions etc.

They are not confined to capital account as the above mentioned RBI policies include remittances too which are in the current account. These controls can be economy-wide or specific to either a sector or industry as can be inferred from above.

Capital controls are temporary and are aimed at stabilization. In the long run they limit economic progress and efficiency.

SRIRAM'S IAS
New Delhi

POVERTY: CONCEPTS, DATA, POLICY AND ANALYSIS

Poverty is deprivation of basic needs that determine the quality of life- food, clothing, shelter, safe drinking water etc. It also includes the deprivation of opportunities to health, education, skills, employment etc. Agricultural wage earners, small and marginal farmers and casual workers engaged in non-agricultural activities, constitute the bulk of the rural poor. Small land holdings and their low productivity are the cause of poverty among households dependent on land-based activities for their livelihood. Poor educational base and lack of other vocational skills also perpetuate poverty. Due to the poor physical and social capital base, a large proportion of the people are forced to seek employment in vocations with extremely low levels of productivity and wages.

There are many reasons for poverty which include:

- Colonial destruction of economy
- Uncontrolled population
- Growth is not rapid to eradicate poverty
- Models of growth may be unsuitable for poverty alleviation. For example, capital-intense growth in a labour surplus country like India
- Poverty is a vicious circle preventing investment and development.
- Geographic factors, for example lack of fertile land and access to natural resources.
- Anti-poverty schemes not being effective due to institutional and other inadequacies
- Insurgencies as in the north east of India and naxalism as in the eastern corridor
- Lack of education and skills.
- gender discrimination

Poverty Is A Cognitive Tax

Scientists have demonstrated what we observe around us: Chronic poverty causes health difficulties, educational failure, mental health challenges, and impoverished aspirations. Finances for appropriate provision are not available, and overexposure to stress has negative consequences on physical and emotional development. Poverty causes cognitive depletion and thus is a "cognitive tax" on the poor. Researchers suggest that people who find themselves poor spend an enormous amount of mental energy managing the state of poverty. The constant preoccupation with the difficulty generated as a result of not having appropriate resources narrows down thinking, focusing attention on the concern at hand. This intense and concentrated use of energy reduces a person's "mental bandwidth", preventing them from managing effectively other areas of their lives, because worry is consuming them.

A variety of studies point to a correlation between poverty and counterproductive behavior. The poor use less preventive health care, fail to adhere to drug regimens ,are less likely to keep appointments , are less productive workers , less attentive parents , and worse managers of their finances. These behaviors are troubling in their own right, but they are particularly troubling because they can further deepen poverty. Some explanations of this correlation focus on the environmental conditions of poverty. Predatory lenders in poor areas, for example, may create

high-interest-rate borrowing, and unreliable transportation can cause absenteeism. Lower levels of formal education, for example, shows as financial illiteracy.

The condition of poverty imposed, as one study showed, a mental burden similar to losing 13 IQ points, or comparable to the cognitive difference that's been observed between chronic alcoholics and normal adults.

The finding further weakens the theory that poor people, through inherent weakness, are responsible for their own poverty – or that they ought to be able to lift themselves out of it with enough effort. This research suggests that the reality of poverty actually makes it harder to execute fundamental life skills. Being poor means coping with not just a shortfall of money, but also with a concurrent shortfall of cognitive resources. Poverty being the villain, it strengthens the case for welfare state and inclusive growth.

Poverty Concepts

Types of Poverty:

Human Poverty is the lack of essential human capabilities- literacy and nutrition.

Income Poverty is the lack of sufficient income to meet minimum consumption needs.

Extreme Poverty The World Bank defines extreme poverty as living on less than $1.90 a day (2016).

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Relative Poverty is the condition in which people lack the minimum amount of income needed in order to maintain the average standard of living in the society in which they live. It is defined in terms of the society in which an individual lives and therefore differs between countries and over time. That is, poverty is relative to the country and its standard of living.

World Bank and relative poverty metrices

WB defined the extreme poverty line first in 1990 at $1 a day which became $1.9 a day presently. In an attempt to be more precise with its classifications, the WB in 2017 November added new standards of poverty for people living in middle- and high-income countries.The new standards are set at $3.20 a day for people in "lower-middle-income" countries, such as Egypt or India; $5.50 a day for "upper-middle-income" countries, such as Jamaica or South Africa; a third standard for high-income countries, like the US, at $21.70 a day.

The United Nations aims to eradicate extreme poverty by 2030 as part of its Sustainable Development Goals. Much of the success is owed to organizations like the World Bank, UNICEF, and the Gates Foundation, which has spent billions over the past decade to alleviate poverty around the world. One of the hallmarks of this success has been the reduction in a group of side effects related to poverty, such as hunger, child mortality, maternal mortality, and widespread declines in the world's deadliest diseases, such as HIV/AIDS and malaria.

Absolute Poverty is defined as "a condition characterized by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also on access to services

Poverty Line

It is the level of income below which one cannot afford to purchase all the resources one requires to live.

Poverty lines are defined as the per capita monetary requirements an individual needs, to afford the purchase of a basic set of goods- food and other goods.

Some definitions include only certain calories of intake and convert it into monetary value. In India monetary requirement to consume 2100 calories in urban areas and 2400 calories in rural areas per day per person was the absolute poverty line but was changed later till the Tendulkar line was adopted in 2010. Other definitions include more goods and services in the basket. The monetary value is determined and indexed to inflation and the line is drawn dynamically.

Headcount Ratio

The incidence of poverty is revealed by this ratio. It shows the percentage of the population whose per capita incomes are below the poverty line, that is, the population that cannot afford to buy a specified basic basket of items.

Poverty Gap (PG)

PG is a measure of the intensity of poverty among the poor: the difference between the mean income among the poor and the poverty line. This indicator measures the magnitude of poverty as well as its intensity- number of poor and how poor they are. The Poverty Gap Index is the combined measurement of incidence of poverty and depth of poverty. PG is also called the Foster-Greer-Thorbecke (FGT) index. It is the gap between the average poverty among the poor and the poverty line.

Misery Index

The misery index was initiated by Chicago Economist Robert Barro in the 1970's. It is the unemployment rate added to the inflation rate. It is assumed that both a higher rate of unemployment and a worsening of inflation cause and intensify the misery. A combination of rising inflation and more people of out of work ("stagflation") implies a deterioration in economic performance and a rise in the misery index.

Planning Commission and Poverty

The Planning Commission as the nodal agency in the Government of India for estimation of poverty has been estimating the number and percentage of poor at national and state levels. Estimates of poverty are made from the large sample survey data on household consumer expenditure conducted by the National Sample Survey Organization (NSSO) of the Ministry of Statistics and Programme Implementation.

NSSO and Poverty Estimates

National Sample Survey Organisation (NSSO) collects household consumer expenditure data every five years on a large sample. Household consumer expenditure surveys are also conducted annually but the sample size is much smaller. Every five years full surveys on 1,20,000 households are carried out. In the intervening period, "thin" samples of around 20,000 households are surveyed. The "thin" samples do not indicate trends fully.

Planning commission initially gave poverty numbers and related data ratios since 1979 based on the Alagh Committee Report of that year. This procedure was subsequently modified by the Lakdawala Committee (1993).The commission appointed an expert group led by Suresh

Tendulkar to suggest a new poverty line for rural areas. It submitted its report in 2009. It used the latest data to construct a new poverty line basket. It moved away from the calorie intake as anchor for poverty estimation and included health and education. Tendulkar committee did not deal with the urban poverty as the line was not controversial at that time.Arjun Sengupta Commission on unorganised enteprises estimated 77% of the population can be categorised poor and vulnerable. The Tendulkar poverty line in 2009-10 was 4,298 per month for a family in urban and 3,364 per month for a family in rural areas.

Rangarajan Committee

A new expert committee under C Rangarajan went into revisiting the methodology for estimation of poverty and identification of the poor after the Tendulkar poverty line was found unsatisfactory in its methodology. The panel looked into the issue of linking poverty estimates with providing benefits under the Centre's social welfare schemes. That is, are entitlements to be given only to the poor? In other words, the committee went into setting standards for poverty definition so that we can face the human challenge of poverty eradication and also assess how far we have done so, so far since Independence. The panel assessed whether poverty can be determined on any criteria other than the consumption basket.

It redefined the poverty line in 2014. According to the the committee, the new poverty line should be Rs 32 in rural areas and Rs 47 in urban areas at 2011-12 prices. The earlier poverty line figure was Rs 27 for rural India and Rs 33 for Urban India. The Rangarajan report added 93.7 million more to the list of the poor assessed as per the Suresh Tendulkar committee formula. The total number of poor has reached 363 million from 269 million in 2011-12. For Rangarajan committee household is poor if it is unable to save. The methods also include certain normative levels of adequate nourishment, clothing, house rent, conveyance, education etc. It also considered average requirements of calories, protein and fats based on ICMR norms differentiated by age and gender. Based on this methodology, Rangarajan committee estimated the number of poor were 19 per cent higher in rural areas and 41 per cent more in urban areas than what was estimated using Tendulkar committee formula.

NC Saxena Committee

The Ministry of Rural Development in 2008 appointed a committee headed by NC Saxena to calculate the rural BPL figures in the states.

Officially, there are two sets of BPL estimates in India, one made by the Planning Commission using NSSO data on household consumption expenditure and the other by the rural development ministry through a state-level BPL house-to-house census. The mismatch between the two, with Planning Commission progressively lowering poverty estimates while the states push higher numbers, has been a source of controversy. The Centre allocates resources for BPL schemes based on the figures of the Planning Commission.The committee chaired by NC Saxena recommended that 50% of India's population be given below-poverty-line cards. Thus, it suggests expansion of the social security net involving fiscal and administrative challenges.

While advocating exclusion of large number of families from the BPL lists, the committee recommended that those families having double the land of the district average of the agricultural land or two wheeler or one running bore well or income tax payers would be deleted from the BPL lists. The panel recommended that some disadvantaged communities be given BPL cards automatically. These include chronically vulnerable groups, such as households with members having tuberculosis, leprosy, disability, mental illnesses or HIV/AIDS and others, designated 'primitive tribe', designated dalit groups, homeless household etc.

The Centre notified 13 new parameters for defining Below Poverty Line (BPL) category of people in the country. It has done away with the earlier definition based on food calories or annual earnings. The revised definition is based on landholding, type of dwelling, clothing, food security, hygiene, capacity for buying commodities, literacy, minimum wages earned by the household, means of livelihood, education of children, debt, migration and priority for assistance. The matter had been stayed by the Supreme Court and has only now been vacated.

Urban Poverty

The Planning Commission had constituted an expert group under S. R. Hashim in 2010 to recommend detailed methodology for identification of BPL families in urban areas in the context of the 12th Five Year Plan. The expert group submitted an interim report recommending that poverty in urban areas be identified through identification of specific vulnerabilities in residential, occupational and social categories.

It said that those who are houseless, live in temporary houses where usage of dwelling space is susceptible to insecurity of tenure and is affected by lack of access to basic services should be considered residentially vulnerable.

Houses with people unemployed for a significant proportion of time or with irregular employment or whose work is subject to unsanitary or hazardous conditions or have no stability of payment for services should be regarded occupationally vulnerable.
Households headed by women or minors or where the elderly are dependent on the head of household or where the level of literacy is low or members are disabled or chronically ill should be considered socially vulnerable, it said.

Pronab Sen Committee

The Ministry of Housing and Urban Poverty Alleviation set up a committee to look into various aspects of Slum statistics /Census and issues regarding conduct of slum census 2011. The committee submitted its report to the Ministry of Housing and Urban Poverty Alleviation in 2010.

The salient finding / recommendations of the committee are: -

- The committee estimated Slum population in the country in 2001 as 75.26 million and the projected slum population in the country for the year 2011 at 93.06 million.
- The committee suggested a different definition for slum than the definition adopted by the census of India 2001 and the states. The committee recommended a normative definition of slum as: "A compact settlement of at least 20 households with a collection of poorly built tenements, mostly of temporary nature, crowed together usually with inadequate sanitary and drinking water facilities in unhygienic conditions."

The committee suggested adoption of the following as slum-like characteristics for the purpose of identification of the slum areas: -

- Predominant roof material: any material other than concrete
- Availability of drinking water source: not with premises of the census house
- Drainage facility: no drainage or open drainage

The committee recommended that a contiguous area with 20-25 house holds having slum like characteristics be counted as slum.

SECC

The Socio Economic and Caste Census 2011 (SECC) was conducted for the 2011 Census of India.GOI approved the Socio Economic and Caste Census 2011 and was conducted in all states and union terriotories of India and the first findings were revealed in 2015. SECC 2011 is also the first paperless census in India conducted on hand-held electronic devices by the government in 640 districts. Therural development ministry, union government has taken a decision to use the SECC data in all its programmes such as MGNREGA, National Food Security Act, and the Deen Dayal Upadhyaya Grameen Kaushalya Yojana. SECC 2011 was the first-ever caste-based census since 1931 Census of India

SECC 2011 has three census components which were conducted by three separate authorities, but under the overall coordination of Ministry of Rural Development in the Government of India:

- Census in Rural Area has been conducted by the Ministry of Rural Development.
- Census in Urban areas is under the administrative jurisdiction of the Ministry of Housing and Urban Poverty Alleviation.
- Caste Census is under the administrative control of Ministry of Home Affairs: Registrar General and Census Commissioner of India.

SECC 2011 data was criticised that caste related data is deliberately withheldTamil Nadu leaders demanded to release the caste-based census data that will help to provide the key to justify the existing 69 per cent quota for backward communities inTamil Nadu. However, the census was welcomed as it reveals how many castes enjoy the benefits and how many don't and to what extent has the welfare spread. Also, it helps better targeting the welfare schemes.

Justice G Rohini Commission

President Ram Nath Kovind appointed a five-member Commission headed by Delhi High Court's former Chief Justice G Rohini to examine the sub-categorisation of Other Backward Classes (OBCs) under Article 340 of the Constitution in October 2017.

This decision has been taken to ensure more backward among the OBC communities to avail the benefits of reservation

It will examine the extent of inequitable distribution of benefits of reservation among the castes or communities included in the broad category of OBCs with reference to such classes included in the Central List.

It will also work out the mechanism, criteria, norms, and parameters in a scientific approach for sub-categorisation within such OBCs and will take up the exercise of identifying the respective castes or communities or sub-castes or synonyms in the Central List of OBCs and classifying them into their respective sub-categories.

The Commission has been asked to submit its report to the President within a period of twelve weeks. On receipt of the report, the Central government will consider ways and means for equitable distribution of the benefits of the reservation in Central government jobs and admission in Central government institutions amongst all strata of OBCs. SECC data will be useful in this context.

Eradication of Poverty

The strategy of the Government includes the following elements

- Socio economic planning
- welfare state. For example, food security Act 2013. Energy security through through schemes like Saubhagya, Ujjwala etc.
- Progressive taxation to garner fiscal resources for spending on poor
- Social safety net like the National Social Assistance Programme (NSAP)
- Open society in which poverty is recognized as a national challenge and earnest efforts are made to tackle it (Amartya Sen)
- Anti-poverty programmes – Pradhan Mantri Awas Yojana, **Deendayal** Antyodaya Yojana (DAY) etc.
- Massive social sector expenditure for skill building
- Decentralization through PRIs and Nagarapalikas for better delivery models

Niti Aayog Task Force on Poverty Elimination

Constituted in 2015 under the Chairmanship of Dr. Arvind Panagariya, Vice Chairman, NITI Aayog, the report of the Task Force primarily focusses on issues of measurement of poverty and strategies to combat poverty. Regarding estimation of poverty, the report could not reach a consensus. With respect to strategies to combat poverty, the Task Force has made recommendations on faster poverty reduction through employment intensive sustained rapid growth and effective implementation of anti-poverty programs.

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New Delhi

MDGs and SDGs

MDG 2000

The Millennium Development Goals (MDGs) were the eight international development goals for the year 2015 that had been established following the Millennium Summit of the United Nations in 2000, following the adoption of the United Nations Millennium Declaration. Following are the MDGs:

- To eradicate extreme poverty and hunger
- To achieve universal primary education
- To promote gender equality and empower women
- To reduce child mortality
- To improve maternal health
- To combat HIV/AIDS, malaria, and other diseases
- To ensure environmental sustainability
- To develop a global partnership for development

SDG 2015

The Sustainable Development Goals (SDGs), officially known as Transforming our world: the 2030 Agenda for Sustainable Development is a set of seventeen aspirational "Global Goals" with 169 targets between them. Spearheaded by the United Nations, through a deliberative process involving its 193 Member States, as well as global civil society, the goals inspired by United Nations Secretary-General Ban Ki-moon that "there can be no Plan B, because there is no Planet B" They were adopted at the UN Sustainable Development Summit September 25–27, 2015

Goal 1. End poverty in all its forms everywhere

Goal 2. End hunger, achieve food security and improved nutrition, and promote sustainable agriculture

Goal 3. Ensure healthy lives and promote well-being for all at all ages

Goal 4. Ensure inclusive and equitable quality education and promote life-long learning opportunities for all

Goal 5. Achieve gender equality and empower all women and girls

Goal 6. Ensure availability and sustainable management of water and sanitation for all

Goal 7. Ensure access to affordable, reliable, sustainable, and modern energy for all

Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all

Goal 9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation

Goal 10. Reduce inequality within and among countries

Goal 11. Make cities and human settlements inclusive, safe, resilient and sustainable

Goal 12. Ensure sustainable consumption and production patterns

Goal 13. Take urgent action to combat climate change and its impacts*

Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development

Goal 15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss

Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels

Goal 17. Strengthen the means of implementation and revitalize the global partnership for sustainable development.

Similarities and Differences

Outline of the similarities and differences between the Millennium Development Goals (MDGs) launched in 2000, and the Sustainable Development Goals (SDGs) in 2015 when the MDGs expired

- **Zero Goals:** The MDG targets for 2015 were set to get us "half way" to the goal of ending hunger and poverty, with similar proportional goals in other fields. The SDGs are designed to finish the job – to get to a statistical "zero" on hunger, poverty, preventable child deaths and other targets. This approach will call for very different strategies: getting "halfway there" encouraged countries to "do the easiest parts first." Getting to zero requires a real focus on the empowering the poorest and hardest to reach.
- **More Comprehensive Goals:** There were 8 MDGs. There are 17 SDGs

- **Inclusive Goal Setting:** The MDGs were created through a top-down process. The SDGs are being created in one of the most inclusive participatory processes the world has ever seen
- **Distinguishing Hunger and Poverty:** In the MDGs, Hunger and Poverty were joined together in MDG1 – as if solving one would solve the other. So much has been learned about nutrition since that time, and the SDGs treat the issue of poverty separately from Food and Nutrition Security.
- **Funding:** The MDGs were largely envisioned to be funded by aid flows – which did not materialize. The SDGs put sustainable, inclusive economic development at the core of the strategy, and address the ability of countries to address social challenges largely through improving their own revenue generating capabilities.
- **Peace Building:** The inclusion of peace-building in SDGs is critical to the success of ending hunger and poverty — yet was totally ignored in the MDGs.
- **Data Revolution:** The MDGs said nothing about monitoring, evaluation and accountability – the SDGs target by 2020 to "increase significantly the availability of high-quality, timely and reliable data disaggregated by income, gender, age, race, ethnicity, migratory status, disability, geographic location and other characteristics relevant in national contexts."
- **Quality Education:** The MDGs focused on quantity (eg, high enrollment rates) only to see the quality of education decline in many societies. The SDGs represent the first attempt by the world community to focus on the quality of education – of learning – and the role of education in achieving a more humane world: "education for sustainable development and sustainable lifestyles, human rights, gender equality, promotion of a culture of peace and non-violence, global citizenship, and appreciation of cultural diversity and of culture's contribution to sustainable development."

Role of Niti Aayog in SDGs

NITI Aayog has been entrusted with the role to co-ordinate 'Transforming our world: the 2030 Agenda for Sustainable Development' (called as SDGs). The task at hand for NITI Aayog is not merely to periodically collect data on SDGs but to act proactively pursue the goals and targets not only quantitatively but also maintaining high standards of quality. Ministry of Statistics and Programme Implementation (MoSPI) has already undertaken a parallel exercise of interaction with the ministries to evolve indicators reflecting the SDG goals and targets.

To achieve these tasks, the draft mapping of the goals and targets as an initial step on proposed Nodal and other Ministries has been carried out in consultation with MoSPI. Further, as an illustration, the Centrally Sponsored Schemes (CSSs), including the 'core of the core', 'core' and 'optional' Schemes being implemented by the States have been mapped alongwith some of the recent initiatives undertaken by the Central Government. In addition, Ministries are implementing Central Sector Schemes and States are also implementing various State Schemes aligned with one or more SDGs.

Voluntary National Review of Implementation of SDGs in India

As a signatory to the 2030 Agenda for Sustainable Development, India is committed to participate in the international review of progress of Sustainable development Goals (SDGs) on a regular basis. The central platform for international follow-up and review of the 2030 Agenda is the High-Level Political Forum (HLPF), which has started meeting annually since 2016 under the auspices

of the UN Economic and Social Council (ECOSOC). In the HLPF, UN member countries are expected to present their Voluntary National Review (VNR) on implementation of SDGs. The VNRs thus serve as a basis for international review of progress of SDGs.

The 2017 HLPF was held in July 2017 at the United Nations, New York. It focused on the theme: 'Eradicating poverty and promoting prosperity in a changing world' and on the SDGs 1 (No Poverty); 2 (Zero Hunger); 3 (Good Health and Well-Being); 5 (Gender Equality); 9 (Industry, Innovation and Infrastructure), 14 (Life Below Water) and 17 (Partnerships for the Goals).

As a part of its role, NITI Aayog has presented the 1 st Voluntary National Review on implementation of SDGs in the country to the 2017 HLPF in July 2017

The report details various measures and programmes being implemented across India towards achieving the core objectives of the 17 ambitious global goals, including poverty eradication, economic growth, ending hunger and achieving food security, gender equality, promoting inclusive and sustainable industrialisation and climate action. The programmes highlighted in the report are the 'Mahatma Gandhi National Rural Employment Guarantee Act', 'Beti Bachao Beti Padhao', 'Sagarmala', 'Clean India' campaign and the Aadhaar Act.

The report said that externally, the country has played a key role in shaping the SDGs and ensuring the balance among its three pillars - economic, social and environmental. Internally, it has launched many programmes to make progress towards these goals. India said it will continue to pursue the implementation of the SDG agenda through close collaboration between the national and sub-national governments as well as active participation of all other relevant stakeholders. It also said that apart from integrating the SDGs into its on-going national and sub-national policies and programmes, India will continue to focus on nurturing partnerships at the regional and global levels," the country's review report said.

New Delhi

It will work towards ensuring a greater flow of finances and technology from developed countries - in alignment with their explicit commitment in the context of the 2030 Agenda - to developing and least developed nations

India's VNR

Government sees **SDG 1** on the most important goal, which needs continued economic growth to be achieved. The key programmes were: PM Jan Dhan Yojana (world's largest financial inclusion programme), National Rural Drinking Water Programme, Swaachh Bharat Mission (Clean India Mission), Housing for All by 2020, and PM's rural roads programme.

SDG 2 on ending hunger, improving nutrition programmes: doubling farmers income by 2022, Integrated Child Development Services, Public Distribution System, and the mid-day meal programme.

SDG 3 on health and wellbeing programmes: National Health Mission, National Vector Borne Disease Programme, and National Programme for Prevention of Non-communicable Diseases.

SDG 5 on gender equality ("the most important SDG as well, in addition to the eradication of poverty"): Save the Girl Child, Educate the Girl Child, Maternity Benefit Programme, Women Transforming India, and Stand Up India.

SDG 9 on Infrastructure and Innovation: Rural Electrification scheme (reached 99% of Indian homes already), Make in India, (building roads and infrastructure, FDI), Attal Innovation Mission.

SDG 14 on life under the water: Mangroves for the Future, National Oil Spill Contingency Plan 2015, National Policy on Marine Fisheries 2017, and Sagarmala (port-led development).

SDG 17 on global partnership for sustainable development: Direct tax reform, GST, public private partnerships, south-south cooperation, Aadhar, direct benefits transfer, and having 2% of company profits being spent on social programmes.

India expects developed countries to help developing ones to reach these goals, especially in the area of curbing illicit financial flows.

Universal Basic Income (UBI)

A universal basic income is a form of social security in which all citizens or residents of a country receive a regular, unconditional sum of money, from government, It is being debated across the world as automation threatens jobs; growth being low needs to be stimulated with basic income and as a form social security. There are advantages:

Transparency: Basic income is a much simpler and more transparent welfare system than the one existing in the welfare states around the world today. Instead of having numerous welfare programs, it would simply be one universal unconditional income. This strategy for introducing basic income is controversial because some basic income supporters argue that it should be added to the existing welfare system rather than a replacement for it. Also, money may not buy goods where people are in remote areas and markets have not developed. Further, there are questions about quality of goods and services and inflation.

Administrative efficiency: One of the benefits of a basic income is lower overall cost than that of the current one. For example, aadhaar linkage and direct transfer. However, if basic income does not deliver is reversed, it becomes problematic as because of it the welfare administration is dismantled like the PHCs, PDS shops etc.

Poverty reduction: Basic income is often argued for by its advocates because of its potential to reduce poverty, or even eradicate poverty. But the claims are contested as the fiscal space available in a country like India is limited and markets have not penetrated.

Basic income and growth: Basic income and growth allows for economic growth: there is assured demand because of the transfers. This is also debatable as the continuation is not guaranteed and so investors confidence may not be high to produce.

Freedom: Beneficiaries can use the income for whatever they want. The down side is that it will open up the faultlines like girls and women being sidelined; wasteful expenditure may be spent on etc. There is also a belief among critics that if people have free and unconditional money, they will not work (as much). Less work means less tax revenue and hence less money for the state and cities to fund public projects. There are also concerns that some people will spend their basic income on alcohol and drugs

Basic income in India started with the project organized by India's Self Employed Women's Association (SEWA) with support from UNICEF in 2011.

In total there are 20 villages in the project.According to pilot projects, positive results were found.Villages spent more on food and healthcare, children's school performance improved in 68% of families, time spent in school nearly tripled, personal savings tripled, and new business startups doubled.

In India the existing subsidies may be pruned by aadhaar linkage and the fiscal savings thus generated may be used for basic income whether it is for schemes like buying internet time or for health expenditure etc. But enormous care should be taken not to be overrun by the exuberance for UBI as that may lead to the existing structures for welfare being replaced by adhoc schemes. Economic Survey 2017 began the debate about the pros and cons of UBI.

Multidimensional Poverty Index (MPI)

Poverty is often defined by one-dimensional measures, such as income. But no one indicator alone can capture the multiple aspects that constitute poverty. Multidimensional poverty is made up of several factors that constitute poor people's experience of deprivation – such as poor health, lack of education, inadequate living standard, lack of income (as one of several factors considered), disempowerment, poor quality of work and threat from violence. A multidimensional measure can incorporate a range of indicators to capture the complexity of poverty and better inform policies to relieve it. Different indicators can be chosen appropriate to the society and situation.

The Multidimensional Poverty Index (MPI) was developed in 2010 by Oxford Poverty & Human Development Initiative and the United Nations Development Programme and uses different factors to determine poverty beyond income-based lists. It replaced the previous Human Poverty Index.

The index uses the same three dimensions as the Human Development Index: health, education, and standard of living. These are measured using ten indicators.

Dimension	Indicators
Health	• Child Mortality • Nutrition
Education	• Years of school • Children enrolled
Living Standards	• Cooking fuel • Toilet • Water • Electricity • Floor • Assets

Each dimension and each indicator within a dimension is equally weighted.

The MPI is an index of acute multidimensional poverty. It shows the number of people who are multi-dimensionally poor (suffering deprivations in 33% of weighted indicators) and the number of deprivations with which poor households typically contend.

INEQUALITY

Economic inequality refers to how economic resources and opportunities are unevenly distributed among people in general- some having disproportionately high some equally disproportionately deprived. It essentially refers to disparities in the distribution of economic assets and income- among individuals and groups within a nation and among nations- it has many dimensions: income, wealth and consumption.

Income Inequality: It refers to the extent to which income is distributed in an uneven manner among a population. Income includes the revenue streams from wages, salaries, interest on a savings account, dividends from shares of stock, rent and profits. In 2017, income disparities have become so pronounced that America's top 10 percent now average more than nine times as much income as the bottom 90 percent. US's top 0.1 percent are making over 198 times the income of the bottom 90 percent.

Wealth Inequality: Wealth refers to the total amount of assets of an individual or household. This may include financial assets, property, gold etc. Wealth inequality thus refers to the unequal distribution of assets among people.

Consumption Inequality: Increases in income and wealth inequality lead to higher inequality in outcomes such as consumption, health, education, transport, entertainment and overall well-being. In economics, it is these outcomes that actually enter the utility function, not income or wealth.

An increase in *consumption inequality* means the poor are buying fewer goods and services as their incomes have declined . Part of the decline is made up by welfare state intervention but the decline is real.

New Delhi

Technically, growth in income and wealth inequality need not mean less consumption by the poor. It is possible that rich are getting richer faster than the poor becoming less poor. But facts are otherwise. Rich are getting rich while the number of poor is growing. It is seen in the fact that economic growth is handicapped by demand deficit which is caused by consumption going down in the USA. Its economic potential is not being realized due to demand constraints.

It may result from the operation of the economic system, access to assets, nature of laws, education and skills, social factors like caste and gender etc.

The Consequences of Rising Inequality

On the human side, absolute and relative deprivation is appalling.

On the economic side, rich become so influential that crony capitalism results.

When wealthy individuals and corporations influence the government policy to their advantage: low minimum wage, no or limited national health insurance, inadequate spending on health, safety or pollution regulations, access etc. Thus, rising inequality has the danger of it aggravating even more.

On the social side, the faultlines in society become reinforced: gender, caste, ethnic and other divides become even more polarized.

Environmental danger deepen as there is no bottom up inputs in policy making and growth at any cost prevails.

Poverty-Inequality Link

Poverty is deprivation of basic human needs. It can be relative (depending on the national income/per capita of the country) or absolute which is deprivation of basic needs.

Inequality is always a relative term: how are different strata in the society placed with reference to the others.

As mentioned above, poverty and inequality generally go together but it need not necessarily be the case, even if absolute inequality rises.

Measures of Inequality

Gini Coefficient

The Gini coefficient measures inequality across the whole of society.If all the income/wealth goes to a single person (maximum inequality) and all others receive nothing, the Gini coefficient is equal to 1. If income is shared equally with everyone receiving the same amount, the Gini is equal to 0. The lower the Gini value, the more equal a society, as is evident from above. Most OECD countries have a coefficient lower than 0.32 with the lowest being 0.24. The UK, a fairly unequal society, scores 0.35 and the US, an even more unequal society, 0.38. In contrast, Denmark, a much more equal society, scores 0.25. The Gini Coefficient India is estimated to be close to 0.50.

New Delhi

The Gini coefficient can measure inequality before or after tax and before or after housing costs. The Gini will change depending on what is measured. A recent paper by well-known economists Lucas Chancel and Thomas Piketty say that India's pre-tax economic inequality is the highest since Independence (2017). The top one percent of income earners are garnering 22 per cent of total income in India.While the period 1951 to 1980 saw the poor narrowing the income gap with the well-to-do, the trend has reversed over the period 1980-2014.

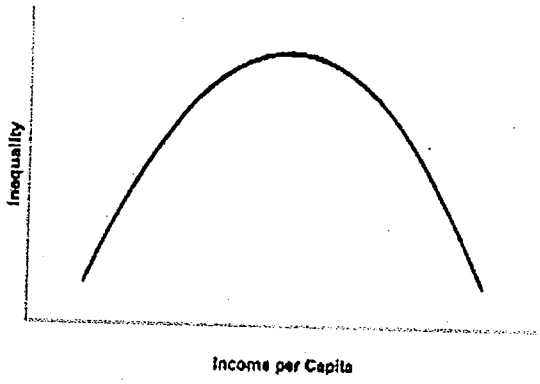
When we calculate the post-tax Gini Coefficient for India, it is likely to be lower the progressive income tax and corporate tax rates that India has particularly since 2013 are reducing disparity. Also, government welfare schemes are many and are working relatively well with Aadhhar, DBT and social audit.

Ahluwalia-Chenery Welfare Index

GDP may grow but the distribution of economic resources may in fact worsen making the rich richer and the poor poorer. Thus, inclusive growth and not merely growth is required. An index that measures how all social groups are impacted by growth is necessary. This problem was recognized by Montek Singh Alhuwalia. Alhuwalia's solution, the Ahluwalia-Chenery Welfare Index, measures how each social group is impacted from the prosperity. It is an alternative measure of income growth, one that gives equal weight to growth of all sections of society.

Kuznets Curve

Economist Simon Kuznets had hypothesised that, as an economy develops, inequality increases but later reduces. In other words, the shape of the Kuznets curve is like an inverted U. Japan, Germany and some other social democracies in Europe support the hypothesis.



Kuznets Curve and Thomas Piketty

Kuznets Curve says: the natural progression of development is towards industrialisation and urbanisation. Initially, this leads to increased inequality in society, as capitalists get richer and the influx of rural labour holds wages down.But as employment opportunities grow and the flow of cheap rural labour ia no longer there, wages rise and an equalisation tendency appears, which gets stronger over time. Thus, if we plot inequality against time, we get an inverted-U or bell-shaped curve. If this hypothesis were true, it would show that the "trickle down" of the benefits of growth to all is a natural and automatic part of market economies: "a rising tide lifts all boats".

The recent work of Thomas Piketty, Capital in the Twenty-First Century, questions the Kuznets Curve.Piketty shows that since 1980, there has been a sharp rise in inequality in the US, Japan and Europe. His data shows a U-curve in the trends of inequality in the advanced nations - US, Japan, Germany, France and Great Britain - the exact opposite of the Kuznets Curve. Inequality grows sharply after having fallen initially for a few years.

Piketty shows that there is nothing natural or automatic about declining inequality under market system. It is the destruction of war, the policies of a Keynesian welfare state and a strong labour movement that led to a decline in inequality in the 60-year period (1914-1974) . The trend shifted towards greater market forces and so inequality rose again since the 1980's and the result is the rise in inequality.

The most important engine that drives inequality up, according to Piketty, is the higher rate of return on capital compared to the low overall growth rate of the economy. In slowly growing economies, past wealth takes on a disproportionately higher importance. Inherited wealth grows faster than overall output and income.

Piketty says that there are powerful forces that can mitigate inequality. He specifically identifies diffusion of knowledge and skill as a key factor. But these too depend on state policies on education, access to training and skill development

Kuznets curve was a very tentative hypethesis by Kuznets who said: "Effective work in this field necessarily calls for a shift from market economics to political and social economy."

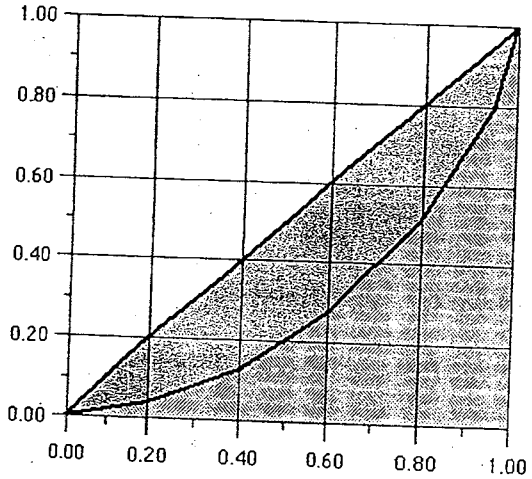
Palma Ratio

Unlike Gini index, ratio measures compare how much people in strata of the income distribution have compared to people at another. For instance, the 20:20 ratio compares how much richer the top 20% of people are, compared to the bottom 20%. For example, Palma ratio used by Oxfam is the ratio of the income share of the top 10% to that of the bottom 40%. In more equal societies this ratio will be one or below, : the top 10% does not receive a larger share of national income than the bottom 40%. In very unequal societies, the ratio may be as large as 7.

Lorenz Curve

The Lorenz curve was developed by Max O. Lorenz as a graphical representation of income inequality. It can be used to measure inequality of income or assets or any other facility.The Lorenz curve is the graphical representation of the Gini data. Gini coefficient is derived by taking the following two:

- area between the line of perfect equality and the Lorenz curve(a)
- area between the line of perfect equality and the line of perfect inequality (b)



Gini number is arrived when a is divided by b.

Ahluwalia-Chenery Welfare Index

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Gender Inequality Index (GII)

The Gender Inequality Index (GII) is an index for measurement of gender disparity that was introduced in the 2010 Human Development Report 20th anniversary edition by the United Nations Development Programme (UNDP). According to the UNDP, this index is a composite measure which captures the loss of achievement, within a country, due to gender inequality, and uses three dimensions to do so: reproductive health, empowerment, and labor market participation. The new index was introduced to remedy the shortcomings of the previous, and no longer used,

indicators, the Gender Development Index (GDI) and the Gender Empowerment Measure (GEM), both of which were introduced in the 1995 Human Development Report.

GII is the first index to include reproductive health indicators as a measurement for gender inequality. The GII's reproductive healthhave two indicators: the Maternal Mortality Ratio (MMR) and the adolescent fertility rate (AFR). With a low MMR, it is implied that pregnant women have access to adequate health needs, therefore the MMR is a good measure of women's access to health care. The UNDP expresses that women's health during pregnancy and childbearing is a clear sign of women's status in society. A high AFR, which measures early childbearing, results in health risks for mothers and infants as well as a lack of higher education attainment. According to the UNDP data, reproductive health accounts for the largest loss due to gender inequality, among all regions.

The empowerment dimension is measured by two indicators: the share of parliamentary seats held by each sex, which is obtained from the International Parliamentary Union, and higher education attainment levels, which is obtained through United Nations Educational, Scientific and Cultural Organization (UNESCO) and some other sources. The GII index of higher education evaluates women's attainment to secondary education and above. Access to higher education expands women's freedom by increasing their ability to question and increases their access to information which expands their public involvement. There is much literature that finds women's access to education may reduce the AFR and child mortality rates within a country. Although women's representation in parliament has been increasing women have been disadvantaged in representation of parliament with a global average of only 16%.

The labor market dimension is measured by women's participation in the workforce. This dimension accounts for paid work, unpaid work, and actively looking for work. The data for this dimension is obtained through the International Labour Organization databases. Due to data limitations women's income and unpaid work are not represented in the labor market dimension of GII.

The metrics of the GII are similar in calculations to the Inequality-adjusted Human Development Index (IHDI), which was also introduced in the 2010 Human Development Report, and can be interpreted as a percentage loss of human development due to shortcomings in the included dimensions. The value of GII range between 0 to 1, with 0 being 0% inequality, indicating women fare equally in comparison to men and 1 being 100% inequality, indicating women fare poorly in comparison to men. There is a correlation between GII ranks and human development distribution, according to the UNDP countries that cxhibit high gender inequality also show inequality in distribution of development, and vice versa.

Inter-Group Equality

Inclusiveness is not just about bringing those below an official fixed poverty line to a level above it. It is also about a growth process which is seen to be 'fair' by different socio-economic groups that constitute our society. The poor are certainly one target group, but inclusiveness must also embrace the concern of other groups such as the Scheduled Castes (SCs), Scheduled Tribes (STs), Other Back- ward Classes (OBCs), women, minorities, the differently abled and other marginalised groups. These distinct 'identity groups' are sometimes correlated with income slabs the SCs and STs, for example, are in the lower income category and all poverty alleviation strategies help them directly. Women on the other hand span the entire income spectrum, but there are gender-based issues of inclusiveness that are relevant all along the spectrum.

Inclusiveness from a group perspective goes beyond a poverty reduction perspective and includes consideration of the status of the group as a whole relative to the general population. For example, narrowing the gap between the SCs or STs and the general population must be part of any reasonable definition of inclusiveness, and this is quite distinct from the concern with poverty, or inequality, though the two are related.

Balanced Regional Development (BRD) and Inclusive Growth

Another aspect of inclusiveness relates to whether all States, and indeed all regions, are seen to benefit from the growth process. The regional dimension has grown in importance in recent years. On the positive side, many of the erstwhile backward States have begun to show significant improvement in growth performance and the variation in growth rates across States has narrowed. However, both the better performing and other States are increasingly concerned about their backward regions, or districts, which may not share the general improvement in living standards experienced elsewhere. Many of these districts have unique characteristics including high concentration of tribal population in forested areas, or Minorities in urban areas. Some districts are also affected by left wing extremism, making the task of development much more difficult.

Government pays special attention to the scope for accelerating growth in the States that are lagging behind. This requires strengthening of States' own capacities to plan, to implement and to bring greater synergies within their own administration and with the Central Government. An important constraint on the growth of backward regions in the country is the poor state of infrastructure, especially road connectivity, schools and health facilities and the availability of electricity, all of which combine to hold back development. Improvement in infrastructure must therefore be an important component of any region- ally inclusive development strategy.

The efforts of the govt in this regard are

- special category states
- Green revolution in the eastern region
- North eastern region Vision 2020
- PMGSY
- Bharatmala(2017)
- Saubhagya(2017)
- DDY
- PMAY

Green Revolution in Eastern India

It was during Union Budget 2010-11 that for the first time, separate funds were allocated for the eastern parts of the country. The scheme, which comes under Rashtriya Krishi Vikas Yojana, includes Assam, Bihar, Jharkhand, eastern UP, Chhattisgarh, Odisha and West Bengal. Rice was a priority crop under the scheme. The other areas of focus were asset-building activities such as water management, construction of farm ponds and repair of irrigation channels. The main motive behind this project is to ensure food security. The idea is to tap the eastern region for food grains and pulses. The Centre has also allocated finance for encouraging crop diversification to promote technological innovation. The original Green Revolution States face the problem of stagnating yields and over-exploitation of water resources. The answer lies in crop diversification.

Impact of inequality etc.

When inequality is growing, economic growth will not achieve its potential in reducing poverty. Steep inequality damages the long-term prospects for economic growth by creating conflict or instability and it also limit growth by restricting the number of people who can participate in markets. Urban-dominated growth in India has caused social friction as a result of the high levels of migration to cities and a shortage of foreign investment in more isolated areas.

To examine why growth is not reducing inequality, we need to see the fact that income growth is concentrated in certain urban centers, and those whose incomes increase are usually already above average in income and education, that those best positioned to gain from new economic opportunities are the educated urban-dwellers. On the other hand, the poor rely mainly on agriculture, and the agricultural sector has not been growing as fast as other sectors in most of Asia. They are not very high on human capital- education and skills and so can not enjoy the fruits of growth. Their health standards are low and thus can not be very productive and innovative which make the poverty cycle vicious for them.

The current context of new technologies, market-oriented reforms and globalization has not favored the agricultural sector. Other causes of the agricultural sector's lackluster growth include: the decrease in transfers of new technology to farmers, and government that invest little in agriculture and do little to encourage private investment in the sector.

Given that high levels of inequality are partly the result of government policy, government should address inequalities by introducing policies that ensure labour intensive growth; backward region development; social security; increased public investment in agriculture. Skills and training programs etc.

For millions of children, inequality means not having access to adequate nutrition, health, and basic education. Therefore, public policy has huge challenges in providing these services.

In sum, main reasons for widening economic gaps in recent years are:

- stagnation in agriculture while the economy is growing
- discrepancy in investment between urban and rural areas which favoured better-educated, better-off urban populations.
- Improvements in rural infrastructure were being held back by government policies which deterred private investment.
- Unevenness in growth in incomes across urban and rural areas, leading and lagging regions in the country, for example coastal and interior, and highly educated households and the less educated are important factors associated with increases in inequality.

Social Security

Certain social conditions need protection to prevent further distress - old age, poverty, unemployment, disability etc. Government provides social protection by way of wage employment, food grain either free or at affordable prices, old age pension etc. In some cases there is social insurance for disability etc.

In social insurance people receive benefits or services in return for contributions to an insurance scheme. These services include provision for retirement pensions, disability insurance, etc. Public distribution system in India is a social security example.

Social safety net is similar. It involves a collection of services provided by the state or other institutions including welfare, unemployment benefit, universal healthcare, homeless shelters etc to prevent individuals from falling into poverty beyond a certain level. For example, NREGA in India.

For many decades now, there have been laws in India that provided social security.

- **Workmen's compensation Act 1923:** A beginning was made in social security with the passing of the Workmen's Compensation Act in 1923. The Act provides for payment of compensation to workmen and their dependents in case of injury and accident (including certain occupational disease) arising out of and in the course of employment and resulting in disablement or death.
- **Maternity benefit scheme:** The Maternity Benefit Act, 1961 regulates employment of women in certain establishments for a certain period before and after childbirth and provides for maternity and other benefits.
- **Gratuity scheme:** The Payment of Gratuity Act, 1972 provides for payment of gratuity at the rate of 15 days' wages for each completed year of service subject to certain maximum.
- **Employees state insurance scheme:** The Employees' State Insurance Act provides medical care in kind and cash benefits in the contingency of sickness, maternity and employment injury and pension for dependents in the event of the death of a worker because of employment injury.
- **Employees provident fund:** Retirement benefits in the form of provident fund, family pension and deposit-linked insurance are available to employees.
- Employees Pension scheme
- Atal Bima Yojana
- Rashtriya Swasthya Bima Yojana
- Unorganised Workers Social Security Act 2008

EAG

The government had constituted an Empowered Action Group (EAG) under the Ministry of Health and Family Welfare following 2001 census to stabilise population in eight states (called EAG states) that were lagging in containing population. As per the latest census, EAG states Bihar, Jharkhand, Uttar Pradesh, Uttarakhand, Rajasthan, Madhya Pradesh, Chhattisgarh and Odisha have shown little improvement. They cover over 45 per cent of India's population.

EAG needs to strengthen the systems of governance and monitoring. However, the greater need is to involve the community successfully through local empowerment and convergence. In a federal structure like India, there is need to strengthen the Centre-State coordination before direct interventions can be made at district levels. Problems in the EAG States are less to do with the availability of funds than the issue of governance. Therefore, proposals for resolving the systemic issues relating to key areas such as human resource management, logistics management, integration of numerous health societies at State and district levels, regular release of funds to

operational levels, joint planning/training for the field staff of the cognate departments, greater autonomy to the districts and within districts, to hospitals and PRIs, are integral parts of the plan. Among the Empowered Action Group (EAG) states and Assam, all states except Uttarakhand have registered the decline in the infant mortality rate in 2016 in comparison to 2015 as reported in 2017.

Aajeevika Grameen Express Yojana (AGEY)

The Government of India has decided to launch a new sub-scheme named "Aajeevika Grameen Express Yojana (AGEY)" as part of the Deendayal Antyodaya Yojana – National Rural Livelihoods Mission (DAY-NRLM). The Self Help Groups under DAY-NRLM will operate road transport service in backward areas. This will help to provide safe, affordable and community monitored rural transport services to connect remote villages with key services and amenities (such as access to markets, education and health) for the overall economic development of backward rural areas. This will also provide an additional avenue of livelihood for SHGs.

The Community Investment Fund (CIF) provided to Community Based Organization (CBOs) under DAY-NRLM will be utilized to support the SHG members in this new livelihoods initiative. The beneficiary SHG member will be provided an interest free loan by the CBO from its Community Investment Fund upto Rs.6.50 lakh for purchase of the vehicle. Alternative, CBO will own the vehicle and lease it to an SHG member to operate the vehicle and pay lease rental to the CBO.

AGEY will be initially implemented in 250 Blocks in the country on pilot basis with each Block provided upto 6 vehicles to operate the transport services. The Blocks will be selected by States from among the Blocks where NRLM is being implemented intensively and where mature CBOs are already functioning. Backwardness, lack of transportation links and sustainability of service would be the guiding factors in the selection of Blocks and routes.

The State Rural Livelihood Missions (SRLMs) will do a feasibility study and traffic survey in the selected blocks to identity the routes and the number and capacity of vehicles which can be operated on sustainable basis. The study will be conducted by technically sound organizations with expertise in transport network planning. The choice of vehicle could be either e-riksha, 3 wheeler or 4 wheeler within a cost ceiling of Rs.6.50 lakh.
The SRLMs will be co-ordinating with State Transport Department for issue of permit for the vehicle. The SHG member operating the vehicle shall ensure that all necessary legal and statutory requirement such as valid permit, road tax permit, valid insurance policy etc. are met. The SHG member shall run the vehicle on approved routes at pre-determined frequency as jointly agreed between the CBO and the SHG operator based on financial viability and the need for transport link. All vehicles under the scheme shall have a defined colour code and carry AGEY branding to ensure their identity and avoid diversion to other routes.

The State Rural Livelihood Mission will arrange capacity building for their staff at State, District and Block levels for operating the Scheme. The members of the CBO and the beneficiary SHG member shall also be provided adequate training in the Rural Self Employment Training Institutes (RSETIs) and other partner organizations.

National Rural Livelihoods Mission (NRLM)

The Ministry of Rural Development, Government of India launched in 2013 a new programme known as National Rural Livelihoods Mission (NRLM) by restructuring and replacing Aajeevika programme which was earlier the Swarnjayanti Gram Swarozgar Yojana (SGSY). NRLM was renamed as DAY-NRLM (Deendayal Antyodaya Yojana - National Rural Livelihoods Mission) in 2016 and is the flagship program of Govt. of India for promoting poverty reduction through building strong institutions of the poor, particularly women, and enabling these institutions to access a range of financial services and livelihoods services.

DAY-NRLM is designed to be a highly intensive program and focuses on intensive application of human and material resources in order to mobilize the poor into functionally effective community owned institutions, promote their financial inclusion and strengthen their livelihoods. DAY-NRLM complements these institutional platforms of the poor with services that include financial and capital services, production and productivity enhancement services, technology, knowledge, skills and inputs, market linkage, etc. The community institutions also offer a platform for convergence and partnerships with various stakeholders by building environment for the poor to access their rights and entitlements and public service.

A women's self-help group, coming together on the basis of mutual affinity is the primary building block of the DAY-NRLM community institutional design. DAY-NRLM focuses on building, nurturing and strengthening the institutions of the poor women, including the SHGs and their Federations at village and higher levels. In addition, DAY-NRLM promotes livelihood institutions of rural poor. The mission provides a continuous hand-holding support to the institutions of poor for a period of 5-7 years till they come out of abject poverty. The community institutional architecture put in place under DAY-NRLM will provide support for a much longer duration and of a greater intensity.

New Delhi

The support from DAY-NRLM includes all round capacity building of the SHGs ensuring that the group functions effectively on all issues concerning their members, financial management, providing them with initial fund support to address vulnerabilities and high cost indebtedness, formation and nurturing of SHG federations, making the federations evolve as strong support organizations, making livelihoods of the poor sustainable, formation and nurturing of livelihoods organizations, skill development of the rural youth to start their own enterprises or take up jobs in organized sector, enabling these institutions to access their entitlements from the key line departments, etc.

The implementation of DAY-NRLM has been in a Mission Mode since 2013. DAY-NRLM adopts a demand driven approach, enabling the States to formulate their own State specific poverty reduction action plans. DAY-NRLM enables the State rural livelihoods missions to professionalize their human resources at State, district and block level. The State missions are capacitated to deliver a wide range of quality services to the rural poor. DAY-NRLM emphasizes continuous capacity building, imparting requisite skills and creating linkages with livelihoods opportunities for the poor, including those emerging in the organized sector, and monitoring against targets of poverty reduction outcomes. The blocks and districts in which all the components of DAY-NRLM will be implemented, either through the SRLMs or partner institutions or NGOs, will be the intensive blocks and districts, whereas remaining will be non-intensive blocks and districts. The selections of intensive districts are done by the states based on the demographic vulnerabilities. It will be rolled out in a phased manner over the next 7-8 years. All blocks in the country will become intensive blocks over time.

Women SHGs and their Federations

Women SHGs under DAY-NRLM consist of 10-20 persons. In case of special SHGs i.e. groups in the difficult areas, groups with disabled persons, and groups formed in remote tribal areas, this number may be a minimum of 5 persons. DAY-NRLM promotes affinity based women Self –help groups. Only for groups to be formed with Persons with disabilities, and other special categories like elders, transgenders, DAY-NRLM will have both men and women in the self-help groups. SHG is an informal group and registration under any Societies Act, State cooperative Act or a partnership firm is not mandatory .However, Federations of Self Help Groups formed at village, Gram Panchayat, Cluster or higher level may be registered under appropriate acts prevailing in their States.

Financial Assistance to the SHGs

Revolving Fund (RF): DAY-NRLM would provide Revolving Fund (RF) support to SHGs in existence for a minimum period of 3/6 months and follow the norms of good SHGs, i.e. they follow 'Panchasutra' – regular meetings, regular savings, regular internal lending, regular recoveries and maintenance of proper books of accounts. Only such SHGs that have not received any RF earlier will be provided with RF, as corpus, with a minimum of ₹10,000 and up to a maximum of ₹15,000 per SHG. The purpose of RF is to strengthen their institutional and financial management capacity and build a good credit history within the group.

Community Investment support Fund (CIF)

CIF will be provided to the SHGs in the intensive blocks, routed through the Village level/ Cluster level Federations, to be maintained in perpetuity by the Federations. The CIF will be used, by the Federations, to advance loans to the SHGs and/or to undertake the common/collective socio-economic activities.

DAY - NRLM Values

New Delhi

The core values which guide all the activities under NRLM are as follows:

- Inclusion of the poorest, and meaningful role to the poorest in all the processes
- Transparency and accountability of all processes and institutions
- Ownership and key role of the poor and their institutions in all stages – planning, implementation, and, monitoring
- Community self-reliance and self-dependence

Key Features

- **Universal Social Mobilisation:** At least one woman member from each identified rural poor household, is to be brought under the Self Help Group (SHG) network in a time bound manner. Special emphasis is particularly on vulnerable communities such as manual scavengers, victims of human trafficking, Particularly Vulnerable Tribal Groups (PVTGs), Persons with Disabilities (PwDs) and bonded labour. NRLM has devised special strategies to reach out to these communities and help them graduate out of poverty.
- **Participatory Identification of Poor (PIP):** The inclusion of the target group under NRLM is determined by a well-defined, transparent and equitable process of participatory identification of poor, at the level of the community. All households identified as poor through the PIP process is the NRLM Target Group and is eligible for all the benefits under the programme. Target Group is identified through the Participatory Identification of Poor (PIP) method.

- **Community Funds as Resources in Perpetuity:** NRLM provides Revolving Fund (RF) and Community Investment Fund (CIF) as resources in perpetuity to the institutions of the poor, to strengthen their institutional and financial management capacity and build their track record to attract mainstream bank finance.
- **Financial Inclusion:** NRLM works on both demand and supply sides of financial inclusion. On the demand side, it promotes financial literacy among the poor and provides catalytic capital to the SHGs and their federations. On the supply side, the Mission coordinates with the financial sector and encourages use of Information, Communication & Technology (ICT) based financial technologies, business correspondents and community facilitators like 'Bank Mitras'. It also works towards universal coverage of rural poor against risk of loss of life, health and assets. Further, it works on remittances, especially in areas where migration is endemic.
- **Livelihoods:** NRLM focuses on stabilizing and promoting existing livelihood portfolio of the poor through its three pillars – 'vulnerability reduction' and 'livelihoods enhancement' through deepening/enhancing and expanding existing livelihoods options and tapping new opportunities in farm and non-farm sectors; 'employment' - building skills for the job market outside; and 'enterprises' - nurturing self-employed and entrepreneurs (for micro-enterprises).
- **Convergence and partnerships**
- **Convergence:** NRLM places a high emphasis on convergence with other programmes of the MoRD and other Central Ministries. Convergence is also sought with programmes of state governments for developing synergies directly or indirectly with institutions of the poor.
- **Partnerships with NGOs and other CSOs:** NRLM has been proactively seeking partnerships with Non-Government Organizations (NGOs) and other Civil Society Organizations (CSOs), at two levels - strategic and implementation. The partnerships are guided by NRLM's core beliefs and values, and mutual agreement on processes and outcomes. Partnership guidelines to partner with NGOs, CSOs have been finalized and approved this year.
- **Linkages with PRIs:** In view of the eminent roles of Panchayat Raj Institutions (PRIs), it is necessary to consciously structure and facilitates a mutually beneficial working relationship between Panchayats and institutions of the poor, particularly at the level of Village Panchayats. Formal platforms would be established for regular consultations between such institutions and PRIs for exchange of mutual advice, support and sharing of resources.

Saubhagya

Pradhan Mantri Sahaj Bijli Har Ghar Yojana (Saubhagya) may emerge as the foundation for multiple growth related, inclusive and environmental goals: reduce import of fossil fuels, boost underutilized power plants and meet its climate change commitments. By providing universal access to electricity under the scheme, it helps to promote induction cooking, heating and charging electric vehicles, apart from the initial target of providing lighting. This, in turn, will reduce India's energy imports and generate fresh demand for electricity in the country. The Rs16,320-crore Saubhagya scheme will provide electricity connections to over 40 million families in rural and urban areas by December 2018.

Once there is electricity in the village, it will create a multiplier effect. A service cable will be drawn from the nearest electricity pole to the household premise where an electricity meter will be installed along with the wiring for a single light point with LED bulb and a mobile charging point. Any substitution of fuels for cooking, transportation and heating will improve India's per capita power consumption of around 1,200 kWh which is among the lowest in the world. The scheme will also help India, the world's third largest energy consumer after the US and China, to help meet its global climate change commitments. The government has set a target of lowering import dependence in oil by 10 percentage points to 67% by 2022, when the country will celebrate 75 years of Independence.

There will be advances in areas of electric vehicles and induction cooking. India has drawn up an ambitious plan for a mass shift to electric vehicles by 2030 with state-owned Energy Efficiency Services Ltd (EESL) going ahead with the first stage of procuring 10,000 electric cars. Saubhagya will have several benefits apart from enhancing demand on the grid and viability of stressed assets. Last mile connectivity will provide options to customers to utilise electricity for cooking, mobility, heating and lighting apart from socioeconomic benefits. According to the government, the Saubhagya scheme will require an additional 28,000 megawatt (MW) of power, considering an average load of 1 kilowatt (kW) per household for eight hours in a day.

IMR

Infant mortality rate compares the number of deaths of infants under one year old in a given year per 1,000 live births in the same year. This rate is often used as an indicator of the level of health in a country. India improved on IMR and reported an 8% decline in the infant mortality rate (IMR) in 2016 from a year ago, an improvement aided by a higher number of institutional deliveries and campaigns to promote breastfeeding and immunization. IMR declined to 34 per 1,000 live births last year from 37 per 1,000 live births in 2015, according to the Sample Registration System (SRS) bulletin, released by the Office of the Registrar General in September 2017.

The bulletin said the birth cohort—babies born during the year—had come down to below 25 million for the first time. In 2005, only 38% deliveries were taking place in hospitals; but now, more than 79.8% are institutional deliveries. India has registered 90,000 fewer infant deaths in 2016 as compared to 2015. The total number of estimated infant deaths had declined to 840,000 in 2016 from 930,000 in 2015.

IMR declined in 29 states and Union territories, was stable in two states and increased in five states and Union territories. The highest decline of 7 points was reported by Chandigarh and the highest increase of 6 points was reported by Arunachal Pradesh. The gender difference between female and male IMR has also reduced to less than 10 points. It is a major boost to the 'Beti Bachao Beti Padhao' initiative of the government. Earlier it used to be above 20 points. There has been a gradual change in social systems such as delayed marriages, thereby lesser adolescent pregnancies, and economic status of people with time that has also contributed to progress in health systems. The government identified and targeted 184 districts with the worst IMR to bring about an improvement. Free health services for pregnant women and newborns also helped. The highest IMR in 2016 was reported in Madhya Pradesh (47) followed by Assam and Odisha (44), Uttar Pradesh (43) and Rajasthan (41). Efforts of focusing on low-performing states are paying off. Improvement is attributed to countrywide efforts to expand health services coverage, including reproductive, maternal and newborn health services.

The lowest IMR was reported by Goa (8) followed by Kerala and Puducherry (10). Rural IMR (38) was 15 points higher than the urban IMR (23). In comparison to 2015, the rural-urban difference narrowed by one point (16 to 15). The rural IMR declined by 3 points (41 to 38).

Globalisation And Inequality

The integration of the world economy through the progressive globalization of trade, investment and finance has reached unprecedented levels. This new wave of globalization is having far-reaching implications for the economic well-being of citizens in all regions and among all income groups, and is the subject of active public debate about globalization and its implications for growth and inequality and the distribution of income within countries. The debate on the distributional effects of globalization is often polarized between two points of view. One school of thought argues that globalization leads to a rising tide of income, which raises all boats. Hence, even low-income groups come out as winners from globalization in absolute terms. The opposing school argues that although globalization may improve overall incomes, the benefits are not shared equally among the citizens of a country, with clear losers in relative and possibly even absolute terms. Moreover, widening income disparities may not only raise welfare and social concerns, but may also limit the drivers of growth because the opportunities created by the process of globalization may not be fully exploited.The sustainability of globalization will also depend on maintaining broad support across the population, which could be adversely affected by rising inequality.

Different countries have felt different outcomes under globalization. China tapped its potential fully- even as inequality grew with it, poverty has been dramatically reduced. In US and India, inequality grew due to:

More talented sections having their pay gallop while others grew far less. There are broader and disproportionate upper-income gains. When compared with gains for middle- and lower-income groups. It matters because it influences society's willingness to tolerate inequality and the credibility of globalization.

There is a growing consensus that trade, driven in part by the integration of China into the world economy, has played a role in rising income .Rising import competition has adversely affected manufacturing employment, led firms to either shut down abd become distribution agents for chinese goods or upgrade their production and caused labor earnings to fall. Also, the financial markets with speculative activity made rich richer with others having little or no scope for improving their lot.

Industrialists in some sectors saw their wealth grow as they found their market footprint expanded globally. That made little difference to poor and low income groups and much of it capital-intensive growth.

To bridge the inequality is possible if there are redistributional interventions. There are: RTE, Health Mission, PMGSY, Golden Quadrilateral; NHDP, Digital India, Skill Mission etc. But the progress is slow and the quality in some needs drastic improvement like in schools, hospitals, nutrition and skills. Till the interventions pay off, opportunities for the lower part of the pyramid are likely to stagnate and inequality will rise rapidly.

Populism is one direct effect of globalization falling far short of expectations of the ordinary people.

PUBLIC SECTOR

Evolution, Reforms and Performance

Public sector units are enterprises - some are commercially oriented and some are not (Food Corporation of India) are owned by Government- Central or state- either wholly or at least the majority of shares in each. Public sector enterprise normally has forms of organisational structure like departmental undertakings (Railways etc); statutory corporations (Oil and Natural Gas Corporation Limited); companies registered under the Companies Act 2013 (Bharat Heavy Electricals Limited -BHEL) mainly. Departmental undertakings are not formed by or with the consent of the legislative authority. These are set up by the executive actions of government bodies and are charged with the duty of carrying out specially defined functions. These undertakings are not independent entities. They are subject to budgetary, audit and other controls of the government and are managed by civil servants. They are financed by annual budgets. A departmental undertaking is best suited where the main purpose of the enterprise is to collect revenue for the state and to provide public utilities and services at fair prices in larger public interest. Some examples of departmental undertakings are the Railway, Postal Department etc.

Statutory corporations are enterprises normally engaged in economic or manufacturing activities and are set up by act of legislature. These corporations are legal entities separate from the government and also the persons who conduct their affairs. ONGC, IOC etc are some examples. Shares of such corporations are in the name of the government and these are thus owned and controlled by the government. Statutory corporations enjoy extensive legal autonomy, and their rules, objectives, functions and duties are defined and specified in the Parliamentary Act. Financing statutory corporations is not part of the Budget and therefore, they can retain their revenues, and also spend as per the rules laid down by the statute.

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Control Boards are set up to manage government projects- for example, the river valley projects. Bhakra Management Board.

Government Company is one where the government owns 51% or more of the paid up capital, according to Companies Act 2013.

Rarely, PSE can be in the form of cooperative society to support cooperative movement- Indian Farmers Fertilizer Cooperative Ltd (IFFCO), Krishi Bharati Cooperative Ltd (KRIBHCO) etc. They are registered under Multi State Cooperative Societies Act. Over 65% of the capital of the units is held by the Central Government

In India, we have all these types of PSEs.

Since the beginning of socio-economic planning after the Independence, public sector played a preeminent role in India. Commanding heights of the economy were to be in the hands of the public sector – basically infrastructure and basic industries like heavy engineering, power, metals etc. PSEs dominated the Industrial Policy Statement 1948 and IP Resolution 1956. They were opted for by the Government partly as the Government wanted to steer the economy towards planning goals rapidly and also because of pragmatic compulsions like the presence of the private sector in manufacturing was negligible and they were not willing to take up the unprofitable work of investing in infrastructure.

The objectives of the PSUs are

- To build a self reliant economy
- To prevent/reduce concentration of private economic power
- Establish sound economic infrastructure
- Set up industries in the backward regions and thus help bring about balanced regional development
- Assist in ancillarization and thus spread the benefits of industrialization
- Create sufficient levels of employment and set standards in labour welfare
- Selling goods and services at reasonable prices so as to serve consumer, keep prices affordable and help non inflationary growth process.
- Invest in areas where the private sector would not invest like in roads, transport and so on.

Since planning began in 1951, the public sector has been the main engine of inclusive growth as can be seen below.

The Public Enterprises (PE) Survey is a consolidated annual report on the performance of all Central Public Sector Enterprises (CPSEs) and their subsidiaries for the financial year 2015-16 which was made public in 2017. It is laid in both the Houses of Parliament every year during the Budget Session.

The overall performance of CPSEs in India has shown improvement during the financial year 2015-16 over the previous year despite declining commodity prices and a subdued global economic scenario. The overall net profit of the 244 operating CPSEs went up to Rs.1,15,767 crore in 2015-16.

The CPSEs have been making a substantial contribution to the Central Government through payment of dividend, interest, corporate taxes, excise duties etc. The contribution by the CPSEs through these avenues increased to Rs.2,78,075 crore in 2015-16. The survey excludes excluding insurance, finance and other companies.

The importance of the PSEs is

- The record of the PSUs in supplying many goods and services like coal, transport, power, irrigation and so on is commendable
- The PSUs are a model employer providing various facilities like education, housing and so on.
- Establishing industries in MP , Rajasthan , Bihar and so on , the efforts of the PSUs to reduce regional economic imbalances are not insignificant
- Non-inflationary growth process is facilitated because of the PSEs as prices of their goods and services can be administered.

While considering the performance of the PSUs it must be recognised that most of them had locational disadvantage; sold the product at administered prices (government fixed price); did not have access to the best of technology; had excess of manpower; operated in areas not meant for profit making like Railways; were subject to multiple controls and excess of accountability and so on. Even while sick PSEs are reducing in number, the problems are compounded by : resource crunch, erosion of net-worth due to continuous losses incurred by the PSUs, reluctance of financial

institutions to provide funds for revival of PSUs, heavy interest burden, old and obsolete plant and machinery, outdated technology, low capacity utilisation, excess manpower, weak marketing strategy, etc. Inadequate autonomy is one reason. Populism and the absence of rational pricing of goods and services is another reason for the low levels of efficiency in PSUs.

Public Sector and Economic Reforms

Economic reforms were, made necessary to make the economy competitive through market forces. It was expected to post higher growth rates; make industry yield higher productivity, profits and taxes which can contribute to poverty alleviation on a war footing. Public sector was in need of competition to unlock its value. Therefore, domestic and foreign capital was invited to force the PSEs to compete and perform. Government recognized the need for PSE reform during the 7th FYP (1985-1990).

The New Industrial Policy 1991 made significant changes like dereserving many areas with only 3 areas being reserved today(2017); equity disinvestment; managerial revamp with greater autonomy; refering a sick PSU to the Board of Industrial and Financial Reconstruction (BIFR) and so on.

List of industries reserved for the public sector

1. Atomic Energy
2. Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953
3. Railway passenger transport.

The period since 1991 when reforms were launched saw many reforms in the way PSEs should function

- Dereservation
- withdraw them from commercial and other areas like hotels, bakery, cycles etc
- disinvest a portion of the PSU equity for a variety of purposes
- strategic sale where a PSE is sold over to a strategic partner who buys majority equity and takes over management and may extend to complete ownership in due course.
- Increasingly they are being subject to market discipline primarily by listing on the stock exchanges which is the direct outcome of divestment
- Globalization - liberal FDI norms and import of capital goods, compel the PSUs to perform.
- The MOU system is being improved with greater weightage being given to the criterion of financial performance
- Navaratnas (1997) are granted financial and managerial autonomy for global competitiveness (Read ahead)
- mini –ratnas were taken up for similar reforms
- Maharatnas have been recognized since 2011
- professionalization of boards
- ETF(Bharat-22) 2017

As mentioned above, the reforms have paid off and the performance improved.

Public sector enterprises have been set up to serve the broad macro-economic objectives of higher economic growth, self-sufficiency in production of goods and services, long term equilibrium in balance of payments and low and stable prices. While there were only five Central Public Sector Enterprises (CPSEs) with a total investment of Rs. 29.00crore at the time of the First Five Year Plan, there are as many 244 CPSEs today (2017).

A large number of CPSEs have been set up as Greenfield projects consequent to the initiatives taken during the Five Year Plans. CPSEs such as National Textile Corporation, Coal India Ltd.(and its subsidiaries) have, however, been taken over from the private sector consequent to their 'nationalization'. Industrial companies such as Indian Petrochemicals Corporation Ltd., Modern Food Industries Ltd., Hindustan Zinc Ltd., Bharat Aluminium Company and Maruti Udyog Ltd., on the other hand, which were CPSEs earlier, ceased to be CPSEs after their 'privatization'.

Along with other public sector majors such as Indian Railways in transportation, the CPSEs are leading companies of India with significant market-shares in sectors such as petroleum, (e.g. Coal India Ltd. and NMDC), power generation (e.g. NTPC and NHPC), power transmission (e.g. Power Grid Corporation of India Ltd.), heavy engineering (e.g. BHEL), aviation industry (eg. Hindustan Aeronautics Ltd. and Air India Ltd.) storage and public distribution system (eg. Food Corporation of India and Central Warehousing Corporation), shipping and trading (eg. Shipping Corporation of India Ltd. and State Trading Corporation Ltd.) and telecommunication (eg. BSNL and MTNL).

With economic liberalization, post-1991, sectors that were exclusive preserve of the public sector enterprises were opened to the private sector. The CPSEs, therefore, are faced with competition from both domestic private sector companies (some of which have grown very fast) and the large multi-national corporation (MNCs).

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Disinvestment and Privatization

The New Industrial Policy 1991, as mentioned above, talked of disinvestment and the Finance Minister's Budget Speech in 1999-2000 talked of privatization for the first time. Definitions are important.

Disinvestment is the sale of shares of the Government to the retail public or employees or mutual funds or the FIIs. In other words, in disinvestment (divestment), there is no change in the management from public to private hands because either the government holds majority equity (51%) or even if the government holds less than 51% of equity, rest of it is sold to various individuals and institutions none of whom holds enough to take over management. It is essentially money-raising exercise with some accompanying benefits. Holding less than 51% is technically possible but so far has never been done because at that level, the PSE ceases to be a public sector company.

If the Government sells chunk of equity to a single buyer- 26% or 51% or more- to whom the management is also handed over, it is called strategic sale and the buyer is called strategic partner. It is a case of privatization. The buyer is one who has presence in the sector and can add value to the unit. For example, IPCL being sold to Reliance Industries Ltd (RIL) and Balco sold to Sterlite.

Government may also sell off a unit to a strategic buyer- entire equity.

Strategic buyer is one who not only buys the chunk of entire equity- in one tranche or more- but also takes over management. That is the `strategic' part of the sale. It is unlike usual disinvestment where sale of shares is unaccompanied by management control transfer. The strategic partner gives higher price for the shares as he gets management control along with it(management premium). Also, running of the unit improves.

Privatization and strategic sale are the same.

As mentioned above, disinvestment can be for less than 50% stake sale in which case the company remains a Government company.

The advantages with strategic sale (privatization) are that it gets investment; the strategic partner with management control will invest further for diversification and technological improvement; market perception will improve as it is no longer a government company; and shareholder value will increase. With the improvement of the functioning of the company, workers' protection will also be guaranteed.

Corporatization is a related term. It means: government units are reorganized along business lines. Typically they are required to pay taxes, raise capital from the market (with no government backing, explicit or implicit), and operate according to commercial principles. Government corporations focus on maximizing profits and achieving a favorable return on investment. They have to operate in a level playing field along with the private sector without any special advantages, more or less.

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Advantages of Disinvestment/Privatization

- it raises finances for the government that can be spent on restructuring the PSEs
- makes additional finances available for the social sector priorities
- exposes the enterprises to market discipline, thereby forcing them to become more efficient and survive on their own financial and economic strength
- when units become more professionalized and profitable , budgetary support for them can be minimized freeing resources for social and infrastructural needs
- results in wider distribution of wealth through offering of shares to small investors and employees.
- beneficial effect on the capital market; the increase in floating stock would give the market more depth and liquidity and facilitate raising of funds by the PSEs for their projects or expansion, in future.
- Opening up the public sector to appropriate private investment would increase economic activity and benefits the economy, employment and tax revenues in the medium to long term.
- Reducing the public debt that is threatening to assume unmanageable proportions
- Releasing other tangible and intangible resources, such as, large government manpower currently locked up in managing the PSEs, and their time and energy, for redeployment in high priority social sectors that are short of such resources

In many areas, e.g., the telecom sector, the end of public sector monopoly brought relief to consumers by way of more choices and cheaper and better quality of products and services. Competition made them perform better as outlined above.

Criticism of Divestment

While the advantages are convincing, the criticism is not to be dismissed wither.

- They constitute family silver and should not be liquidated
  - PSEs check the private sector in the wider market place and so are crucial to economy. For example, if PSEs are not there, private enterprises may cartelise etc
  - PSEs contribute by way of dividends and profits and thus are important sources of public finance
  - The exercise is essentially meant to garner resources for filling the revenue deficit

A prudent middle path needs to be adopted by way of extent of divestment; unit chosen; pace of the process; method adopted – IPO, strategic sale etc; valuation debate etc.

By 2016, about Rs.1.8 lakh crores were raised totally since 1992, approximately.

Valuation of Shares

Fixing the price of shares for PSEs is done on the basis of the discounted cash flow (DCF) model. The DCF model is a method of valuing a business today based on the stream of its future profits or cash flows. It is said to be the best of the given methods.

Net asset valuation is not adopted as it applies only to the units that are being wound up and not for running businesses.

Government Policy on Disinvestment /Privatization

As a part of reforming the PSEs, Government's policy on disinvestment and privatization is evolving since the beginning of the reforms in 1991.

Its main elements are: -

- Divest to raise money and other advantages
- Strategic sale is considered for loss making companies. NITI Aayog recommended strategic disinvestment of 34 sick public sector units
- List all unlisted public sector enterprises and sell a minimum of 25 percent of equity to the public as mandated by SEBI by 2017
- Buyback of shares , for example, CIL and EIL in 2017
- Profit-making PSUs will not be privatized
- Restructure and revive potentially viable PSUs;
- Close down PSUs which cannot be revived or sold
- Fully protect the interests of workers.

Strategic & Non-strategic Classification

Government classified the Public Sector Enterprises into strategic and non-strategic areas for the purpose of disinvestment. It was decided that the Strategic Public Sector Enterprises would be those in the areas of:

- Arms and ammunitions and the allied items of defence equipment, defence aircrafts and warships;
- Atomic energy (except in the areas related to the generation of nuclear power and applications of radiation and radio-isotopes to agriculture, medicine and non-strategic industries);
- Railway transport.
- All other Public Sector Enterprises were to be considered non-strategic.

Buyback of Shares

Buy-Back is a corporate action in which a company buys back its shares from the existing shareholders usually at a price higher than market price. When it buys back, the number of shares outstanding in the market reduces.

A buyback allows companies to gain name and also material advantages. By reducing the number of shares outstanding on the market, buybacks increase the proportion of shares a company owns that is in percentage terms. Companies buy back shares on the open market over an extended period of time.

The reasons for and advantages of buy-back:

- To provide an additional exit route to shareholders when shares are under valued or are thinly traded;
- To enhance consolidation of stake in the company;
- To return surplus cash to shareholders;
- To support share price during periods of sluggish market conditions;

State-owned Engineers India Ltd's Rs. 658.80 crore share buyback took place recently. The funds for the buyback were met out of internally generated cash resources of the company. The government was the largest beneficiary as it sold its shares in the company. The government encouraged cash—surplus PSUs to go for share buybacks to meet its disinvestment target. For the 2017—18 fiscal, it set a target of raising Rs. 72,500 crore through minority sales, strategic disinvestments as well as through listing of state—owned insurance companies.

EIL is a Navratna public sector unit under the administrative control of the Ministry of Petroleum and Natural Gas. It is an engineering consultancy company providing design, engineering, procurement, construction and integrated project management services, principally focused on the oil and gas, petrochemicals, fertiliser and LNG industry segments in India and internationally. The company also operates in other sectors including non—ferrous mining and metallurgy, waste water and infrastructure. It is also a primary provider of engineering consultancy services for the government's energy security initiative under its Integrated Energy Policy for strategic crude storages.

Cross-Holdings

State-owned companies like Coal India, NTPC and NHPC, have significant cash on their balance sheets. It can be used by them to buy shares of one another as the companies are related and have synergies. Similarly, oil companies. When they buy shares of one another in bulk, the can guide each other and work with a common purpose. Government benefits as such purchase is done from the promoter.

PSE-ETF

GOI in 2014 sold some of its equity to a private fund manager in 10 PSEs. Toghether they make a fund. The fund is the basis for units issued to those who gave money. The fund is listed on the stock exchange and is traded. The advantage is that the average valuation of 10 PSEs is reflected and thus the risk is less though so is the reward. It is called exchange traded fund (ETF). GOI raised Rs 3,000 crore in 2014 with the launch of its first CPSE. Subsequently, it raised Rs 8,500 crore through two follow-on offers of the CPSE ETF in 2017. Bharat-22 is being launched in 2017.

SUUTI

Government holds stake in 51 companies, both listed and unlisted, through the Specified Undertaking of Unit Trust of India, or SUUTI. Of these, 43 companies are listed on the stock exchanges and eight companies are unlisted.GOI has significant shareholdings in three companies, ITC, Axis Bank (erstwhile UTI Bank) and Larsen & Toubro, earlier held by the erstwhile Unit Trust of India before its breakup. SUUTI's equity stakes in L&T, ITC and Axis Bank are valued at above Rs 50,000 crore.

Bharat-22

In 2017, the next stage of ETF was launched in an innovative manner. It is called Bahart-22 and is somewhat different from the earlier one htough essentials are same.Bharat-22 has 19 central public sector enterprises, government banks and some holdings of the government's investment arm SUUTI.

Bharat-22 has 22 constituents against CPSE ETF's 10. In that sense, Bharat-22 is more diversified. Bharat-22 has a single company cap of 15% weightage in the fund, and a sectoral cap of 22%, ensuring that it is well represented by a diversified spectrum of PSUs.While CPSE ETF has only state-run companies as its constituents, Bharat-22 has the government selling stakes in some of the private sector blue-chip companies as well like some holdings of SUUTI (Specified Undertaking of Unit Trust of India) as mentioned above.Bharat-22 has six sectors. It features banking stocks, CPSEs such as Nalco, ONGC. SUUTI's holding in ITC has also been included. Unlike the earlier ETF, in Bharat-22, the weights of the constituent companies can be changed by the manager.

Methods of Disinvestment of Minority Stake in CPSEs

- Initial Public Offering (IPO) – offer of shares by an unlisted CPSE or the Government out of its shareholding or a combination of both to the public for subscription for the first time.
- Further Public Offering (FPO) – offer of shares by a listed CPSE or the Government out of its shareholding or a combination of both to the public for subscription.

- Offer for sale (OFS) of shares by promoters through Stock Exchange mechanism – method allows auction of shares on the platform provided by the Stock Exchange; extensively used by the Government since 2012.
- Strategic sale – sale of substantial portion of the Government share holding of a central public sector enterprise (CPSE) of upto 50%, or such higher percentage as the competent authority may determine, along with transfer of management control.
- Institutional Placement Program (IPP) – only Institutions can participate in the offering.
- CPSE Exchange Traded Fund (ETF) – Disinvestment through ETF route allows simultaneous sale of GoI's stake in various CPSEs across diverse sectors through single offering. It provides a mechanism for the GoI to monetize its shareholding in those CPSEs which form part of the ETF basket.
- Cross holdings

Use of Disinvestment Proceeds

The proceeds of disinvestment are credited into National Investment Fund (NIF) constituted in November, 2005 and are used for the approved purpose, as decided from time to time.

Presently, the disinvestment proceeds are credited to the existing NIF which is a 'Public Account' under the Government Accounts and the funds would remain there until withdrawn /invested for the approved purposes. The NIF is utilized for the following purposes:

- Subscribing to the shares being issued by the CPSEs on rights basis, so as to ensure that 51% ownership of the Government in CPSEs is not diluted.
- Preferential allotment of shares of the CPSE to promoters as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 so that Government shareholding does not go down below 51% in all cases where the CPSE is going to raise fresh equity to meet their Capex program.
- Recapitalization of public sector banks and public sector insurance companies so as to strengthen them through further capital infusion towards achieving the Basel III norms.
- Investment by Government in RRBs/IIFCL/NABARD/Exim Bank;
- Equity infusion in various Metro projects;
- Investment in Bhartiya Nabhikiya Vidyut Nigam Limited and Uranium Corporation of India Ltd.
- Investment in Indian Railways towards capital expenditure.

Navaratna, Miniratna and Maharatna Companies

Navaratnas

Economic reforms subject PSEs to market competition. Gloablization makes the competition more intense. To perform in such conditions, PSEs need a level playing field with the private players. Hence, the Navaratna package that gives autonomy to PSEs.Government introduced the navaratna concept in 1997. It granted enhanced autonomy to nine selected PSEs referred to as "Navaratnas". These were IOC, IPCL, ONGC, BPCL, HPCL, NTPC, SAIL, VSNL and BHEL.

IPCL and VSNL were strategically sold to Reliance and Tatas respectively. Eight more CPSEs were made navaratnas since then. Totally, there are 17(2017)

Navratna CPSEs

- Bharat Electronics Limited
- Bharat Petroleum Corporation Limited
- Container Corporation of India Limited
- Engineers India Limited
- Hindustan Aeronautics Limited
- Hindustan Petroleum Corporation Limited
- Mahanagar Telephone Nigam Limited
- National Aluminium Company Limited
- National Buildings Construction Corporation Limited
- NMDC Limited
- Neyveli Lignite Corporation Limited
- Oil India Limited
- Power Finance Corporation Limited
- Power Grid Corporation of India Limited
- Rashtriya Ispat Nigam Limited
- Rural Electrification Corporation Limited
- Shipping Corporation of India Limited

The government has a quantitative system to confer the status of "Navarathna" on PSE. According to the system, every PSE is rated on the following parameters:

- Net Profit to Net Worth
- Total Manpower Cost as a Percentage of Total cost of Production
- Profit before Depreciation ,Interest and Taxes (PBDIT) on Capital Employed
- PBDIT on turnover
- Earning per Share &
- Inter-sectoral performance

To gain Navarathna status, a PSE must score atleast 60 out of 100 based on these parameters.Additionally, a company must first be a miniratna and must have four independent directors on its board before it can be made a navaratna

These navaratnas, subject to certain guidelines, now have freedom to

- incur capital expenditure
- decide upon joint ventures
- set up subsidiaries/offices abroad
- enter into technological and strategic alliances
- raise funds from capital markets (international and domestic)
- enjoy substantial operational and managerial autonomy
- Boards of these PSEs have been broad-based with induction of nonofficial part-time professional directors.

For example, 'Navaratna' status empowers it to invest up to Rs. 1000 cr or 15% of their net worth on a single project without seeking government approval. The overall ceiling on such investment in all projects put together is 30% of the networth of the company.

Miniratna Companies

There are two types of miniratna companies: Type 1 and 2.Together there are 73 such companies. Miniratnas can also enter into joint ventures, set subsidiary companies and overseas offices but with certain conditions.

Category I Miniratna

They are PSEs that have made profits continuously for the last three years and earned a net profit of Rs 30 crores or more in one of the three years. These miniratnas are granted certain autonomy like incurring capital expenditure without government approval up to Rs. 500 crores or equal to their net worth, whichever is lower. There are 48 miniratnas. Bridge & Roof Company (India) Limited was added late in 2010.

Category II Miniratna

This category include those PSEs which have made profits for the last three years continuously and should have a positive net worth. Category II miniratnas have autonomy to incurring the capital expenditure without government approval up to Rs. 300 crores or up to 50% of their net worth whichever is lower. There are 14 such miniratnas: Bharat Pumps & Compressors Limited was added late in 2010.

Maharatnas

The Government introduced Maharatna scheme in February, 2010 with the objective to delegate enhanced powers to the Boards of identified large sized Navratna CPSEs so as to facilitate expansion of their operations, both in domestic as well as global markets.

Eligibility criteria for grant of Maharatna status: - The CPSEs fulfilling the following criteria are eligible to be considered for grant of Maharatna status:-

- Having Navratna status
- Listed on Indian stock exchange, with minimum prescribed public shareholding under SEBI regulations
- An average annual turnover during the last 3 years of more than Rs.25,000 crore
- An average annual net worth during the last 3 years of more than Rs.15,000 crore
- An average annual net profit after tax during the last 3 years of more than Rs.5,000 crore
- Significant global presence or international operations.

Delegation of powers to Maharatna CPSEs :- The Maharatna CPSEs in addition to having Navratna powers have been delegated additional powers in the area of investment in joint ventures/ subsidiaries and human resources development. The Maharatna CPSEs can invest ` 5,000 crore in one project (` 1,000 crore for Navratna CPSEs) .

Maharatna CPSEs :- The Government has granted Maharatna status to 7 CPSEs : (i) Bharat Heavy Electricals Limited, (ii) Coal India Limited, (iii) GAIL (India) Limited, (iv) Indian Oil Corporation Limited, (v) NTPC Limited, (vi) Oil & Natural Gas Corporation Limited and (vii) Steel Authority of India Limited. 7.1.4 During the year 2015-16, the Inter Ministerial Committee reviewed the performance of four Maharatna CPSEs, viz. Indian Oil Corporation Limited, GAIL (India) Limited, NTPC Limited and Oil & Natural Gas Corporation Limited.

Ad-hoc Group of Experts (AGE) Report

Empowerment of Central Public Sector Enterprises was set up in 2004. It was headed by Arjun Sengupta. It recommended in 2006

- greater autonomy for Public Sector Units
- central PSUs to have truly independent boards. It has recommended empowering the PSU boards to take decisions about mergers, joint ventures, pricing, exports, appointments, selection of dealers, promotion and transfer of employees, and so on. The ministry concerned should not review the PSU more than twice a year. Supervision should be done by sector specific supervisory boards.
- ministries should not interfere with the functioning of the PSUs under them. Their managements should be accountable to the board and not to the ministry
- government should be given flexibility to divest its stake in PSUs. As long as the government's stake remains above 51 per cent, it should not require Parliament's permission to divest its shares — even in navratnas, miniratnas, and consistently profit-making PSUs. This can be done through a board decision.
- supplementary audit by the Comptroller and Auditor General of India of the PSEs should be an exception rather than rule, as it delays the publishing of audited accounts as required by SEBI.
- reworking of the accountability of the PSEs to Parliament so that the questions raised on their functioning do not compromise sensitive trade data and work as an impediment in functioning as commercial enterprises.

SRIRAM'S IAS

The Government accepted some of the recommendations of AGE relating to enhancement of financial powers of Navratna, Miniratna and other profit-making CPSEs. The remaining recommendations relating to ownership issues, audit of Government companies, Article 12 of the Constitution. Parliamentary accountability, vigilance, management in CPSEs, etc. are under examination.

MOU

The beginning of the policy of Memorandum of Understanding can be traced to the report of the Arjun Sengupta Committee in mid eighties. One of the recommendations of this committee was for the introduction of the system of MOU for measurement of performance of public enterprises. The MOU system was introduced on an experimental basis in 1987-88. It was based on the French system. From 1989-90 the signaling system was adopted and it remains in vogue till the present.

One of the most important differences between the French system and the signaling system relates to the possibility of making an overall judgement on the enterprise's performance in the latter system. In performance contracts belonging to the French system, it was possible to only point out whether a particular target was met or not. This created great difficulty for making an overall judgement regarding enterprise's performance. The signalling system overcomes this problem by adopting the system of "five point scale" and "criteria weight" which ultimately result in calculation of "composite score" or an index of the performance of the enterprise

The MOU system has been adopted as it was felt that PSEs are unable to perform at efficient levels because of multi-point accountability. Also, there was no clarity of objectives. Absence of functional autonomy also hampered their performance.

MOU is a freely negotiated agreement between the public enterprise and the administrative ministry. Under the agreement, the enterprises undertake to achieve the targets set in the agreement at the beginning of the year. The MOU covers both financial performance as well as non-financial performance. Under this system performance of the company is categorized into five categories namely: excellent, very good, good, fair, and poor.

The objectives of the MOU system are to improve the performance of public enterprises by increasing autonomy and accountability of the management; remove the fuzziness in the goals and objectives the enterprise is to pursue through clearly laid down performance targets at the beginning of the year; enable the evaluation of managerial performance through objective criteria and provide a mechanism to reward good performance through performance incentives to stimulate improved performance.

Some Recent Initiatives in Restructuring The PSEs

- Maharatna status to 7 companies
- more companies given navaratna and mini ratna status to improve their performance in the global competitive environment
- ETF
- Niti Aayog given the role to recommend strategic sale etc.

Autonomy for PSEs

Managerial and financial autonomy is important for the PSEs to function well in a market economy where there is severe competition and the companies are also listed on the stock exchanges. Steps for rendering autonomy to the PSEs are essentially two

- Maharatnas
- Navaratna and miniratna status
- MOU
- Disinvestment

(Given above in detail)
Read along with the AGE report given above.

Professionalisation of PSU Boards

- MOU
- outside professionals should be inducted in the boards of PSU in the form of non-official Directors whose number should be at least 1/3 of the Actual strength of the Board
- Under the Navratna/Miniratna package, the board of select PSUs have been professionalised by inducting a minimum of 4 non-official Directors in case of Navratnas and 3 in case of Miniratnas.
- number of Government Directors on the Board should not be more than two

Focus Areas For PSU Restructuring

Tenure of the CEO and Board of Directors:
The managerial problems in the PSU begin with the tenure of CEO and the Board of Directors. The selection, service conditions and the tenure of the Board of Directors is subject to the Government rules and regulations. Unlike the private sector where CEO have almost a decade to nurture the company, in PSU the rules with respect to superannuation tends to focus attention on short term strategies-co-terminus with CEO's tenure. There is, hence a need to provide continuity in the management by appointing CEO and other members in the Board of Directors for longer tenure with representation of shareholders other than GoI Shareholders:

Multiple-Audit

The business decision in PSUs gets influenced by presence of a number of controlling agencies, such as the Ministry, parliamentary committees, CAG, CVC etc. The end result of this is recourse to a risk- adverse approach to business. For example, there is a decision related purchase of second hand equipment where on the spot decision is required and transparent processes such as global bid are not available. It helps the company to save if it can take quick decisions. In some cases there could be loss which needs to be out of the purview of CVC as otherwise it will dampen the decision making process in commercial matters.

Role of Administrative Ministry

It needs to change. Like a shareholder of any other company, the Ministry's role should be limited to contributing as shareholder in AGM/EGM of the companies, and providing it the requisite support. The role of Ministry in day-to-day management through correspondence should be avoided.

New Delhi

Non Commercial Activities

PSUs are expected to function on commercial consideration but are burdened with takeover of some sick/potentially sick units.

Investment in newer units is based on socio-political consideration. This results in non-flexibility of to the company to reorganise its own business. Regularisation of contract labour under article 12 of the Constitution forces PSUs to absorb extra labour without any consideration to the existing manpower strength. PSUs are unable to spin-of loss making units or close operations in those units, which have become operationally unviable.

Niti Aayog and Disinvestment

Finance minister said in his Budget 2016-17 speech that NITI Aayog would identify Public Sector Units for strategic sale. A new policy for management of government investment in Public Sector Enterprises, including disinvestment and strategic sale, was approved to leverage the assets of CPSEs for generation of resources for investment in new projects; encourage CPSEs to divest individual assets like land, manufacturing units, etc to release their asset value for making investment in new projects; for efficient management of investment in CPSEs by addressing issues such as capital restructuring, dividend and bonus shares.

The NITI Aayog was tasked to identify the CPSEs for strategic sale.

DIPAM

The Department of Disinvestment was renamed as Department of Investment and Public Asset Management or 'Dipam'. It is aimed at proper management of Centre's investments in equity including its disinvestment in central public sector undertakings.

The new department has been mandated to "advise the government in the matters of financial restructuring of central public sector enterprises and for attracting investment through capital markets."

Finance Minister announced renaming of the Department of Disinvestment in his budget speech for 2016-17.

The Dipam is a part of work Finance Ministry and it deals with "all matters relating to management of central government investments in equity including disinvestment of equity in central public sector undertakings".

It also deals with "all matters relating to sale of central government equity through offer for sale or private placement or any other mode in the erstwhile central public sector undertakings."

All other post disinvestment matters, including those relating to and arising out of the exercise of call option (buying more shares of the same unit by the one who bought the majority stake already as in Balco) by the strategic partner in the erstwhile central public sector undertakings, shall continue to be handled by the administrative ministry or department concerned, where necessary, in consultation with the Dipam.

Purchase Preference Policy

Government gives purchase preference in supply of goods and services to the Government Departments, Autonomous bodies and other PSEs if the price quoted by the supplying CPSE is within 10% of the lowest valid bid price, other things being equal. It helps support the PSEs.

INFRASTRUCTURE

Infrastructure is the foundation for economic growth. It includes both the physical, natural and organizational structures which are the preconditions for sustainable economic development: roads, ports, airports, bridges, railways, water supply, sewers, power, telecommunications, irrigation etc.

Infrastructure facilitates the production of goods and services; distribution of final products to markets as well as basic social services such as schools and hospitals.

Infrastructure can be physical or social or natural. It can be hard or soft. "Hard" infrastructure refers to the large physical networks necessary for the functioning of a modern industrial nation, whereas "soft" infrastructure refers to all the institutions (organisations) which are required to maintain the economic system, health, and cultural and social standards of a country, such as the financial system, the education system, the health care system, the system of government, and law enforcement.

Various types of Infrastructure

Transport infrastructure

- Road and highway networks, including structures (bridges, tunnels, culverts)
- Mass transit systems (Commuter rail systems, subways, tramways, and bus transportation)
- Railways (rail track, railway stations), level crossings, signalling and communications systems
- Canals and navigable waterways (inland waterways)
- Seaports
- Airports

New Delhi

Adequate transportation infrastructure is a essential for economic development and growth. Apart from facilitating cheaper and more efficient movements of goods, people and thus enabling growth, it also helps in national integration. Transportation infrastructure impacts the distribution of economic activity and development across regions; helps business to multiply; consumer welfare; productivity enhancement; balanced regional development; employment; demand; and makes the government access higher levels of fiscal resources to direct and indirect taxes. It is seen in the case of Golden Quadrilateral and PMGSY- the latter accounting for benefits for agriculture too.

Energy infrastructure

- Electrical power network, including generation plants, electrical grid, substations, and local distribution.
- Natural gas pipelines, storage and distribution terminals
- Petroleum pipelines
- Specialized coal handling facilities for washing, storing, and transporting coal.
- Renewable energy infrastructure like wind, solar power , hydro power, geothermal power and biomass or biofuel facilities
- Coal mines, oil wells and natural gas wells (may also be classified as being part of the mining and industrial sector of the economy)

Water management infrastructure

- Drinking water supply
- Sewage collection, and disposal of waste water
- Drainage systems
- Major irrigation systems (reservoirs, irrigation canals)
- Major flood control systems

Communications infrastructure

- Postal service
- Telephone networks (land lines) including telephone exchange systems
- Mobile phone networks
- Television and radio transmission stations
- Cable television physical networks including receiving stations and cable distribution networks
- The Internet, including the internet backbone
- Communications satellites
- Undersea cables
- Major private, government or dedicated telecommunications networks, such as those used for internal communication and monitoring by major infrastructure companies, by governments, by the military or by emergency services, as well as national research and education networks

Solid waste management

- Municipal garbage and recyclables collection
- Solid waste landfills
- Solid waste incinerators and plasma gasification facilities (Plasma gasification is a process which converts organic matter into synthetic gas, electricity, and slag using plasma.)
- Materials recovery facilities
- Hazardous waste disposal facilities

Information technology (IT) infrastructure

IT components that are the foundation of an IT service- physical components (computer and networking hardware and facilities), various software and network components.

Soft infrastructure

Soft infrastructure means the body of rules and regulations governing the various systems, the financing of these systems, as well as the systems and organizations by which highly skilled and specialized professionals are trained, advance in their careers by acquiring experience, and are disciplined if required by professional associations (professional training, accreditation and discipline).

Unlike hard infrastructure, the essence of soft infrastructure is the delivery of specialized services to people.

Economic infrastructure

- The financial system, including the banking system, financial institutions, the payment system, exchanges, the money supply, financial regulations, as well as accounting standards and regulations

- Major business logistics facilities and systems, including warehouses as well as warehousing and shipping management systems
- Manufacturing infrastructure, including industrial parks and special economic zones, plus the public safety, zoning and environmental laws and regulations that govern and limit industrial activity, and standards organizations
- Agricultural, forestry and fisheries infrastructure, including specialized food and livestock transportation and storage facilities

Social infrastructure

- The health care system, including hospitals, the financing of health care, including health insurance,
- The educational and research system
- Skilling bodies
- Social welfare systems, including both government support and private charity for the poor, for people in distress or victims of abuse
- Sports and recreational infrastructure, such as parks, sports facilities, the system of sports leagues and associations
- Cultural infrastructure, such as museums, libraries, theatres, studios, and specialized training facilities
- Business travel and tourism infrastructure

Critical infrastructure

It consists of assets that are essential for the functioning of an economy:

- electricity generation, transmission and distribution;
- gas production, transport and distribution;
- oil and oil products production, transport and distribution;
- telecommunication;
- water supply (drinking water, waste water/sewage, stemming of surface water (e.g. dikes and sluices));
- agriculture, food production and distribution;
- public health (hospitals, ambulances);
- transportation systems (fuel supply, railway network, airports, harbours, inland shipping);
- financial services (banking, clearing);
- Security services (police, military).

National Critical Information Infrastructure Protection Centre (NCIPC)

NCIIPC is an organisation of the Government of India created under Sec 70A of the Information Technology Act, 2000 (amended 2008) in 2014. Based in New Delhi, India, it is designated as the National Nodal Agency in respect of Critical Information Infrastructure Protection.The Information Technology Act, 2000 defines Critical Information Infrastructure (CII) as "... those computer resource, the incapacitation or destruction of which, shall have debilitating impact on national security, economy, public health or safety" .NCIIPC broadly identified the following as 'Critical Sectors' :

- Power & Energy
- Banking, Financial Services & Insurance
- Telecom
- Transport

- Government
- Strategic & Public Enterprises

NCIIPC functions and duties

- National nodal agency for all measures to protect nation's critical information infrastructure.
- Protect and deliver advice that aims to reduce the vulnerabilities of critical information infrastructure, against cyber terrorism, cyber warfare and other threats.
- Identification of all critical information infrastructure elements for approval by the appropriate Government for notifying the same.
- Provide strategic leadership and coherence across Government to respond to cyber security threats against the identified critical information infrastructure.
- Coordinate, share, monitor, collect, analyze and forecast, national level threat to CII for policy guidance, expertise sharing and situational awareness for early warning or alerts. The basic responsibility for protecting CII system shall lie with the agency running that CII.
- Assisting in the development of appropriate plans, adoption of standards, sharing of best practices and refinement of procurement processes in respect of protection of Critical Information Infrastructure.
- Evolving protection strategies, policies, vulnerability assessment and auditing methodologies and plans for their dissemination and implementation for protection of Critical Information Infrastructure.
- Undertaking research and development and allied activities, providing funding (including grants-in-aid) for creating, collaborating and development of innovative future technology for developing and enabling the growth of skills, working closely with wider public sector industries, academia et al and with international partners for protection of Critical Information Infrastructure.
- Developing or organising training and awareness programs as also nurturing and development of audit and certification agencies for protection of Critical Information Infrastructure.
- Developing and executing national and international cooperation strategies for protection of Critical Information Infrastructure.
- Issuing guidelines, advisories and vulnerability or audit notes etc. relating to protection of critical information infrastructure and practices, procedures, prevention and response in consultation with the stake holders, in close coordination with Indian Computer Emergency Response Team and other organisations working in the field or related fields.
- Exchanging cyber incidents and other information relating to attacks and vulnerabilities with Indian Computer Emergency Response Team and other concerned organisations in the field.
- In the event of any threat to critical information infrastructure the National Critical Information Infrastructure Protection Centre may call for information and give directions to the critical sectors or persons serving or having a critical impact on Critical Information Infrastructure.

NCIIPC functions under the guidance of National Technical Research Organization (NTRO). NCIPC is the nodal agency which coordinates the cyber security operations related to critical infrastructures in India. NCIPC will set up sectoral Computer Emergency Response Teams (CERTs) and will also install sensors on critical systems for getting real-time information regarding cyber attack of any kind for preparing a quick response.

Urban infrastructure

Urban or municipal infrastructure refers to hard infrastructure systems owned and operated by municipalities, such as streets, water distribution, and sewers. It may also include some of the facilities associated with soft infrastructure, such as parks, public pools and libraries.

Green infrastructure

Green infrastructure is a concept that highlights the importance of the natural environment in decisions about land use planning. In particular there is an emphasis on the "life support" functions provided by a network of natural ecosystems, with an emphasis on interconnectivity to support long-term sustainability. Examples include green belts, wild life sanctuaries; eco sensitive regions, Tiger, lion, and elephant reserves; bird sanctuaries; western ghats being conserved etc.

Natural infrastructure

It may be used synonymously with green infrastructure. Natural infrastructures are planned and managed natural or semi-natural systems, which can provide benefits : forests, agricultural lands, estuaries, coastal landscapes and wetlands.These solutions comprises coastal ecosystem (mangroves, coral reefs) for coastline protection from storms; watershed restoration (by sustainable land management) for water quality regulation; afforestation for carbon sequestration; habitat restoration or conservation for pollination; phyto-remediation to rehabilitate contaminated soil and water. In India, about 800 million people were affected by around 288 weather-related disasters during 1995-2015. In order to avoid risk and damage, and to build resilience to these disasters, natural infrastructure solutions are increasingly being considered and implemented. It helps in achievement of Sustainable Development Goals (SDGs) and the Paris Climate Agreement targets Intended Nationally Determined Contributions (INDCs).

Financing Infrastructure

Investment in infrastructure is part of the capital accumulation required for economic development and has an impact on socioeconomic measures of welfare. Traditionally, infrastructure development used to occur through the public sector. However, given the scarcity of public resources and the need to shift scarce public resources into health and education, efforts have been made to induct private participation in the development of infrastructure.

Currently, the source of financing varies significantly across sectors. In India, some are monopoly: railways and nuclear power. Some sectors are dominated by government spending, others by overseas development aid (ODA) and yet others by private investors. PPP is emerging as the dominant model. Debt and equity are, like anywhere else, the ways of raising resources.

The total investment in infrastructure sectors in the Twelfth Plan(2012-17) is estimated to be Rs.55.7 lakh crore.The share of private investment in the total investment in infrastructure was 48 per cent during the Twelfth Plan .

Infrastructure may be owned and managed by governments or by private companies, such as sole public utility or railway companies. Or it can be a joint operation of construction, management and ownership (PPP) in which there are many models as we will see ahead.

PPPs

Governments in most developing countries face the challenge to meet the growing demand for new and better infrastructure services. As available funding from the traditional sources and capacity in the public sector to implement many projects at one time remain limited, governments have found that partnership with the private sector is an attractive alternative to increase and improve the supply of infrastructure services.

The partners in a PPP, usually through a legally binding contract or some other mechanism, agree to share responsibilities related to implementation and/or operation and management of an infrastructure project. This collaboration or partnership is built on the expertise of each partner that meets clearly defined public needs through the appropriate allocation of:

- Resources
- Risks
- Responsibilities, and
- Rewards

The availability of high-quality infrastructure and the overcoming of India's infrastructure deficit is crucial to attaining and sustaining rapid growth that generates the gainful jobs. It is urgently required for India to grow rapidly and generate a demographic dividend.The Government of India identified public–private partnerships (PPP) as a way of developing the country's infrastructure for its economic growth. PPPs in infrastructure represent a valuable instrument to speed up infrastructure development in India. Since first half of the 2000s, PPPs were successfully implemented. India offers today the world's largest market for PPPs.

PPPs have become attractive to governments for infrastructure development as:

- They can enhance the supply of much-needed infrastructure services.
- They may not require any immediate cash spending. They provide relief from the burden of the costs of design and construction.
- They allow transfer of many project risks to the private sector.
- They promise better project design, choice of technology, construction, operation and service delivery.
- Rationalize tariff for services like power and roads without any resistance from public

Kelkar Committee defines PPPs as : Public Private Partnerships (PPPs) in infrastructure refer to the provision of a public asset and service by a private partner who has been conceded the right (the "Concession") for the purpose, for a specified period of time, on the basis of marketdetermined revenue streams, that allow for commercial return on investment.

There are many models of PPPs being followed in India.

Build–operate–transfer (BOT) or build–own–operate–transfer (BOOT) is a form of project financing in which a private entity receives a concession from the private or public sector to finance, design, construct, own, and operate a facility stated in the concession contract. This enables the concessionaire to recover investment, operating and maintenance expenses in the project. Due to the long-term nature of the arrangement, the fees are usually raised during the concession period.

BOT has uses in infrastructure projects as a form of public–private partnership. In the BOT project, Government delegates to a private sector entity to design, build infrastructure and to operate and maintain these facilities for a certain period. During this period the private party is entitled to retain all revenues generated by the project. The facility will be then transferred to government at the end of the concession agreement.

V-BOT

In a BOT project, there are instances where the contractor realizes the investment and profit ahead of the contract period and there are cases where he does not realize even after the contract period is over. There should thus be flexibility.

The government is considering offering a "rolling contract" for road development that will have the above said flexibility. NHAI will reserve the right to take over the project to stem public opposition over "super profits". The model—variable build operate and transfer (V-BOT) .There have been several instances of protests in states including Delhi, UP and Maharashtra against the toll collection by the concessionaires for many more years than necessary. Under this model, the projects will be bid out on the basis of total cost (including construction, financing, operation and maintenance) for a defined contract period. The lowest bidder will get the project and will build, operate and collect toll. If toll collection increases beyond the projection due to high traffic growth, the contractor will recover the cost before the quoted period and NHAI will terminate the contract. NHAI will then collect toll to recover the land cost. When that amount is recovered, toll will be cut by 40%. All such projects will compulsorily have 100% electronic toll collection, installation of automatic traffic count and classifier system, video image detection and other systems.

Delhi-Noida Direct (DND) Flyway

Allahabad High Court in 2016 scrapped the toll levied on commuters using the Delhi-Noida Direct (DND) Flyway, a major traffic artery connecting southeast Delhi with Noida across the Yamuna in Uttar Pradesh. Noida Toll Bridge Company Ltd (NTBCL) is the special purpose vehicle to develop, construct, operate and maintain DND.The Allahabad High Court order was caused by a public interest petition filed by a body of Noida residents. The court considered several aspects of the case before ruling that NTBCL had "recovered all reasonable returns" on its investment, and was no longer entitled to collect toll.Supreme Court upheld the same in 2017.

Concession

A concession or concession agreement is a grant of rights, land or property by a government, local authority, corporation, individual or other legal entity.Public services such as roads, hospitals may be operated as a concession. In the case of a public service concession, a private company enters into an agreement with the government to have the exclusive right to operate, maintain and carry out investment in a public utility for a given number of years.

In concessions, payments can take place both ways: concessionaire pays to government for the concession rights and the government may pay the concessionaire, which it provides under the agreement to meet certain specific conditions. For example, hybrid annuity model or VGF. Usually, such payments by the government may be necessary to make projects commercially viableand/or reduce the level of commercial risk taken by the private sector, particularly in a developing or untested PPP market. Typical concession periods range between 5 to 50 years.

A BOOT structure differs from BOT in that the private entity owns the works. During the concession period the private company owns and operates the facility with the prime goal to

recover the costs of investment and maintenance while trying to achieve higher margin on project. The private entity has additional rights being owner- raise loans against it as collateral.

Hybrid-Annuity Model (HAM)

HAM was introduced in 2016 essentially for road infrastructure projects. About 30 highways projects have been awarded under HAM by the National Highway Authority of India (NHAI) at a total cost of about Rs.28,000 crore. Half the projects awarded in 2016- 17 were under HAM.

As per HAM model, 40% of the capital cost quoted is paid upfront by government while the remaining 60% of the cost will be paid over the life of the project as annuities. That is the meaning of "hybrid". It must be differentiated from VGF where the gap is given as grant. In HAM, the initial payment is adjusted from annuities.

HAM is a financial innovation in funding for infrastructure that emerged from a practical need. The BOT model was not considered viable by the private players to invest as the private player had to fully mobilise finances and bear the risk. Banks were unwilling to lend to these projects as they had burnt their fingers and accumulated NPAs. Risks were unevenly distributed getween government and private builder as developers had to take the entire risk of low passenger traffic. Projections on traffic go wrong affecting returns. Hence the reluctance to commit large sums of money in such models.

It helps by distributing the risk between developers and the Government. The annuity payment structure means that the developers aren not taking traffic risk all by themselves. From the Government's perspective, it starts road projects by investing a portion of the project cost.

Government has many incentives: builds roads, enables businesses, boosts tax buoyancy as it triggers economic growth, land prices go up in the vicinity that helps the owners etc. There is less traffic congestion. HAM projects are also being tested in urban infra developments such as metro rail projects.

In 2017, Hybrid Annuity based PPP model was adopted for the first time in the country in sewage management sector in two major cities in Ganga river basin - Varanasi and Haridwar.

TOT

The government approved a model under which toll highways operated by the National Highways Authority of India (NHAI) for over two years will be leased out to entities which will collect toll and operate the project for a specified duration, in a return for an upfront fee. The money raised will be used to invest in developing more highways.

GOI identified 75 national highway projects adding up to 4,500 km for the toll-operate-transfer (TOT) model. The overall annual toll collected from these projects is about Rs2,700 crore. Projects under the TOT model will be awarded through international competitive bidding where foreign funds can also take part.

TOT model will bring new investments to the highways sector. Under the TOT model, the investor will collect toll and be responsible for operation and maintenance of the project.

Proceeds from TOT auctions will free up valuable taxpayer capital and augment resources for new infrastructure projects.

The model is likely to help NHAI raise capital to fund road projects based on the engineering, procurement and construction (EPC) and hybrid annuity models. It will also be an opportunity for pension funds and infrastructure investors to invest in India's road sector profitably.

Swiss Challenge

Under the Swiss challenge method any party with credentials can submit a development proposal to the government. That proposal will be put online and a second party can suggest to improve and better that proposal.

In case the original proposer is able to match the more attractive and competing counter proposal, the project will be awarded to him. An expert committee will decide the best proposal. The Swiss challenge method is one that has been used in India by various states including Karnataka, Andhra Pradesh, Rajasthan, Madhya Pradesh, Bihar, Punjab and Gujarat for roads and housing projects.

This method can be applied to projects that are taken up on a PPP basis , EPC etc. The Union cabinet gave its approval to redevelop 400 railway stations using the Swiss challenge method. It helps in passenger service, modernization, mega investments, job creation etc.

The advocates of Swiss Challenge cite the following benefits: efficiency in the use of capital; good citizen services; transparency; genuine competition; cost saving fro the government ;speed up the process of awarding projects.

The critics of this method point to absence of real competition as in reality unsolicited bidder may not be in reality unsolicited because of the politics-business nexus.

In an age of crony capitalism, companies may employ questionable means to win mega projects. Thus this method has a potential to encourage large-scale corruption and erosion of precious public resources.

Effective legal and regulatory regime is necessary to make the most of the Swiss Challenge method.

Kelkar Committee report on 'Revisiting and Revitalising the PPP model of infrastructure development,' presented GOI in 2015 discouraged the government from following the 'Swiss Challenge' model of auctioning infrastructure projects.

Viability Gap Funding

The VGF Scheme was notified in 2006 to enhance the financial viability of competitively bid infrastructure projects, which are justified by economic returns, but do not pass the standard thresholds of financial returns- that is their commercial viability is not good to be taken up by the private parties Under the scheme, grant assistance of up to 20 per cent of capital costs is provided by the Central Government to PPP projects undertaken by any Central Ministry, State Government, statutory entity or local body, thus leveraging budgetary resources to access a larger

pool of private capital. An additional grant of up to 20 per cent of project costs may be provided by the sponsoring Ministry, State Government or project authority.

UDAN (Ude Desh ka Aam Naagrik) is an ambitious regional air connectivity scheme for which GOI set up a trust for disbursing viability gap funds to the participating airlines. Airports Authority of India (AAI) is the nodal agency for the scheme that aims to connect un-served as well as under-served airports and make flying affordable for the masses. As at least half of the seats in UDAN flights are to be offered at subsidised fares, the participating carriers would be provided a certain amount of Viability Gap Funding (VGF) -- an amount shared between the Centre and the state concerned.

Take out financing

Banks attract deposits whose average life is about 3-5 years and so can not be lent to finance infrastructure. But take out financing can be helpful as banks lend long term but after 3-5 years, a firm like India Infrastructure Finance Company Limited (IIFCL) takes out the account from the banks books. It pays the bank what the borrower owes it and collects the money from the borrower. It was introduced in 2009-10.Takeout financing is an accepted international practice of releasing long-term funds for financing infrastructure projects. It can be used to effectively address Asset-Liability mismatch of commercial banks arising out of financing infrastructure projects and also to free up capital for financing new projects.

Objectives of the Takeout Finance Scheme:

- To boost the availability of longer tenor debt finance for infrastructure projects.
- To address issues of asset-liability mismatch
- To expand sources of finance for infrastructure projects by facilitating participation of new entities i.e. medium / small sized banks, insurance companies and pension funds.

India Infrastructure Finance Company Limited (IIFCL)

IIFCL was incorporated in 2006 for providing long-term loans for financing infrastructure projects that typically involve long gestation periods. IIFCL provides financial assistance both through direct lending to project companies and by refinancing banks and financial institutions as also take out financing. IIFCL raises funds from both domestic and overseas markets on the strength of government guarantees.

IIFCL is a wholly-owned Government of India company.

The sectors eligible for financial assistance from IIFCL broadly include transportation, energy, water, sanitation, communication, social and commercial infrastructure.

IIFCL has been registered as a NBFC with RBI.

The authorized and paid up capital of the company (2017) stood at Rs 6,000 Crore and Rs 4,002 Crore, respectively.

By 2017, IIFCL made cumulative gross sanctions of Rs 77,000 Crore to 442 projects under direct lending and cumulative disbursements of Rs 56,000 Crore under Refinance and Takeout Finance.

Plug and play model

The Union Budget 2015-16 proposed a 'plug-and-play' model for big-ticket infrastructure projects such as power plants, airports and roads, where all regulatory clearances will be put in place before they are awarded to private developers through a transparent auction.

GOI announced plans to set up five ultramega power projects (UMPPs) of 4,000 mw each under the 'plug-andplay' model. This means winners of the contract can start implementing the project immediately, without worrying about all the regulatory clearances and coal or gas linkages — the causes for so many stalled projects in the country. This should unlock investments to the extent of Rs 1 lakh crore. Government will consider plug-and-play model for other projects such as roads, ports, rail lines and airports as well.

It will help the government attract foreign and domestic investments into much-needed infrastructure projects as it will significantly cut down project implementation time and cost and time overruns.

Infrastructure Debt Fund

Infrastructure projects are capital intensive and have long payback periods, and, therefore, require long-term funds at comparatively low costs. Infrastructure projects in India are financed mainly by commercial banks and NBFCs. The present bond market lacks depth to address the needs for a long-term debt. With a view to overcoming these shortcomings, Infrastructure Development Funds (IDFs) are being set up for channelising long-term debt from domestic and foreign pension and insurance funds, as well as from other sources. The Reserve Bank of India, and the Securities and Exchange Board of India have already laid down regulatory framework for the IDFs.

Setting up of Infrastructure Debt Funds (IDFs) was announced in the Union Budget for 2011-12. An IDF can be structured either as a company or as a trust. If set up as a trust, it would be regulated by SEBI under the Mutual Fund Regulations. If set up as a company, the IDF would be structured as a Non-Banking Finance Company (NBFC) and will be under the regulatory oversight of RBI. Guidelines with enabling provisions have already been issued by the Reserve Bank of India and SEBI. By 2017, three infra debt funds have been set up through the NBFC route and three through the MF route.

An IDF-NBFC would issue either rupee or dollar denominated bonds to mobilise money to be invested in infrastructure PPPs.

Establishment of Infrastructure Debt Fund through PPP model is gaining ground in India. Three IDFs set up through the NBFC route — L&T IDF, India Infradebt and IDFC IDF— have grown galloped from ₹600 crore about in 2015 to over ₹9,000 crore in 2017-18.

Infradebt Limited fund is jointly promoted by ICICI Bank, Bank of Baroda, Life Insurance Corporation (LIC) and Citicorp Finance (India).

Infrastructure Investment Trust (InvITs)

Infrastructure Investment Trust (InvITs) is like a mutual fund, which enables direct investment of small amounts of money from individual/institutional investors in infrastructure to earn income as

return. InvITs work like mutual funds or real estate investment trusts (REITs). InvITs can be treated as the modified version of REITs designed to suit the specific circumstances of the infrastructure sector. They are regulated by SEBI.

Masala Bonds

(discussed elsewhere)

Engineering, Procurement, Construction (EPC) Contract and Turnkey

Developed countries are preferring Engineering, Procurement and Construction (EPC) contracts where the contractor is responsible for design and construction on a turnkey basis and for a fixed price. Turnkey is a traditional public sector procurement model for infrastructure facilities. Generally, a private contractor is selected through a bidding process. The private contractor designs and builds a facility for a fixed payment. The contractor assumes risks involved in the design and construction phases. This type of private sector participation is also known as Design-Build.Both EPC and Turnkey projects for general purposes are similar.

Lease

In this category of arrangement, the operator (the leaseholder) is responsible for operating and maintaining the infrastructure facility (that already exists) and services, but generally the operator is not required to make any large investment. However, often this model is applied in combination with other models such as build- operate-transfer. Under a lease, the operator retains revenue collected from customers/users of the facility and makes a specified lease fee payment to the contracting authority. Generally, the government undertakes the responsibility for investment and thus bears investment risks. The operational risks are transferred to the operator.

New Delhi

Suitability and which model to select

Each model has its own pros and cons and can be suitable for achieving the major objectives of private-private partnership to a varying degree. Special characteristics of some sectors and their technological development, legal and regulatory regimes, and public perception about the services in a sector can also be important factors in deciding the suitability of a particular model of PPP.

There is no single PPP model that can satisfy all conditions.

A typical PPP structure can be quite complex involving contractual arrangements between a number of parties, including the government, project sponsor, project operator, financiers, suppliers, contractors, engineers and customers. The creation of a separate commercial venture called a Special Purpose/Project Vehicle (SPV) is a key feature of most PPPs. The SPV is a legal entity that undertakes a project and negotiates contract agreements with other parties including the government.

SPV has many advantages. Protected finance is available. A project may be too large and complicated to be undertaken by one single investor considering its investment size, management and operational skills required and risks involved. In such a case, the SPV mechanism allows joining hands with other investors who could invest, bring in technical and management capacity and share risks, as necessary.The government may also contribute to the long-term equity capital of the SPV in exchange of shares. For example, GSTN.

Sometimes, governments want to ensure a continued interest (with or without controlling authority) in the management and operations of infrastructure assets such as a port or an airport particularly those which have strategic importance, or in assets that require significant financial contribution from the government. In such a case, a joint venture may be established. A joint venture is an operating company owned by a government entity and a private company (or multiple companies including foreign companies if permitted by law), or a consortium of private companies.

Other than its strategic, financial and economic interest, the government may also like to directly participate in a PPP project. The main reasons for such direct involvement may include:

- To hold interest in strategic assets;
- To address political sensitivity and fulfil social obligations;
- To ensure commercial viability of the project;
- To provide greater confidence to lenders; and
- To have better insight to protect public interest.

PPP in Highways

The National Highway network of the country spans about 70,548 km. The National Highway Development Project (NHDP), covering a length of about 54,000 km of highways, is India's largest road development programme in its history. The government has encouraged increased private sector participation in upgrading the arterial road network of the country to world class standards. More than 60 per cent of the estimated investment requirement is expected to be financed through PPP. With several key projects on the anvil spanning a length of about 45,000 km (including six-laning of four-laned roads, expressways and port connectivity projects) and a large number of projects in States, there is great reliance on PPPs. Expressways are the highest class of roads in the Indian road network. They are six or eight-lane highways.Under Bharatmala project(2017), over 83,000 km of national highways will be constructed at an estimated investment of Rs 7 lakh crore by 2022.Private participation through public private partnership (PPP) of about Rs 1 lakh crores.

PPP in Civil Aviation

(Udaan given elsewhere)

PPP in Urban Infrastructure

Private sector participation needs to be encouraged in urban infrastructure sectors like water supply and sewerage and solid waste management. In urban transport, private sector can provide more efficient transport services, construct and maintain modern bus terminals with commercial complexes, over bridges, city roads and so on. PPP initiatives are also being undertaken to develop metro rail systems in Indian cities.

Hyderabad Metro Rail Project

Hyderabad Metro Rail Project on PPP mode, being developed on Design, Build, Finance, Operate and Transfer (DBFOT) mode. The project was awarded to the successful bidder for a VGF provided by the Central Government while the remaining investment will be made by the concessionaire. This is the single largest private investment in a PPP project in India. It is also one of the largest metro rail projects built and operated by a private entity anywhere in the world. The project demonstrates how large volumes of private capital can be deployed in public projects in a transparent, efficient and competitive manner. The concession has been awarded on the basis of the Model Concession Agreement for Urban Transit developed by GOI.

The Mumbai Monorail is a monorail system in the city of Mumbai. The project is being implemented by Mumbai Metropolitan Region Development Authority (MMRDA), with a consortium of Larsen & Toubro (L&T) and a Malaysian infrastructure firm Scomi Engineering. The system started commercial operation after partially opening its Phase 1 to the public in 2014. Upon the completion of entire Phase 1 in mid-2017, the Mumbai Monorail becomes the fifth-largest monorail system in the world.

PPP in Ports

The government has encouraged private sec- tor participation in port development and operations. Foreign direct investment up to 100 per cent is permitted under the automatic route for port development projects. Private investment has been envisaged on PPP basis in ports of Kolkata, Haldia, Paradip, Vizag, Ennore, Chennai, Tuticorin, Cochin, New Mangalore, Mormugao, Mumbai, JNPT and Kandla.

PPPs in Social Sectors

The Twelfth Plan (2012-17) lays special emphasis on the development of social sectors in view of their impact on human development and quality of life, especially of the underprivileged sections. The physical targets set in the Plan cannot be met out of public resources alone. It is, therefore, imperative that resources have to be attracted from the private sector to ensure that targets, in physical and financial terms, are met by the end of the Twelfth Plan period.

In the social sectors, it may not be possible to adopt the user-charge-based concessions, although they may not be completely ruled out. However, concessions which would provide reimbursement of service costs could attract considerable private investment. The main advantages of adopting the PPP approach in the social sectors would be enhanced investment, reduction in time and cost over-runs, improvement in efficiencies and better quality of performance.

New Delhi

PPP in Education

A scheme for setting up 2,500 schools under PPP mode was rolled out in the Twelfth Plan. The purpose of the scheme is to meet the government's objective of establishing world-class schools for providing quality education to underprivileged children who cannot afford to pay the tuition fee that good private schools charge. It is expected that the scheme will help in creating capacity for providing quality education to 40 lakh children, out of which 25 lakh will be from the underprivileged category.

The respective rights and obligations of the private entity and the government will be codified in an agreement with the former undertaking to deliver the agreed service on the payment of a charge by the government. Recurring tuition support would be provided for up to 1,000 students from under privileged categories at par with the amount that the Central Government spends on a student in Kendriya Vidyalaya. There would be no capital support and land would have to be procured by the private entity. Infrastructure support shall be made available by the government for the under- privileged students at the rate of 25 per cent of the recurring tuition support. The concession would be for a period of 10 years.

The scheme for 2,500 PPP schools should be viewed as an opportunity to evolve innovative ways to empower and enable non-government players to engage in providing world-class education, especially to children from low-income families. The objective should be to combine the respective strengths of the public and private sectors to complement each other in pursuit of the

shared goal of good education for all. In particular, adoption of the PPP mode would lead to rapid expansion of access to world-class education by low-income families.

In 2012, GOI approved a scheme for setting up 20 IITs in PPP mode with an overall outlay of Rs 2,800 crore.While land for the purpose was made available free of cost by state governments concerned, an IIT was established at a capital cost of Rs 128 crore each to be contributed in ratio of 50:35:15 by centre, state and industry partner respectively.

Areas that come under PPP might include almost every aspect of education, including evaluation and implementation, ownership, management, funding, running of institutions, academic aspects, special education programmes, like bridge courses, teacher training services, extra academic aspects, examinations, including entrance examinations, support services, hostels, healthcare, transport, maintenance, security, and so on, though policy formulation is normally considered as an exclusive prerogative of the state. In recent years several hybrid partnerships have also evolved, involving new combinations and permutations of state and non-state sectors engaged in a range of activities in education.

Criticism: Most partnerships of the recent period are based on market-oriented logic, while many models prevalent during earlier periods were not so, and they were also not described as PPP models. There is a main difference between the earlier models and the recent ones. The government was interested in PPP, when it proposed, for example, university-industry collaborations, essentially for academic reasons, to improve the relevance of curriculum, increase employability of graduates etc. Nowadays, the main objective of proposing PPP is to raise private funds and save public resources.

PPP models do not feel the need to view education, as a social good, a public good and a social merit good, as distinct from production of normal commercial goods and infrastructure. It is widely felt that as a result, PPP adversely influences the publicness of education. PPP then may lead to gradual or rapid shrinking of the state sector and an expansion of private sector which may eventually emerge as the sole player in education displacing public sector altogether.

In other words, public-private partnerships often end in favour of privatisation of Education and diminution of the role of thegovernment.

Table 1. PPP an Incompatible Partnership: Conflicting Interests of the Public and Private Players in Education

	State/Public	*Market/Private*
Nature & purpose of education	Social good	Individual gain
Motivation	Service	Profit
Main Concern	Knowledge	Skills
Area of interests	Generic	Specific
Duration of interest	Long term	Short term
Team effort	Rarely	Always
Research	Publish/public good	Strict confidential/private good
Time Schedule	Flexible	Rigid
Nature of Universities	Diversity	Uniformity
Relevance	Society	Market

Source: Jandhyala B G Tilak

PPP in Health Care Services

Several State Governments are experimenting with delivery of health services through different models. Planning Commission also considered a scheme for setting up secondary and tertiary care hospitals through PPPs at various District Headquarters. The principal objective of the scheme is to create a health care delivery mechanism comprising multi-specialty hospital to meet the growing health care needs of the poor, and for supplementing human resources in the sector by setting up nursing schools and medical colleges.

Niti Aayog: Public Private Partnership for Non-Communicable Diseases (NCDs) in District Hospitals: Draft Guidelines 2017

National Health Policy, 2017 advocates the case of increased role for private sector in the urban areas: "Given the large presence of private sector in urban areas, the policy recommends exploring the possibilities of developing sustainable models of partnership with for profit and not for profit sector for urban health care delivery."

Niti Aayog and the Union ministry for health and family welfare have proposed a model contract to increase the role of private hospitals in treating non-communicable diseases in urban India. The agreement, which has been shared with states for their comments, allows private hospitals to bid for 30-year leases over parts of district hospital buildings and land to set up 50- or 100-bed hospitals in towns other than India's eight largest metropolises.

According to the model contract, the district hospitals will need to share their back-end services such as blood banks and ambulance services with the private players. The state government could also provide part of the funds needed by these private players to set up the new hospitals. The district health administration will ensure referrals for treatment from primary health centres, community health centres, disease screening centres and other government health programmes and ventures are made to these private hospitals.The World Bank was engaged as "technical partner" to prepare the document. Under the model contract, these private hospitals will provide secondary and tertiary medical treatment for cancer, heart diseases and respiratory tract ailments at prices that are not higher than those prescribed under government health insurance schemes.

The rationale for coming up with this model is the fact that these three diseases do account for almost 35-40 per cent of total mortality in the country. So attention to them is not misplaced. It is also a fact that three-quarters of the specialists, equipment and beds are in the private sector. Partnership with them is therefore inevitable. Given below are the arguments of the proponents summarized by Amitabh Kant of Niti Aayog and opponents as presented by Sujata Rao , former Health Secretary,GOI.

Pros

The for the PPP is justified on the following grounds:

- rampant absenteeism of doctors — ranging from 28 per cent to 68 per cent in different states.
- The increase in government expenditure to 2-2.5 per cent of GDP for the expansion of public health services fails to fructify, and has hovered in the range of 0.9-1.3 per cent from1990 till date.
- Community Health Centres report a 65 per cent vacancy rate of specialists since governments are simply unable to attract and retain talent.

- private sector continues to grow at 15 per cent per annum, accounting for 58 per cent of rural and 68 per cent of urban in-patient care with 80-90 per cent of health facilities and a five-fold higher doctor density.
- Non-communicable diseases account for 60 per cent of the premature mortality in India and cardiovascular diseases, pulmonary diseases, cancer, as well as hypertension, diabetes and stroke are among the leading killers, accounting for four of the top five causes of death
- The aim is to ensure that district hospitals provide basic services for the diagnosis and treatment of NCDs at affordable rates or free of cost for those patients for whom the government chooses to cover such costs through insurance or through budgetary grants. This will help decongest tertiary level health facilities, help in the geographic dispersal of skills required for NCD care and provide quality care to people closer home at a lower cost.

Cons

- one-sidedness of the agreement, with the government bearing all the risk and the private partner having all the profits. Risk is unequally spread.
- The challenge in the Niti Aayog hybrid model is its implementation. How do public and private managements coexist in the same physical space? A hospital is a living institution that cannot be dismembered. Salary streams, motivation levels, working methods, prescription practices, monitoring and accountability systems, work expectations, all vary. Everyday, there are instances of patients being denied treatment in private hospitals till payment is made or preferring paying patients to the government insured ones or levying additional charges in addition to the sum reimbursed. Private hospitals are also known to overcharge devices like stents and drugs that are the key revenue earning centres. How, then, will the government operate its low-cost generics jan aushadhi pharmacies alongside the private entity pharmacies? In other words, in such a model how will conflicts of interest be managed?

New Delhi

(Primary healthcare is the first level of contact between patient with the health system: immunization, treatment of common diseases or injuries, provision of essential facilities, health education, provision of food and nutrition and adequate supply of safe drinking water.

Secondary Healthcare means patients from primary health care are referred to specialists in higher hospitals for treatment.

Tertiary Health care involves specialized consultative care provided on referral from primary and secondary medical care. Specialised Intensive Care Units, advanced diagnostic support services and specialized medical personnel on the key features of tertiary health care.)

PPP in Skill Development

As part of the government's initiative to augment the programmes for skill development, GOI announced setting up of 1,500 ITIs through PPP in unserved blocks. The objective is to create centres of excellence in vocational education especially for the youth from low-income families in order to improve their prospects of gainful employment. A major proportion of the costs incurred by an ITI are of a recurring nature, and GOI therefore, provides support for the recurring expenditure incurred by an ITI towards training students from underprivileged families. Further, GOI provides capital grant to meet a part of the cost of creating the infrastructure for setting up the ITIs. Under Phase 1 of Pradhan Mantri Kaushal Vikas Yojana (PMKVY), the government has trained millions More than 1,100 new industrial training institutes (ITIs) have been created in

www.freeupscmaterials.org

2016. Cabinet approved a national apprenticeship promotion scheme under which five million people are to be trained by 2019-20 at a cost of Rs 10,000 crore.

In 2013 the Companies Act mandated all organizations with a minimum net worth of Rs 500 crores, a turnover of Rs 1,000 crores, and a net profit of at least Rs 5 crores, to spend at least 2% of their profits on CSR. Leading corporations have taken an active role in working with ITIs to strengthen them and improve the quality of learning outcomes from the institutions.

PPP in Digital India

Digital India is a campaign launched by the Government of India in 2015 which includes plans to connect rural areas withhigh-speed internet networks. Digital India consists of three core components. They are:

- Development of secure and stable Digital Infrastructure
- Delivering government services digitally
- Universal Digital Literacy

The BharatNet project, earlier National Optical Fibre Network or NOFN, seeks to bring high-speed broadband to all 2.5 lakh gram panchayats through optical fibre. It was approved by Cabinet in 2011.It is to be funded by Universal Service Obligation Fund (USOF). The project intends to enable the government of India to provide e-services and e-applications nationally.

Under BharatNet Phase I, Optical Fibre Cable (OFC) connectivity reached in over 1, 00, 000 Gram Panchayats (GPs) across different States in the country by November 2017. The second phase (BharatNet Phase 2) aims at covering the remaining 1.50 lakh GPS March 2019

(USOF The NTP of 1999 had Universal Service as one of its main objectives.The resources for meeting the Universal Service Obligation (USO) were to be generated through a Universal Access Levy (UAL), at a prescribed percentage of the revenue earned by the telecom licensees (telcos).)

TRAI said that "public-private-partnership" (PPP) model is best suited for this project. Under PPP model, private sector's capacity for delivery is combined with the government's role as an enabler and regulator to overcome market failures.Build-Own-Operate-Transfer (BOOT) model has potential to ensure long-term incentive and reduces risks. TRAI:'A PPP model that aligns private incentives with long term service delivery in the vein of the Build-Own-Operate-Transfer/Build-Operate-Transfer models of implementation be the preferred means of implementation.'

TRAI said that a project like BharatNet should be done by entities that have their own interests in monetisation of the network.

PPP in Swachh Bharat

Swachh Bharat Abhiyan (SBA) was started in 2014 with the objectives that include eliminating open defecation through the construction of household-owned and community-owned toilets and establishing an accountable mechanism of monitoring toilet use. It aims to achieve an Open-Defecation Free (ODF) India by 2 October 2019, the 150th anniversary of the birth of Mahatma Gandhi, by constructing 12 million toilets in rural India at a projected cost of ₹1.96 lakh crore.

It is India's largest cleanliness drive to date with 3 million government employees, school students, and college students from all parts of India participating in 4,041 statutory cities, towns and associated rural areas.

The mission contains two sub-missions: Swachh Bharat Abhiyan ("Gramin" or rural), which operates under the Ministry of Drinking Water and Sanitation; and Swachh Bharat Abhiyan (Urban), which operates under the Ministry of Housing and Urban Affairs.

The government has stressed on promoting PPP. Community cleanliness projects can be funded via the PPP model.

Waste-to-energy projects can be taken up by PPP model.Mumbai has the potential to set up a 120-MW power station based on garbage the city generates, fetching Rs.1,000 crore a year. The PPP model can also be brought in by roping in corporates in such power projects.

Swach Bharat is very important part of CSR and Public Private Partnership (PPP). The Government's commitment that every person should have access to safe drinking water, a toilet and a hygiene facility by 2019 needs CSR and PPP framework for funds as well as quality interventions and programs, which can maximize social impact and the focus on behavior change to influence positive behaviors.

Concerns

Resort to PPPs in the social sector often raises concerns about the commercialisation of services that are normally expected to be provided free or highly subsidised. These are important concerns but they can be addressed by well-drafted concession agreements and strict monitoring to ensure that PPP concessionaires abide by their commitments. This must be reinforced with penalties for non compliance.

While extending the concept of PPP to social and urban sector projects, the need for 'people's' participation in the design and monitoring of PPP schemes becomes crucial. Local citizens are direct stakeholders in such projects and therefore their support becomes crucial. Therefore, some cities and States have begun to shape PPPs in the social and urban sectors as People–Public–Private Partnerships (PPPPs). This is a valuable innovation which should be applauded.

Recommendations of Kelkar Committee 2015

Public Private Partnerships (PPPs) in infrastructure refer to the provision of a public asset and service by a private partner who has been conceded the right (the "Concession") for the purpose, for a specified period of time, on the basis of market determined revenue streams, that allow for commercial return on investment. PPPs in infrastructure represent a valuable instrument to speed up infrastructure development in India. This speeding up is urgently required for India to grow rapidly and generate a demographic dividend for itself and also to tap into the large pool of pension and institutional funds from aging populations in the developed countries.

India offers today the world's largest market for PPPs. It has accumulated a wealth of experience in getting to this premiere position. As the PPP market in infrastructure matures in India, new challenges and opportunities have emerged and will continue to emerge. Periodic review of PPPs, as in the present Committee's remit, are a must to help address issues before they become endemic and to mainstream innovations and foster new ones that improve the successful delivery of PPP projects.

India's success in deploying PPPs as an important instrument for creating infrastructure in India will depend on a change in attitude and in the mind-set of all authorities dealing with PPPs,

including public agencies partnering with the private sector, government departments supervising PPPs, and auditing and legislative institutions providing oversight of PPP's.

The Committee on Revisiting and Revitalizing the PPP model of Infrastructure Development headed by Dr. Vijay Kelkar submitted its report to the Finance Ministry in November 2015. The Committee was formed following the Finance Minister's announcemet on revising the Public Private Partnership (PPP) mode of infrastructure development in his budget speech, 2015-16.

Terms of reference of the Committee included: (i) reviewing the experience of PPP policy, including the variations in contracts and the difficulties experienced, (ii) analysing the risks involved in PPP projects in different sectors and the framework of risk sharing between the project developer and the government, (iii) proposing design modifications to the contractual arrangements of PPPs based on the above; and (iv) proposing measures to improve capacity building in government for effective implementation of PPP projects.

Recommendations

Revisiting PPPs: The Committee noted that, with the current demographic transition, and the consequent growing need for better infrastructure, it is important for India to improve its current model of PPPs. PPPs have the potential to deliver infrastructure projects better and faster. Currently, PPP contracts focus more on fiscal benefits. The Committee recommended that the focus should instead be on service delivery for citizens. Further, fiscal reporting practices and performance monitoring of PPPs should be improved.

The PPP model requires the involvement of a private partner to leverage financing and improve operational efficiencies. Therefore, state owned enterprises or public sector undertakings should not be allowed to bid for PPP projects. PPPs should not be used by the government to evade its responsibility of service delivery to citizens. This model should be adopted only after checking its viability for a project, in terms of costs and risks. Further, PPP structures should not be adopted for very small projects, since the benefits are not commensurate with the costs.

Risk allocation and management: The Committee noted that inefficient and inequitable allocation of risk can be a major factor leading to failure of PPPs. PPP contracts should ensure optimal risk allocation across all stakeholders by ensuring that it is allocated to the entity that is best suited to manage the risk. A generic risk monitoring and evaluation framework should be developed covering all aspects of a project's lifecycle. The Committee also recommended the guidelines for risk allocation.

Strengthening policy and governance: Ministry of Finance may develop a national PPP policy document, endorsed by Parliament. The Committee also recommended formulating a PPP law, if feasible. Further, the Prevention of Corruption Act, 1988 should be amended to distinguish between genuine errors in decision making and acts of corruption by public servants.

Strengthening institutional capacity: The capacity of all stakeholders including regulators, authorities, consultants, financing agencies, etc should be built up. A national level institution should be set up to support institutional capacity building activities, and encouraging private investments with regard to PPPs. Independent regulators must be set up in sectors that are going for PPPs. An Infrastructure PPP Project Review Committee may be set up to evaluate PPP projects. An Infrastructure PPP Adjudication Tribunal should also be constituted. A quick, efficient, and enforceable dispute resolution mechanism must be developed for PPP projects.

Strengthening contracts: Since infrastructure projects span over 20-30 years, a private developer may lose bargaining power because of abrupt changes in the economic or policy environment. The Committee recommended that the private sector must be protected against such loss of bargaining power. This could be ensured by amending the terms of the PPP contracts to allow for renegotiations. The decision on a renegotiated concession agreement must be based on (i) full disclosure of renegotiated costs, risks and benefits, (ii) comparison with the financial position of the government at the time of signing the agreement, and (iii) comparison with the existing financial position of the government just before renegotiation.

PPPs and Capacity Building in the States

The State Governments generally do not have dedicated staff resources for handling PPP projects or for building the requisite capacity. Such capacity is critical for conceptualising project proposals, engaging consultants, interacting with and supervising consultants, analysing and processing their advice for government approvals, interacting with prospective investors, executing the project documents and monitoring implementation.

SIA

Social impact assessment (SIA) assesses the social effects of infrastructure projects and other development interventions. The origin of SIA comes from the environmental impact assessment (EIA) model, which first emerged in the 1970s in the U.S. as a way to assess the impacts on environment (trees, soil, rivers and other water bodies, wild life etc) of certain development schemes and projects before they go ahead – for example, new roads, industrial facilities, mines, dams, ports, airports, and other infrastructure projects. It has been incorporated since into the formal planning and approval processes in several countries, in order to categorize and assess how major developments may affect populations, groups, and settlements.

New Delhi

Social impact assessment is also of increasing importance as a means to measure and monitor the social returns or social outputs of a project. Social impacts can be defined as the consequences to people of any proposed action that changes the way they live, work, relate to one another, organise themselves and function as individuals and members of society. This definition includes social-psychological changes, for example to people's values, attitudes and perceptions of themselves and their community and environment. Indeed, some SIA practitioners consider social impacts to be only 'as experienced' (e.g. stress, disruption, hunger) and differentiate these from the causal processes (e.g. over-crowding, infrastructure pressure, poverty). Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 makes SIA mandatory.

The main types of social impact that occur as a result of these project-related changes can be grouped into five overlapping categories:

- lifestyle impacts – on the way people behave and relate to family, friends and cohorts on a day-to-day basis;
- cultural impacts – on shared customs, obligations, values, language, religious belief and other elements which make a social or ethnic group distinct;
- community impacts – on infrastructure, services, voluntary organisations, activity networks and cohesion;
- amenity/quality of life impacts – on sense of place, aesthetics and heritage, perception of belonging, security and livability, and aspirations for the future; and

- health impacts – on mental, physical and social well being, although these aspects are also the subject of health impact assessment

The key points of the above discussion are that:

- social and biophysical impacts are interconnected and should be assessed together;
- SIA is understood to be concerned with the human consequences of development proposals, identifying all significant social impacts that arise in this context; and

National Investment & Manufacturing Zones (NIMZs)

Government notified the National Manufacturing Policy (NMP) on 4th November, 2011 with the objective of enhancing the share of manufacturing in GDP to 25% and creating 100 million jobs over a decade or so. National Investment and Manufacturing Zones (NIMZs) are one of the important instruments of the Policy to achieve its objectives. So far Government has granted 'in-principle' approval to the fourteen NIMZs (outside the DMIC region). These are:

- Nagpur in Maharashtra
- Prakasam in Andhra Pradesh
- Chittoor in Andhra Pradesh
- Medak in Telangana
- Hyderabad Pharma NIMZ at Rangareddy and Mahabubnagar Districts in Telangana.
- Tumkur in Karnataka
- Kolar in Karnataka
- Bidar in Karnataka
- Gulbarga in Karnataka
- Kalinganagar, Jajpur District in Odisha
- Ramanathapuram District of Tamil Nadu
- Ponneri Taluk, Thiruvallur District, Tamil Nadu
- Auraiya District in Uttar Pradesh and
- Jhansi District in Uttar Pradesh

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Of these, the NIMZ at Prakasam in Andhra Pradesh; Medak in Telangana and Kalinganagar, Jajpur district in Odisha have been granted final approval.

Eight Investment Regions along the Delhi Mumbai Industrial Corridor (DMIC) project have also been announced as NIMZs. The details are as under:

- Ahmedabad-Dholera Investment Region, Gujarat
- Shendra-Bidkin Industrial Park city near Aurangabad, Maharashtra
- Manesar-Bawal Investment Region, Haryana
- Khushkhera-Bhiwadi-Neemrana Investment Region, Rajasthan
- Pithampur-Dhar-Mhow Investment Region, Madhya Pradesh
- Dadri-Noida-Ghaziabad Investment Region, Uttar Pradesh
- Dighi Port Industrial Area, Maharashtra ; and
- Jodhpur-Pali-Marwar Region in Rajasthan

The basic detail is as follows: State government selects the land and applies to the Central government to accept its proposal to set up an NIMZ. If the central government accepts, it notifies the same and sets up an SPV that manages it. State government owns it itself or makes any other arrangement of ownership. NIMZs are developed as green field industrial townships, benchmarked

with the best manufacturing hubs in the world. These NIMZs seek to address the infrastructural bottleneck which has been cited as a constraining factor for the growth of manufacturing".

The NMIZ functions as "a self-governing and autonomous body and will be declared by the State Governments as an Industrial Township under Art 243 Q (c) of the Constitution. They would be different from SEZs in terms of size, level of infrastructure planning, and governance structure related to regulatory procedures and exit policies". NIMZ may also have SEZs located in them. While SEZs mainly concentrated on exports, NIMZs have no such role, though they may export if they choose to. SEZs exist for the services sectors as well while NIMZ does not.

Thus, NIMZ is an all-inclusive gigantic structure combining production units, public utilities, logistics, environmental protection mechanisms, residential areas and administrative services. It may also include one or more Special Economic Zones (SEZs), Industrial Parks and Warehousing Zones, Export Oriented Units (EOUs) and Domestic Tariff Area (DTA) units.

NIMZ would have an area of at least 5000 hectares .As regards internal infrastructure of NMIZ, it will be provided by a Developer or a group of Co-developers, while external linkages will be provided by Govt. of India and the concerned State Govt. Thus, it requires Centre-State co-ordination.

While the Central Govt. will be responsible for notifying the NIMZ and issuing necessary clearances, the State Governments have many tasks to perform. Apart from selecting the land and acquiring if necessary: such as ensuring water requirements, power connectivity, infrastructure linkages, etc. Other functions of states government include, among other things,

- land,
- funding of initial cost of land,
- exploring funding arrangements, including from international funding institutions, long term tax free debentures, etc
- power connectivity,
- water requirements,
- state roads connectivity,
- sewerage and effluent treatment,
- health, safety and environmental issues, etc.

New Delhi

The preference will be for non-agricultural land with adequate water supply. If needed, the states may reserve a certain share of the land for MSMEs. Ownership of an NIMZ will either be with the state government, a state government undertaking in joint ownership with a private partner or under any other appropriate model. Wasteland, as far as possible will be acquired and agricultural land will be kept to minimum. It should not be in ecologically sensitive area.

NIMZs will put in place a comprehensive exit policy that will promote productivity while providing flexibility by reducing some of the moving rigidities in the labour market and by ensuring protection of workers' rights as laid down in the statute.

Affordable Housing

Affordable housing addresses the housing needs of the lower or middle income households. Disposable income of the people remains the primary factor in determining the affordability. As a result, it becomes the increased responsibility of the government to cater to the rising demand for

affordable housing. The Government of India has taken various measures to meet the increased demand for affordable housing along with some developers and stressing on public-private partnerships (PPP) for development of these units.

There were many problems initially in developing affordable housing: lack of land and high construction costs; unfavourable tax environment and lack of incentives. A major catalyst instrumental in this segment's growth was the Indian government's ambitious housing program.

In 2015, Prime Minister Narendra Modi announced the 'Housing for All by 2022' scheme targeting two crore homes to be built across all urban locations over the next five years. 2017-18 Union Budget has many initiatives for the affordable sector:

- The government has granted the much-coveted infrastructure status to affordable housing, giving developers access to cheaper sources of funding, including external commercial borrowings (ECBs).
- Affordable housing promoters have been granted more time for project completion - the deadline has been increased to five years from the current three years.
- The qualifying criteria for affordable housing have been revised to 30 square meters and 60 square meters on the carpet, rather than the saleable area, for metros and non-metros respectively. This effectively increases the size of the affordable housing market across India.
- a new Credit Linked Subsidy Scheme (CLSS) for the mid-income group was announced with a provision of Rs 1,000 crore.

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The government is reaching out to developers to make 'Housing for All by 2022' a reality. An additional incentive of 39% higher allocations was announced for affordable housing development this financial year under the Pradhan Mantri Awas Yojana (PMAY). It has also extended the CLSS to loans up to Rs 12 lakh.

New Delhi

Government policies like the Real Estate Regulatory Authority (RERA) made buyer confident. The availability of cheap finance is also driving the demand for affordable housing.

Refinance of housing loans by National Housing Banks (NHBs) will give further boost to the sector.

There are however challenges.

The biggest challenge to create affordable housing is the unlocking of land in urban areas. Unless adequate land is made available, creating 2 crore homes may be a distant dream. According to an estimate, close to 57,392 acres will be required to build the 2 crore homes. This will require unlocking non-essential lands currently being held by large government bodies.

The housing shortage in India is pegged at 1.9 crore units and the government has recognized the need to fill the gap in urban housing. The drive to bring homes to the country's 1.3 billion people is expected to bring a colossal $1.3 trillion of investment to the housing sector over the next seven years. The government's financial and policy thrust, regulatory support, rising urbanization, and increasing affordability is converting demand for affordable homes into a commercially viable opportunity.

Infrastructure Status

In the Budget 2017-18, GOI gave 'affordable housing' infrastructure status to facilitate higher investment in the sector and, in turn, achieve the government's ambitious goal of 'Housing for All'.

The grant of infrastructure status would mean builders will be eligible for many government tax and subsidy incentives, and institutional funding at affordable rates for low cost homes.

With the infrastructure status, the sector can look at funding through insurance companies, which is a huge alternate sector and opens up a new avenue for long term real estate funding. It also means higher limit on external commercial borrowings which will attract more investments.

PPP Policy for Affordable Housing

Central Government announced a new PPP Policy for Affordable Housing that allows extending central assistance of up to Rs.2.50 lakh per each house to be built by private builders even on private lands besides opening up immense potential for private investments in affordable housing projects on government lands in urban areas.

The policy gives eight PPP (Public Private Partnership) options for private sector to invest in affordable housing segment. It seeks to divide risks among the government, developers and financial institutions, to those who can manage them the best besides leveraging under utilized and un-utilized private and public lands towards meeting the Housing for All target by 202..

It proposes eight implementation models for affordable housing using PPP, six of those using government lands, and two using private land. These are:

- Government land based subsidised housing: The public authority will allot land to the selected private developer, who will design, build, and transfer the housing units back to the authority. The public authority will pay the developer based on pre-determined milestones.
- Mixed development cross-subsidised housing: Instead of receiving payments from the public authority, the developer can cross subsidise the project by developing high end housing on a part of the allotted land.
- Annuity based subsidised housing: The public authority will allot the land and pay the developer in annuity payments (up to 10 years). The developer will maintain the project for this period, and will be monitored by the authority.
- Annuity cum capital grant based subsidised housing: A significant proportion of the cost (40-50%) will be paid by the authority during the construction phase. The remainder will be paid as an annuity (up to 10 years).
- Direct relationship ownership housing: The land will be allotted to the developer by the authority. The beneficiary will directly pay to the private developer.
- Direct relationship rental housing: The developer will own the housing units and receive rent from the beneficiaries.
- Credit Linked Subsidy Scheme (CLSS) approach: The private developer will be responsible for providing land as well as the development of the project. Under the CLSS

component of the Pradhan Mantri Awas Yojana (PMAY), the central government will provide an interest - subsidy of Rs 2.50 lakh per house on loans taken by beneficiaries.

- Affordable Housing Partnership (AHP) approach: The private developer will be responsible for providing land and the development of the project. The central government will provide the allottees an assistance of Rs 1.50 lakh for each economically weaker section housing unit

Sagar Mala Project

Problems with the port sector in India

For long, the growth of India's maritime sector has been hampered by many procedural and policy related challenges, the most important among them being the presence of a dual institutional structure that has led to the development of major ports (those owned by the central government) and non-major ports (those owned by the state governments) as individual projects.

Lack of infrastructure for evacuation of cargo at major and non-major ports leading to a sub-optimal transport modal mix, limited hinterland linkages and its impact on transportation costs, limited development of coastal areas for manufacturing and economic activities, low penetration of coastal and inland shipping, lack of scale and deep draft at ports also contributed to the skewed growth.

Sagar Mala project is a strategic and customer-oriented initiative of the Government of India to modernize India's Ports so that port-led development can be augmented and coastlines can be developed to contribute in India's growth. It looks towards "transforming the existing Ports into modern world class Ports and integrate the development of the Ports, the Industrial clusters and hinterland and efficient evacuation systems through road, rail, inland and coastal waterways resulting in Ports becoming the drivers of economic activity in coastal areas. It aims at harnessing India's 7,500-km long coastline, 14,500-km of potentially navigable waterways and strategic location on key international maritime trade routes.

Indian coastline will be developed as Coastal Economic Regions (CER). The Sagarmala Development Company was given the nod for incorporation by Indian Cabinet in July 2016 with an initial authorized share capital of Rs 1000 Crore and subscribed share capital of Rs 90 Crore, to give a push to port-led development. The Sagarmala National Perspective Plan was released in April-2016 with details on Project Plan and Implementation.

Sagar Mala project—an infrastructure-cum-policy initiative being readied by the shipping ministry— seeks to allow the central government to have a say in the development of non-major ports. The initiative, according to the ministry, will strive to tackle all the challenges by focusing on port modernization, efficient evacuation and coastal economic development through a structured framework for ensuring inter-agency collaboration and integrated development. It will provide the necessary institutional framework to enable the central and state authorities to work together for ensuring inclusive growth.

Coastal Economic Regions (CER)

As a part of flagship Sagarmala (string of ports) project, the government will develop 10 Coastal Economic Regions (CERs) which will be the focal point for economic development along India's vast coastline of over 7,000km. Each CER will hold an integrated and comprehensive plan of the

area, combining the growth potential of various industrial clusters and economic activities with the upgradation and development of both major and non-major ports simultaneously. The CER will also develop transport systems for land- and water-borne evacuation of cargo from and to the ports on a regional basis, thus ensuring an optimal modal mix. By linking major and non-major ports, industrial clusters and evacuation infrastructure into a single system at a larger regional level, a CER will enable seamless and efficient movement of cargo through gateways, thereby allowing ports to enhance competitiveness and offer multiple freight options to customers.

Ports will thus be able to actively participate in driving the economic development of a wider region, which is similar to the role large global ports are playing in their respective countries.This will need enabling policies, institutional framework and appropriate funding mechanism for promoting collaborative development.

The Sagar Mala project would be implemented by a company set up at the national level. Each CER will be developed through a special purpose vehicle having equity participation from the state government concerned and the company. The management of the CER special purpose vehicle would vest with the state government.

Port-led development model successfully delivered in Gujarat. This includes development port-based industrial parks, captive industries and ancillary facilities such as ship repair, shipbuilding, ship-breaking, bunkering, container freight stations, warehousing facilities, industries requiring significant import of raw materials and industries with large export potential. This will ultimately result in more cargo for ports. The states, too, have much to gain from such a collaboration because it would ensure funding and other institutional support from the centre.

Sagar Mala has come at the right time for the central government-owned ports, many of which are losing market share to non-major ports mainly due to regulatory reasons. Extending a collaborative hand would help both set of ports to grow. The project would need Rs 5,000 crore in investment in the next five years.

While this will primarily focus on major and minor ports, government is also going for its other agenda to attract private investment in the inland waterway sector that can provide a competitive alternative to road and rail network for cargo transport. Thus, Make in India programme gets boost.

Logistics Performance Index (LPI)

It is a benchmarking tool created to help countries identify the challenges and opportunities they face in their performance on trade logistics and what they can do to improve their performance. It is the weighted average of the country scores on key dimensions: quality of logistics services (e.g., transport operators, customs brokers); Ability to track and trace consignments; Timeliness of shipments in reaching destination within the scheduled or expected delivery time etc. This measure indicates the relative ease and efficiency with which products can be moved into and inside a country.

Logistics Performance Index is reported by World Bank in every 2 years. The LPI is based on a worldwide survey of stakeholders on the ground providing feedback on the logistics "friendliness" of the countries in which they operate and those with which they trade.In the 2016 logistics performance index,top position is held by Germany. India holds 35th position, a significant improvement from 2014.

NIIF

National Investment and Infrastructure Fund (NIIF) is a fund created by the Government of India for strengthening infrastructure financing in the country. It must be noted that his is different from the National Investment Fund which is raised form public sector disinvestment.

India needs investments worth an estimated Rs 43 lakh crore (about $646 billion) in the infrastructure sector over the next five years. As much as 70% of this requirement will be in power, roads and urban infrastructure. Since most public-sector banks are struggling to cope with toxic assets, their ability to fund large infrastructure projects is very limited. So funds for infrastructure from other sources, including NIIF, assume importance.

The NIIF and its sub-funds are supposed to invest in infrastructure projects — greenfield, brownfield and stalled. The NIIF will have an initial corpus of Rs 40,000 crore, of which 49% will be contributed by the government. The remaining 51% is to be raised from sovereign wealth funds, other global long-term investors and public-sector units. The government has already approved its contribution of Rs 20,000 crore towards the NIIF. Of this, however, Rs 1,000 crore has been budgeted for 2017-18, and Rs 4,000 crore for the last fiscal.

The NIIF was set up as a trust under the provisions of the Indian Trusts Act, 1882.The NIIF was registered with Securities and Exchange Board of India as investment fund in 2015. NIIF aims to raise debt to invest in the equity of infrastructure finance companies such as Indian Rail Finance Corporation (IRFC) and National Housing Bank (NHB). It could also consider other nationally important projects, for example, in manufacturing, if commercially viable.

The idea is that these infrastructure finance companies can then use this extra equity, manifold. It is a fund of funds and may invest in other SEBI registered funds.

New Metro Policy

The new metro rail policy empowers states, by putting the onus on them to improve project viability by stressing on economic viability and private participation. It elaborates, that the viability can be improved by promoting transit-oriented development (TOD) and allying it with real estate development, improving last-mile connectivity as well as attracting private investments. The policy provides for rigorous assessment of new metro proposals, including alternate transit mode analysis to ensure that the least-cost and most-efficient mass transit mode is selected for public transport. The new policy plans to empower states to regulate and set up a Fare-Fixation Authority as well as promoting other non-fare revenues such as advertisements, lease of space. Also there are provisions to raise resources using innovative mechanisms like 'Betterment Levy' on nearby assets, issuance of corporate bonds and improve last-mile connectivity for a catchment area of nearly five km, to promote metro ridership. The three models are outlined in the policy:

- Public-Private Partnership with Central assistance. This will be part of the Union Finance Ministry's viability gap funding scheme.
- Grant by Centre whereby 10% of Metro project cost will be provided by the Central government as lump sum amount.
- 50-50% Equity sharing model taken between the Centre and state.

Green Bonds

Green bonds are debt instruments that raise money to fund clean energy projects. Companies that raise money through these bonds have to invest it only in areas that are environment-friendly such as renewable energy, waste management, clean transport or sustainable land use.Though the green bond market has been in existence globally since 2007, in India it took off in 2015. Their significance lies in the clean environment that it will create; reverse climate change; augment financial resources for investment; provide foreign currency etc.

Yes Bank was the first Indian entity to raise money through green bonds, raising ₹1000 crore from insurance companies, pension funds, mutual fund houses and foreign portfolio investors to fund solar, wind and biomass projects in 2015. Later, the EXIM Bank raised about $500 million from international investors through green bonds.

Since India signed the Paris climate deal in 2015, a number of public and private companies have sold green bonds to raise money. Companies such as IDBI Bank, Axis Bank and NTPC Ltd have raised large sums through green bonds. State Bank of India plans to raise in 2017-18 up to $3 billion in the country's biggest overseas green-bond issue for funding projects that will help achieve the government's commitments toward sustainable growth.There has been an aggressive commitment for renewable energy by the government which has set very stringent renewable energy targets—175 gigawatts by 2022—an estimated requirement of $200 billion. Hence, in the next five years, we will see a huge amount of infrastructure spending on such projects.The Securities and Exchange Board of India (Sebi), in 2015, endorsed the Green Bond principles which are internationally recognized standards.

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SEBI Guidelines

In 2015, Securities and Exchange Board of India (SEBI) proposed new norms for issuance and listing of green bonds. The proposed norms mainly relate to disclosure requirements by the companies intending to issue such bonds, as also to the periodic reporting of fund allocation:list of projects to which Green Bond proceeds have been allocated. This may also include the details of expected environmental impact of such projects.

However, for designating an issue of corporate bonds as green bonds, in addition to the compliance with the requirements under the existing regulations, an issuer will have to disclose in the offer document certain additional information about the green bonds, which have been based upon the Green Bond Principles, 2015.

Green Bond Principles 2015

As the market for green bonds grew rapidly, a group of banks initiated the development of the Green Bond Principles (GBP)—a set of voluntary guidelines framing the issuance of green bonds.GBP encourage transparency, disclosure, and integrity in the development of the green bond market. The GBP suggest a process for designating, disclosing, managing, and reporting on the proceeds of the bond. They are designed to provide issuers with guidance on the key components involved in launching a green bond, including providing information to aid investors in evaluating the environmental impact of their green bond investments. The International Capital Markets Association acts as the GBP's secretariat and facilitates the work of its members, including issuers, investors, banks underwriting green bonds, and other market participants.

The GBP recognize several broad categories of potential eligible projects, which include but are not limited to the following:

- Renewable energy
- Energy efficiency (including efficient buildings)
- Sustainable waste management
- Sustainable land use (including sustainable forestry and agriculture)
- Biodiversity conservation
- Clean transportation
- Sustainable water management (including clean and/or drinking water)
- Climate change adaptation

India's Inland Waterways

India has an extensive network of inland waterways in the form of rivers, canals, backwaters and creeks. The total navigable length is 14,500 km (9,000 mi), out of which about 5,200 km (3,200 mi) of the river and 4,000 km (2,500 mi) of canals can be used by mechanized crafts. Freight transportation by waterways is under-utilized in India compared to other large countries and geographic areas like the United States, China and the European Union. The total cargo moved (in tonne kilometers) by the inland waterway was just 0.1% of the total inland traffic in India, compared to the 21% figure for United States. Cargo transportation in an organized manner is confined to a few waterways in Goa, West Bengal, Assam, and Kerala.

Cost of water transportation in India is barely 50 paise a kilometer, as compared to ₹1 by railways and ₹1.5by roads. Hence water transportation is receiving significant attention in recent times. Inland waterways in India consist of the Ganges (Ganga)–Bhagirathi–Hooghly rivers, the Brahmaputra, the Barak river, the rivers in Goa, the backwaters in Kerala, inland waters in Mumbai and the deltaic regions of the Godavari - Krishna rivers. About 44 million tones of cargo is moved annually through these waterways using mechanized vessels and country boats.

Inland Waterways and National Waterways Act 2016

In April 2016 National Waterways Act came into force. It declares 106 additional inland waterways as the national waterways in addition to five existing national waterways. The declaration of these National Waterways would enable Inland Waterways Authority of India (IWAI) to develop the feasible stretches for Shipping and Navigation. The right over the use of water, river bed and the land will remain with the State Government.

The legislation provides conversion into waterways 15 rivers in West Bengal, 14 each in Assam and Maharashtra, 11 in Karnataka, 12 in Uttar Pradesh, 9 in Tamil Nadu and 6 each in Bihar and Goa and 5 each in Gujarat, Meghalaya, Odisha and Telangana, among others. It also includes plan to convert the Yamuna in Delhi and Haryana into a waterway. Five of the river-stretches, which have been declared as National Waterways, include Allahabad Haldia on Ganga (1,620 km), Brahmaputra's Dhubri-Sadiya (891 km), West Coast Canal Kottapuram Kollam (205 km), Kakinada Puducherry canals (1,078 km) and East Coast Canal integrated with Brahmani river and Mahanadi delta rivers (588 km).

The Act highlights the crucial importance of waterways in the economic development of the country, which for long remained a backburner. India's trade through the waterways constitutes only 3.5 per cent. Inland water development is cost-effective. Often it has been said that it is far

easier and less expensive to transport goods from Mumbai to London than it is from Mumbai to Delhi. In this context, the Minister said that inland waterways cost only 30 paise to move cargo through waterways in comparison to Rs 1.5 through road and Rupee one from raill.

The Act also ensures that it is equally environment-friendly especially in protecting the riverine ecology and fisheries and importantly tackling pollution. Inland waterways interlink three important issues:

- Tool for industrial development: The competitive edge of key industries (steel, agro, oil & minerals) on the global market strongly relies on cost-effective inbound and outbound shipments of raw materials by waterways. A positive chain effect is established that can directly benefits non-waterway regions through competitive pricing of end products.
- Tool for economic growth: In densely populated parts of India with strong industry presence, inland waterways will help keep goods moving by avoiding a traffic gridlock when economic growth leads to rising freight volumes again. Investments in waterways infrastructure will serve, besides sustainable transport, regional development and tourism. The neighbourhood first approach of the government will get adequate boost by developing India's inland waterways.
- Tool for sustainable development: Clearly inland waterway transport will reduce negative externalities. Investments in waterways will serve biodiversity and integrated water management.

The social and environmental benefits of inland water transport are potentially high. Reduced fuel consumption, reduced global warming, cheaper goods and services for customers, more fisheries and wildlife, less accidents on road, decongested highways, cheaper travel opportunities for riverine communities are some very immediate benefits. Fishing can become a viable livelihood option again for the riverine communities. Importantly, it will also force cities and towns to reduce untreated sewage into rivers as they will tend to decrease the economic value of the river.

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Other benefits are: creation of business opportunities and jobs, and public benefits, such as recreation. Some of the key benefits provided by inland waterways may lie in those areas which are currently not quantified and valued, such as drainage and community benefits including a sense of civic pride. Further evidence on the benefits of green transport opportunities is also required as these may prove to play a significant role in reducing travel carbon emissions. These are high on the government's agenda.

Jal Marg Vikas

It is a project on the river Ganga, being developed between Allahabad and Haldia to cover a distance of 1620 kms. The project envisages development of a fairway with three metres depth, which would enable commercial navigation of at least 1500 ton vessels on the river. Construction of multi modal terminals, jetties, river information system, channel marking, navigational lock, river training and conservancy works are to be undertaken as part of the project. The project is being implemented with technical and investment support from World Bank and would be completed over a period of six years at an estimated cost of Rs. 4200 crore.

Special Economic Zones (SEZs)

India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. With a view to

overcome the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the Special Economic Zones (SEZs) Policy was announced in 2000. This policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations.

To instill confidence in investors and signal the Government's commitment to a stable SEZ policy regime and with a view to impart stability to the SEZ regime thereby generating greater economic activity and employment through the establishment of SEZs, Special Economic Zones Act, 2005, was made in 2005 The main objectives of the SEZ Act are:

- generation of additional economic activity
- promotion of exports of goods and services;
- promotion of investment from domestic and foreign sources;
- creation of employment opportunities;
- development of infrastructure facilities;

It is expected that this will trigger a large flow of foreign and domestic investment in SEZs, in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities.

The SEZ Act 2005 envisages key role for the State Governments in Export Promotion and creation of related infrastructure. A Single Window SEZ approval mechanism has been provided through a 19 member inter-ministerial SEZ Board of Approval (BoA). The applications duly recommended by the respective State Governments/UT Administration are considered by this BoA periodically. All decisions of the Board of approvals are with consensus.The SEZ Rules provide for different minimum land requirement for different class of SEZs. Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

Approval Mechanism

The developer submits the proposal for establishment of SEZ to the concerned State Government. The State Government has to forward the proposal with its recommendation to the Board of Approval. The applicant also has the option to submit the proposal directly to the Board of Approval.The Board of Approval has been constituted by the Central Government in exercise of the powers conferred under the SEZ Act. All the decisions are taken in the Board of Approval by consensus.

The functioning of the SEZs is governed by a three tier administrative set up. The Board of Approval is the apex body. The Approval Committee at the Zone level deals with approval of units in the SEZs and other related issues. Each Zone is headed by a Development Commissioner, who is ex-officio chairperson of the Approval Committee.

Once an SEZ has been approved by the Board of Approval and Central Government has notified the area of the SEZ, units are allowed to be set up in the SEZ. All the proposals for setting up of units in the SEZ are approved at the Zone level by the Approval Committee consisting of Development Commissioner, Customs Authorities and representatives of State Government.

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Fact Sheet on Special Economic Zones

Number of Formal approvals (*As on 07.09.2017*)	424
Number of notified SEZs (*As on 07.09.2017*)	354 + *(7 Central Govt. + 11 State/Pvt. SEZs)*
Number of In-Principle Approvals (*As on 07.09.2017*)	31
Operational SEZs (*As on 30th June, 2017*)	222
Units approved in SEZs (*As on 30th June, 2017*)	4,643

INVESTMENT	Investment (*As on February, 2006*)	Incremental Investment	Total Investment (*As on 30th June, 2017*)
Central Government SEZs	Rs.2,279.20 cr.	Rs.13,694.80 cr.	Rs.15,974 cr.
State/Pvt. SEZs set up before 2006	Rs.1,756.31 cr.	Rs.9,721.69 cr.	Rs.11,478 cr.
SEZs Notified under the Act	-	Rs.4,05,690 cr.	Rs.4,05,690 cr.
Total	**Rs.4,035.51 cr.**	**Rs.4,29,106.49 cr.**	**Rs.4,33,142 cr.**

EMPLOYMENT	Employment (*As on February, 2006*)	Incremental Employment	Total Employment (*As on 30th June, 2017*)
Central Government SEZs	1,22,236 persons	1,12,625 persons	2,34,861 persons
State/Pvt. SEZs set up before 2006	12,468 persons	83,502 persons	95,970 persons
SEZs Notified under the Act	0 persons	14,48,020 persons	14,48,020 persons
Total	**1,34,704 persons**	**16,44,147 persons**	**17,78,851 persons**

Exports in 2014-15	**Rs. 4,63,770 Crore**
Exports in 2015-16	**Rs. 4,67,337 Crore**
Exports in 2016-17	**Rs. 5,23,637 Crore**
Exports in 2017-18 (*As on 30th June, 2017*)	**Rs. 1,35,248 Crore** (Growth of 15.39% over the exports of the corresponding period of FY 2016-17)

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Industrial Parks

The Rakesh Mohan Committee Report refers to Integrated Industrial Parks as "self contained island providing high-quality infrastructural facilities. Integrated industrial parks offer industrial, residential, and commercial areas with developed plots/ pre-built factories, power, telecom, water and other social infrastructure".

Stakeholders	Benefits offered
For Users:	Availability of high quality infrastructure in a centralised manner for the end-user industries resulting in lower transaction costs and shorter start-up time for them. Economies of scale in terms of development of land and infrastructure, including common facilities.
For the State:	Macroeconomic benefits like, increase in industrial development, growth of hinterland, etc. Geographical spread of industrial development including development of backward areas. Fulfilment of state's social objectives like generation of employment, creation of social infrastructure, etc. Revenues generated by the government through taxes and duties
For the Developer / Operator:	Commercial returns received by the park developer, operator and utility provider

The industrial parks are usually promoted by the SIDC or such other government agency / statutory authority. The projects are planned, approved, developed, managed and regulated by a governmental agency with minimal private sector participation.

There are different schemes under which the industrial parks could be promoted including: Growth Centre, Export Processing Zone, Free Trade Zone, Export Promotion Industrial Park, Software Technology Park, Electronics Hardware Technology Park.

The key features of the industrial parks development in India are:

- Status of the industrial parks sector varies from State to State, wherein states like Maharashtra, Gujarat, AP, Tamil Nadu, etc. have made significant progress in promoting industrial parks / estates.
- The approaches relating to development, administration, regulation, etc. of industrial parks also vary according to the political and developmental compulsions faced by the individual States.
- Primarily, the industrial parks have been promoted by the government and its agencies with minimal private sector participation (PSP). PSP in industrial parks has met with partial success in India and that too has primarily been restricted to the IT parks.
- A few examples of the private initiative in industrial parks development are Information Technology Park (ITPL), Bangalore; Infocity, Hyderabad; Technopark, Thiruvananthapuram; etc. The Mahindra City at Chennai was envisaged initially as an Auto

Park. However, over a period of time, the concept was changed and the park started focussing on IT and ITeS. The IT sector boom could perhaps have contributed to the development and success of IT parks.

- Often, the decision to set-up an industrial park reflects the and social objectives of the government. With parks throughout the State normally under a single agency, typically the SIDC, the revenues from parks at industrially forward locations are used to cross-subsidise the parks in the backward areas.

China is setting up two industrial parks, one in Gujarat and the other in Maharashtra. India wants Chinese goods made in India as that can help in reduction of trade deficit and also exports from India in future. Indian market is large and also cuts labour costs for China. But India has to protect its small and medium enterprises (SMEs).

Land Pooling Vs Land Acquisition

States, such as Maharashtra, Gujarat, Tamil Nadu, Punjab, Andhra Pradesh and Kerala have used land pooling as a viable alternative to land acquisition. It is a technique for promoting efficient, sustainable and equitable land development in the urban fringes.

The concept of land pooling involves amassing small rural land parcels into a large parcel, provide it with infrastructure and return approximately 60 per cent of the redeveloped land to the owners after the development is complete and appropriating the costs of infrastructure and public spaces. Of the 40 per cent that remains with the local town planning or state government authority, a substantial portion is reserved for setting up infrastructure such as roads, hospitals, schools, parks, provide electricity, water, sewerage and such like. The local planning or developing authority usually sells the rest for financing the costs for the infrastructure and amenities. The target parcels are usually agricultural holdings which are converted to urban use.

New Delhi

Since contiguous parcels are required by the government authority, the land owner usually gets a percentage of his holding back at another location within a radius of 5 km from his original holding. He may also get additional floor space index (FSI), due to which the value of the returned land will be a multiple of the worth of his original holding, even though the plot size has shrunk. A land readjustment scheme like this is initiated by Government

As the method is based on public/private cooperation, the majority of the landowners should support the use of the technique. Forceful acquisition of land should be avoided.

It provides an opportunity for a planned development of the land and infrastructure network and it avoids the problem where different types of land uses and densities are mixed.

It is an attractive method to influence the location and timing of new urban development since it is becoming increasingly difficult to obtain public support for land acquisition. The method is supported and sometimes even initiated by the landowners since they would make considerable profit on the project.

Farmers agreed to become partners in a land pooling scheme proposed by the Andhra Pradesh Capital Region Development Authority (APCRDA), for the development of the Andhra Pradesh state capital at Amaravati, contributing about 33,000 acre to the government for the purpose. The Delhi Development Authority (DDA) identified 200 villages along the outskirts of Delhi in a land

pooling scheme, to convert around 90 villages into development areas and another 90 into urban villages. DDA has recently passed a modified land pooling policy within the Master Plan Delhi 2021.

City and Industrial Development Corporation of Maharashtra Lt(CIDCO) is developing an international airport at Navi Mumbai and villages coming under Navi Mumbai Airport Influence Notified Area (NAINA) are participating in a land pooling scheme to facilitate its construction.

Pooling is seen as a viable alternative to land acquisition primarily because of the difficulties involved in acquiring clear, marketable and litigation-free appropriately sized contiguous land parcels for development –it is sensitive issue in various parts of the country.

New Delhi

INTERNATIONAL MONETARY FUND

The United Nations Monetary and Financial Conference, commonly known as Bretton Woods conference, was held in Bretton Woods, New Hampshire, USA in 1944 to regulate the international monetary and financial order after the conclusion of World War II. The conference resulted in the agreements to set up the International Bank for Reconstruction and Development (IBRD) - popularly known as World Bank; and the International Monetary Fund (IMF). The IMF was set up to foster monetary stability at global level. The IBRD was created to speed up post-war reconstruction. The two institutions are known as the Bretton Woods twins. They are specialized agencies of the United Nations.

IMF

The International Monetary Fund, a UN specialised agency, was established under the Bretton Woods Agreement in 1944 along with the World Bank. It has 189 members (2017). Nauru joined as the 189th member in 2016. Nauru is the second smallest member of the Fund, after Tuvalu. Nauru is a tiny island country in Micronesia, northeast of Australia.

It is headquartered in Washington and its Managing Director is Christine Lagarde. Christine Lagarde was asked to serve as IMF Managing Director for a second five-year term starting on from 2016.

IMF started functioning in 1947. India is a founding member.

IMF Objectives

IMF objectives are:

- To promote international monetary cooperation
- To facilitate balanced growth of international trade for the economic growth of all member countries
- To promote exchange rate stability ; maintain orderly exchange rate arrangements; and to advise against competitive exchange rate revaluation
- To help members in times of balance of payments crisis.

Governance Structure

The Board of Governors is the highest decision-making body of the IMF. It consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the head of the central bank. While the Board of Governors has delegated most of its powers to the IMF's Executive Board, it retains the right to approve quota increases, special drawing right (SDR) allocations, the admittance of new members and amendments to the Articles of Agreement and By-Laws. The Board of Governors also elects or appoints executive directors.

The IMF Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC) and theDevelopment Committee. The IMFC meets twice a year, during the Spring and Annual Meetings. The Committee discusses matters of common concern affecting the global economy and also advises the IMF on the direction its work.

The Development Committee is tasked with advising the Boards of Governors of the IMF and the World Bank on issues related to economic development in emerging and developing countries.

What the IMF Does

In order to achieve the above objectives, the IMF monitors the world's economies, lends to members in economic difficulty and provides technical assistance.

To elaborate, the work of the IMF is of three main types:

- Surveillance which involves the monitoring of economic and financial developments of every member country and the provision of policy advice, aimed especially at crisis-prevention. Also, appraisal of the exchange rate policies of member countries. In the absence of surveillance, the financial volatility in the world today can become worse.
- Lends to countries with balance of payments difficulties.
- Provides countries with technical assistance and training in its areas of expertise.

The IMF also plays an important role in the fight against money-laundering and terrorism.

Benefits to member countries of the IMF are many. They have access to information on the economic policies of all member countries, the opportunity to influence other members' economic policies, technical assistance in banking, fiscal affairs, and exchange matters, financial support in times of payment difficulties, and increased opportunities for trade and investment

Special Drawing Rights (SDRs)

IMF lends in its own artificial currency unit called the SDR. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of five key international currencies- dollar, euro, yen, pound and chinese Yuan which was included in 2016. The basket now consists of the following five currencies with their respective weights: U.S. dollar 41.73%, Euro 30.93%, Renminbi (Chinese yuan) 10.92%, Japanese yen 8.33%, British pound 8.09%. The basket composition is reviewed every five years to ensure that it reflects the relative importance of currencies in the world's trading and financial systems. The weights assigned to each currency in the SDR basket are adjusted to take into account their current prominence in terms of international trade and national foreign exchange reserves.
The SDR value in USD terms in November 2017 is $1.403.

SDRs can be exchanged for national currencies. SDRs are not traded in the forex market like other national currencies but can be exchanged between countries. Private parties do not hold or use them.

SDR is neither a currency, nor a claim on the IMF. It is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs.

Renminbi in SDR Basket

China's currency, the renminbi was added to the "Special Drawing Rights" (SDR) basket of currencies from October 2016. Its inclusion is an important milestone in China's global financial integration and reflects growing international use and trading of renminbi. This is the first time in over 15 years that the list of currencies comprising the SDR has been altered. Since 1999, when the euro replaced the Deutsche mark and French franc, its value has been based on a basket of four

currencies: the U.S. dollar, the euro, the Japanese yen, and the British pound, that met the IMF's inclusion criteria.

Some criteria for inclusion in the basket: that the issuing country is among the largest exporters in the world and that its currency is "freely usable."

A currency is determined to be freely usable when it is widely used to make payments for international transactions and widely traded in the principal exchange markets.

Inclusion in the SDR will deepen the expectations that China will let market forces decide the yuan's exchange rate. China will also make its currency convertible. Renminbi will enjoy greater confidence in international markets and pick up as a reserve currency. That may bolster the value of renminbi but market forces will eventually decide valuations. If renminbi appreciates, it will help India's exports and also cut imports. Global trade also may be favourable relatively to India. India need not stock so many dollars and can diversify thus derisking its external account relatively.

IMF Quota

Upon joining, each member of the IMF is assigned a quota- the amount that the country has to pay to the IMF. It is based broadly on its relative size in the world economy. A member's quota guides:

- subscriptions: the amount the member is obliged to provide to the IMF.
- voting power
- the amount of financing a member can obtain from the IMF

INTERNET

Upon joining the IMF, a country normally pays up to one-quarter of its quota in the form of widely accepted foreign currencies (such as the U.S. dollar, euro, yen, or pound sterling) or Special Drawing Rights (SDRs). The remaining three-quarters are paid in the country's own currency.Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The largest member of the IMF is the United States, with a current quota (2017) of SDR82.99 billion (about US$118 billion). The IMF reviews members' quotas once in five years.

The International Monetary Fund (IMF) in 2016 announced implementation of its long-pending quota reforms, which will give more voting rights to emerging economies such as India in the functioning of the organisation.

With these reforms, India's quota in IMF would rise to 2.7 per cent, from the existing 2.44 per cent. Also, the voting share of India in IMF would increase to 2.6 per cent from 2.34 per cent. It makes India the eighth-largest shareholder.

The reforms also increase the financial strength of IMF, by doubling its permanent capital resources to 477 billion special drawing rights ($659 billion). For the first time, four emerging market countries — BRIC will be among the 10 largest members of the IMF. Other top 10 members include the US, Japan, and the four largest European countries (France, Germany, Italy, and the UK)

The IMF reviews members' quotas once in five years and the last such review took place in December, 2010.

IMF Borrowing Arrangements

While quota subscriptions of member countries are its main source of financing, the IMF can supplement its resources through borrowing if it believes that resources might fall short of members' needs. Through the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB), a number of member countries and institutions lend additional funds to the IMF.The GAB and NAB are credit arrangements between the IMF and a group of members and institutions to provide supplementary resources to the IMF to prevent or cope with problems of the international monetary system or to deal with an exceptional situation that poses a threat to international monetary stability.

India and NAB

India funded IMF for bailouts in financially-stricken Europe, marking a dramatic role reversal from 1991 when it had to borrow International Monetary Fund (IMF) to avert a balance of payments crisis.

GOI provided loans to the multilateral agency's New Arrangements to Borrow (NAB), a fund whose corpus was raised when the debt crisis in Europe showed no signs of abating after the Greek sovereign debt crisis.

India gave $10b in 2012 during the Mexico summit of the G-20 for the Eurozone crisis firewall.

How the IMF lends

A core responsibility of the IMF is to provide loans to member countries experiencing balance of payments problems. This financial assistance enables countries to rebuild their international reserves; stabilize their currencies; continue paying for debt servicing and imports; and restore conditions for strong economic growth while undertaking policies to correct the underlying problems. Unlike development banks, the IMF does not lend for specific projects.

New Delhi

The changing nature of IMF lending

The volume of loans provided by the IMF has fluctuated significantly over time. The oil shock of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF lending. In the 1990s, the transition process in Central and Eastern Europe and the crises in emerging market economies led to further surges of demand for IMF resources. Deep crises in Latin America kept demand for IMF resources high in the early 2000s. IMF lending rose again in late 2008 in the wake of the global financial crisis.

IMF Facilities

Over the years, the IMF developed various loan instruments, or facilities, that are tailored to address the specific circumstances of its diverse membership.

Low-income countries may borrow at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF).

The Exogenous Shocks Facility (ESF) provides policy support and financial assistance to low-income countries facing global shocks. For example, due to commodity prices falling etc.

Non-concessional loans are provided mainly through Stand-By Arrangements (SBA) for members who are in a BOP crisis. When a member takes SBA , he may opt for a long term Extended Fund Facility(EFF) which requires basic changes in the economic policy orientation to open up the economy; or he may not opt out of such EFF having used the SBA funds well and not needing any

further assistance. The IMF also provides emergency assistance to support recovery from natural disasters and conflicts, in some cases at concessional interest rates.

Except for the PRGF and the ESF, all facilities are subject to the IMF's market-related interest rate. The amount that a country can borrow from the Fund—its access limit—varies depending on the type of loan, but is typically a multiple of the country's IMF quota. This limit may be exceeded in exceptional circumstances.

The IMF's analysis of global economic developments, contained in its World Economic Outlook, provide finance ministers and central bank governors with a common framework for discussing the global economy. Twice a year, it publishes the Global Financial Stability Report. The IMF's performance is assessed on a regular basis by an Independent Evaluation Office.

IMF and social protection

To incorporate social protection considerations into IMF operational work, it works with relevant partner institutions. The relevant institutions include: the World Bank, in the areas of poverty assessment, provision of social safety nets and basic social services, and improving the effectiveness and pro-poor orientation of public expenditures; the International Labour Organization (ILO), in the area of labor market and related social policy reforms; United Nations Children's Fund (UNICEF); the Organization for Economic Cooperation and Development (OECD); regional development banks; and bilateral aid agencies etc.

Social protection refers to policies designed to ensure income security and support to all—paying particular attention to the poor and the vulnerable. Anyone who needs social protection should be able to access it. Universal social protection includes: adequate cash transfers for all who need them, especially children; benefits and support for people of working age in case of maternity, disability, work injury or for those without jobs; and pensions for all older persons. This protection can be provided through social insurance, tax-funded social benefits, social assistance services, public works programs and other schemes guaranteeing basic income security.

IMF and Conditionalities

IMF conditionality is a set of policies or conditions that the IMF requires in exchange for financial resources. The IMF does require collateral from countries for loans but also requires the government seeking assistance to correct its macroeconomic imbalances in the form of policy reform. If the conditions are not met, the funds are withheld. Funds are given in installments linked to policy changes. Some conditionalities enforce structural adjustment wherein the economy is opened up to globalization and privatization. Some are of short term significance like expenditure cuts.

Some of the conditions can include:

- Cutting expenditures, also known as austerity.
- Devaluation of currencies,
- Trade liberalisation, or lifting import and export restrictions,
- open upto foreign direct investment and expand domestic stock markets
- Balancing budgets and not overspending,
- Removing price controls and state subsidies,
- Privatization
- deregulate the exchange rate
- currency convertibility
- downsize the government
- enact flexible labour sector reforms

- Enhancing the rights of foreign investors vis-a-vis national laws
- Improving governance and fighting corruption.

These conditions are known as the Washington Consensus.

These loan conditions ensure that the borrowing country will be able to repay the IMF and that the country will solve their balance-of-payment problems complementary to the global growth.

It is clear that most countries can not follow these policies with popular support. At the same time it must be understood that these policies should be selectively followed for the best results by avoiding populism and adhering to genuine welfarism.The Fund admitted that too many conditions were imposed on borrowers; it overstepped its mandate and expertise.Another criticism about the conditionalities is that the reforms suggested are the same for all countries irrespective of the causes of the crisis. India suggested that the IMF conditionalities must be more sensitive to the domestic realities of the member countries.

IMF and the global financial crisis

As the world economy had become engulfed in in 2008 in the worst crisis since the Great Depression, the IMF mobilized on many fronts to support its member countries, increasing its lending, using its cross-country experience to advise on policy solutions and introducing reforms to become more responsive to member countries' needs.It stepped up crisis lending, including a sharp increase in concessional lending to the world's poorest nations and provided analysis and targeted advice. The IMF overhauled its general lending framework to make it better suited to country needs.

The IMF created a broad financial safety net to limit the spread of the crisis.

Since 2010 the I.M.F. focused largely on Europe after the outbreak of the sovereign debt crisis that has threatened the euro.

Reforming the IMF

Role of IMF was criticized for the following reasons

- One size fits all policy under which it gives the same recipe for all ills
- Conditionalities that go with the loans that it disburses demand that spending on social sector be curtailed
- IMF Managing Director is invariably from a European country (the current MD, Chritine Lagarde is from France) and India and other emerging markets are demanding that it should not be geographically confined and be merit – based
- India wants that its economic power ,as it is emerging, should be recognized and so is given greater voting rights
- IMF failed to predict the global recession in 2008-09, let alone prevent it with its surveillance role

Reforms have taken place after the global crisis in some of these matters.

India and the IMF

India and the IMF have had a friendly relationship, which has been beneficial for both. The IMF provided India with loans over the years and this has helped the country in times of BOP pressure.

- India joined the IMF in 1945, as one of the IMF's original members.
- India accepted the obligations of Article VIII of the IMF Articles of Agreement on current account convertibility in 1994.
- India subscribes to the IMF's Special Data Dissemination Standard. Countries belonging to this group make a commitment to observe the standard and to provide information about their data and data dissemination practices.

While India has not been a frequent user of IMF resources, IMF credit has been instrumental in helping India respond to emerging balance of payments problems on two occasions. In 1981-82, India borrowed SDR 3.9 billion. In 1991-93, India borrowed a total of SDR 2.2 billion under two stand-by arrangements (SBA), and in 1991 it borrowed SDR 1.4 billion under the Contingency Compensatory Financing Facility (CCFF).

The relationship between the IMF and India has grown strong over the years. In fact, the country has turned into a creditor to the IMF and has stopped taking loans from it. We lent $10b in 2012(Mexico G20 Summit) to the IMF to bail out the Eurozone countries. India needs IMF as its globalizing economy carries risks like any other; it also needs IMF for technical training and capacity building; it needs to contribute to global monetary stability for its own enlightened self interest; it needs the SDR to diversify its forex holdings for greater safety.

SDRs as an alternative to the US dollar as global reserve currency

The international monetary system needs reform as was made evident by the 2008 global financial crisis. Dollar as a global reserve currency is neither viable nor desirable to the same degree as before Global imbalances- counties like China make and export goods and have current account surpluses and USA imports them and depends on them with huge and unmanageable CADs.

John Maynard Keynes once proposed a global currency, the Bancor, to be placed at the centre of the international monetary system. The idea never caught on. Instead, we now have a system dominated by holdings of US dollars. This has disadvantages. It creates tension due to the use of a national currency, the dollar, as the global currency. This can lead to global volatility as a result of growing US twin deficits. These deficits generate excessive indebtedness, both external and internal. US monetary policy impacts the whole world though it is made with the US interests in mind.

Some experts argue that the global role of SDRs should be increased as it would avoid help diversify the risk from forex holdings; lessen chances of global financial volatility; make US policies relatively less important for the world etc. Global stability enhances as dollar worries recede. However, SDRs can only supplement the dollar and other global reserve currencies and gold as the SDR is the creation of US and the west within the IMF. If SDR becomes a rival to dollar and yen, it may not receive the support of these countries. Nor are the SDRs created in such huge numbers as is warranted to play the larger role that some are recommending.

Chiang Mai Initiative

The **Chiang Mai Initiative (CMI)** is a multilateral currency pooling arrangement among the ten members of theAssociation of Southeast Asian Nations (ASEAN), the People's Republic of China (including Hong Kong), Japan, and South Korea. It draws from a foreign exchange reserves pool worth US$240 billion that was launched in 2010.

After 1997 Asian Financial Crisis, member countries started this initiative to manage regional short-term liquidity problems and to facilitate the work of other international financial arrangements and organisations like International Monetary Fund. It has never been used as there has not been a crisis since 1997 asian financial crisis.

BRICS CRA

The **BRICS Contingent Reserve Arrangement (CRA)** is a pool of foreign currency reserves for the member countries to draw from when they face any balance of paymemnts crisis- actually or potentially. Each member contributes to the pool which is a safety net. It was established in 2015 by the BRICS countries Brazil, Russia, India, China and South Africa. The legal basis is formed by the Treaty for the Establishment of a BRICS Contingent Reserve Arrangement, signed at Fortaleza, Brazil in 2014. It entered into force upon ratification by all BRICS statesin 2015. It became operational in 2016.

The objective of this reserve is to provide protection against global liquidity pressures when members' national currencies are adversely affected by global financial pressures. It is an example of south-south cooperation- that is cooperation among developing countries. It and implies a commitment from each member that it will support the other during crisis. It plays a role similar to the IMF but the BRICS nations say that it is compelemtary to the IMF. Some see CRA as a competitor to the International Monetary Fund (IMF). That is debatable though.

CRA has a capital of $100 billion which is distributed as follows:.

Country	Capital contribution (billion USD)	Access to Funds (billion USD)	Voting Rights
Brazil	18	18	18.10
China	41	21	39.95
India	18	18	18.10
Russia	18	18	18.10
South Africa	5	10	5.75
Total	100	85	100.00

Can CRA be a rival of IMF?

Russian President Vladimir Putin opined that the new BRICS contingent reserve arrangement (CRA) could be a substitute for the IMF, saying that it "creates the foundation for an effective protection of our national economies from a crisis in financial markets."

However, CRA is said to be complementary to IMF as IMF is steeped in assisting the crisis ridden Eurozone countries. Also, with globalization and huge private flows, the need for safety nets is much more than earlier. CRA does not have such funds.

Under the terms of the arrangement, each country can only borrow a part of its contribution before going to the IMF for a stand by arrangement with the IMF. It works out to a very small amount which is grossly inadequate when compared to Russia and Brazil's crisis-borrowing from the IMF over the past twenty years. The IMF approved lending to Russia of $38 billion (SDR 24.786 billion) in the 1990s. In 2002 alone, the IMF approved a 15-month stand-by credit arrangement of about $30 billion for Brazil. Net private financial flows to emerging markets today are about 10 times what they were in 2002, meaning that the size of the loans necessary to address balance of payments financing problems would be even larger now.The BRICS countries are intensely aware of it as revealed in vast pools of foreign exchange reserves that they maintain. The small amont from the BRICS CRA would make only a symbolic difference in a genuine financial crisis. Thus, CRA is only complementary to IMF as of now.

New Delhi

WORLD BANK GROUP

The World Bank Group (WBG) is a family of five international organizations .The Bank came into existence in 1945 following international ratification of the Bretton Woods agreements, which emerged from the United Nations Monetary and Financial Conference (1944). Commencing operations in 1946, it began undertook post-war reconstruction of western Europe. Its current role is different as its focus is to lend to developing countries to rid them of poverty.

The Group's headquarters are in Washington. Its head is called President and today it is Jim Yong Kim, South Korean-American physician and anthropologist who has served as the 12th President of the World Bank since 2012 and is on second 5 year term. The President of the World Bank is conventionally an American. There are 189 countries in the WB today.

It is responsible for the preparation of the World Development Report.

World Bank Group is owned by its member governments which subscribe to its basic share capital, with votes proportional to shareholding. Membership gives certain voting rights that are the same for all countries but there are also additional votes which depend on financial contributions to the organization.

A country has to first join IMF before it can be a member of the WB.

World Bank Group consists of five agencies which are:

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

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

The World Bank's (i.e. the IBRD and IDA's) activities are focused on developing countries, in fields such as human development (e.g. education, health- Swachh Bharat Mission, Sarva Shiksha Abhiyan etc), agriculture and rural development (e.g. irrigation, rural services -Pradhan Mantri Krishi Sinchayee Yojana (PMKSY), Watershed Management Project "Neeranchal" etc), poverty alleviation (Deen Dayal Antyodaya Yojana-National Rural Livelihoods Mission (DAY-NRLM)), environmental protection (e.g. pollution reduction, establishing and enforcing regulations-National Ganga River Basin Project etc), infrastructure (e.g. roads, urban regeneration, electricity, ports Port Modernization & New Port Development under Sagarmala), and governance (e.g. anti-corruption, legal institutions development).

The IBRD and IDA provide loans at soft rates to member countries, as well as grants to the poorest countries. Loans or grants for specific projects are often linked to wider policy changes in the sector or the economy. For example, a loan to improve coastal environmental management may be linked to development of new environmental institutions at national and local levels and the implementation of new regulations to limit pollution.

The activities of the IFC and MIGA include investment in the private sector and providing insurance respectively. (Details ahead)

Difference between WB and WB Group

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

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

The IBRD focuses on middle income and creditworthy poor countries, while IDA focuses on the poorest countries in the world.

World Bank Group incorporates these two in addition to three more:

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

IBRD

The International Bank for Reconstruction and Development (IBRD) is one of five institutions that comprise the World Bank Group. The IBRD is an international organization whose original mission was to finance the reconstruction of nations devastated by World War II. Now, its mission has expanded to fight poverty by means of financing states.

IDA

The International Development Association (IDA), is the part of the World Bank that helps the world's poorest countries. It complements the World Bank's other lending arm — the International Bank for Reconstruction and Development (IBRD) — which serves middle-income countries with capital investment and advisory services.

IDA was created in 1960 and is responsible for providing long-term, interest-free loans to the world's 80 poorest countries. IDA lends money on concessional terms. This means that IDA credits have a zero or very low interest charge and repayments are stretched over 25 to 40 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress. In addition to concessional loans and grants, IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

While the IBRD raises most of its funds on the world's financial markets, IDA is funded largely by contributions from the governments of its richer member countries. Additional funds come from IBRD's and IFC's income and from borrowers' repayments of earlier IDA credits.

Donors meet every three years to replenish IDA funds and review IDA's policies. The most recent replenishment of IDA's resources, the eighteenth (IDA18), has a size of $75 billion to finance projects over the three-year period from 2017 to 2020.

IDA loans address primary education, basic health services, clean water supply and sanitation, environmental safeguards, business-climate improvements, infrastructure and institutional reforms. These projects are intended to pave the way toward economic growth, job creation, higher incomes and better living conditions.

Eligibility for IDA support depends on a country's relative poverty, defined as per capita income below an established threshold and updated annually ($1,165 in fiscal year 2018). IDA also supports some countries, including several small island economies, that are above the operational cutoff but lack the creditworthiness needed to borrow from the International Bank for Reconstruction and Development

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World Bank Group is owned by its member governments which subscribe to its basic share capital, with votes proportional to shareholding. Membership gives certain voting rights that are the same for all countries but there are also additional votes which depend on financial contributions to the organization.

A country has to first join IMF before it can be a member of the WB.

World Bank Group consists of five agencies which are:

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

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

The World Bank's (i.e. the IBRD and IDA's) activities are focused on developing countries, in fields such as human development (e.g. education, health- Swachh Bharat Mission, Sarva Shiksha Abhiyan etc), agriculture and rural development (e.g. irrigation, rural services -Pradhan Mantri Krishi Sinchayee Yojana (PMKSY), Watershed Management Project "Neeranchal" etc), poverty alleviation (Deen Dayal Antyodaya Yojana-National Rural Livelihoods Mission (DAY-NRLM)), environmental protection (e.g. pollution reduction, establishing and enforcing regulations-National Ganga River Basin Project etc), infrastructure (e.g. roads, urban regeneration, electricity, ports Port Modernization & New Port Development under Sagarmala), and governance (e.g. anti-corruption, legal institutions development).

The IBRD and IDA provide loans at soft rates to member countries, as well as grants to the poorest countries. Loans or grants for specific projects are often linked to wider policy changes in the sector or the economy. For example, a loan to improve coastal environmental management may be linked to development of new environmental institutions at national and local levels and the implementation of new regulations to limit pollution.

The activities of the IFC and MIGA include investment in the private sector and providing insurance respectively. (Details ahead)

Difference between WB and WB Group

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

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

The IBRD focuses on middle income and creditworthy poor countries, while IDA focuses on the poorest countries in the world.

World Bank Group incorporates these two in addition to three more:

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

IBRD

The International Bank for Reconstruction and Development (IBRD) is one of five institutions that comprise the World Bank Group. The IBRD is an international organization whose original mission was to finance the reconstruction of nations devastated by World War II. Now, its mission has expanded to fight poverty by means of financing states.

IDA

The International Development Association (IDA), is the part of the World Bank that helps the world's poorest countries. It complements the World Bank's other lending arm — the International Bank for Reconstruction and Development (IBRD) — which serves middle-income countries with capital investment and advisory services.

IDA was created in 1960 and is responsible for providing long-term, interest-free loans to the world's 80 poorest countries. IDA lends money on concessional terms. This means that IDA credits have a zero or very low interest charge and repayments are stretched over 25 to 40 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress. In addition to concessional loans and grants, IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

While the IBRD raises most of its funds on the world's financial markets, IDA is funded largely by contributions from the governments of its richer member countries. Additional funds come from IBRD's and IFC's income and from borrowers' repayments of earlier IDA credits.

Donors meet every three years to replenish IDA funds and review IDA's policies. The most recent replenishment of IDA's resources, the eighteenth (IDA18), has a size of $75 billion to finance projects over the three-year period from 2017 to 2020.

IDA loans address primary education, basic health services, clean water supply and sanitation, environmental safeguards, business-climate improvements, infrastructure and institutional reforms. These projects are intended to pave the way toward economic growth, job creation, higher incomes and better living conditions.

Eligibility for IDA support depends on a country's relative poverty, defined as per capita income below an established threshold and updated annually ($1,165 in fiscal year 2018). IDA also supports some countries, including several small island economies, that are above the operational cutoff but lack the creditworthiness needed to borrow from the International Bank for Reconstruction and Development

(IBRD). Some countries, such as Nigeria and Pakistan, are IDA-eligible based on per capita income levels and are also creditworthy for some IBRD borrowing. They are referred to as "blend" countries.

IDA has 173 members.

IFC

The International Finance Corporation (IFC) promotes private sector investment in its member countries, particularly developing countries as a way to reduce poverty and improve people's lives.

IFC is a member of the World Bank Group and is headquartered in Washington. It shares the primary objective of all World Bank Group institutions: to improve the quality of the lives of people in its developing member countries.

IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world.

India is one of the founder members of the IFC. IFC finances investments with its own resources and by mobilizing capital in the International financial markets. India has 3.38% of the voting power. Over the past few years, in line with a strong strategic focus on India, IFC has augmented its program and portfolio in India by investing in high impact projects. India represents IFC's single-largest country exposure. IFC is working in the the following areas by promoting:

- investment climate for private sector development and inclusive growth;
- financial inclusion by working on financial services and initiatives related to the sustainability of the MFI sector including micro-credit bureau, risk mitigation initiatives, code of conduct setting etc;
- renewable energy (solar and biomass) and cleaner production as well as key subsectors like agribusiness; and
- developing PPP transactions with focus on social services (health and education) and climate change impact projects.
- Infrastructure has been stepped up in India in the last few years and currently accounts for about US$1.3 billion of current committed portfolio.

IFC floated a rupee bond, masala bond in the global credit market to raise a billion dollars that was used to assist the Indian companies in 2014.

MIGA

The Multilateral Investment Guarantee Agency (MIGA) is a member of the World Bank group. It was established to promote foreign direct investment into developing countries. MIGA promotes foreign direct investment into developing countries by insuring investors against political risk, advising governments on attracting investment etc. India is a member.

MIGA can cover only new investments. These include:

- new, greenfield investments;
- new investment contributions associated with the expansion, modernization, or financial restructuring of existing projects; and
- acquisitions involving privatization of state enterprises.

ICSID

The International Centre for Settlement of Investment Disputes (ICSID) is an institution of the World Bank group based in Washington. It provides facilities for the conciliation and arbitration of investment disputes between member countries and individual investors. India is not a member.

India and the World Bank

The advantage of borrowing from the World Bank is the low cost and stable financing it provides with longer maturity periods that better match India's investment needs.Financing through the International Development Association (IDA), the Bank's concessional lending arm, is provided for as low as 0.75% p.a., repayable over a period of 35 years, inclusive of a 10 year grace period.

India benefited from the WB funds in education (Sarva Shiksha Abhiyan); health care; health care; power; agriculture; irrigation; natural gas, roads and other sectors.

India has been borrowing from the World Bank (through IBRD and IDA) for various development projects in areas of poverty alleviation, infrastructure, rural development, human resource development, etc. IDA funds are one of the most concessional external loans for GOI and are used largely in social sector projects that contribute to the achievement of SDGs. IBRD funds are semi - concessional and of a longer maturity and therefore, cheaper than commercial external borrowings.

Since 1949 when India took the first assistance from World Bank, the Bank's cumulative commitment to India stands at US$ 104 billion (US$ 50 billion under IBRD and US$54 billion under IDA) by 2016.

IMF and WB

There are similarities and differences between them. Both are owned and directed by the governments of member nations. Both institutions concern themselves with economic issues and concentrate their efforts on broadening and strengthening the economies of their member nations. The two institutions hold joint annual meetings, which the news media cover extensively. Both have headquarters in Washington, D.C. Unless a country is a member of IMF, it can not be admitted to WB.

Despite these similarities, however, the Bank and the IMF remain distinct. The fundamental difference is this: the Bank is primarily a development institution; the IMF is a cooperative institution that seeks to maintain an orderly system of payments and receipts between nations. Each has a different purpose, a distinct structure, receives its funding from different sources, assists different categories of members and strives to achieve distinct goals.

The International Monetary Fund and the World Bank at a Glance	
International Monetary Fund	**World Bank**
• Single institution	• includes IBRD and IDA
• oversees the international monetary system	• seeks to promote the economic development of the world's poorer countries
• promotes exchange stability and orderly exchange relations among its member countries	• assists developing countries through long-term financing of development projects and programs
• assists all members--both industrial and developing countries--that find themselves in temporary balance of payments difficulties by providing short- to medium-term credits	• provides to the developing countries
• draws its financial resources principally from the quota subscriptions of its member countries	• encourages private enterprises in developing countries through its affiliate, the International Finance Corporation (IFC)
• has at its disposal fully paid-in quotas now totaling USD 650 billion	• acquires most of its financial resources by borrowing on the international bond market
	• members' subscriptions are about USD 250 billion . It also raises from bond market and has profits from its assets.

Bretton Woods 2.0

The original Bretton Woods conference purpose was post–WWII reconstruction. The arrangements need redefinition and refocus in the post-recession world since 2008. The broad mandate should be

- The two institutions need to be democratised
- Merit based appointment to the two institutions
- IMF should have an expanded role and be the lender of last resort. SDRs should be more central to global monetary system
- World Bank should be refocused with clear goals: helping the poorest countries achieve the SDGs to reduce poverty, hunger and disease.
- global trade agenda should be reoriented to help the poorest countries to be more productive; global trade should promote environmental sustainability, to help enforce compliance with reduced carbon emissions and protection of endangered biodiversity
- the new global financial structure should help to rescue the world from human-induced climate change.

G-20

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was established in 1999 to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. The G-20 promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. By contributing to the strengthening of the international financial architecture and providing

opportunities for dialogue on national policies, international co-operation, and international financial institutions, the G-20 helps to support growth and development across the globe.The G-20 was created as a response both to the financial crises of the late 1990s and to a growing recognition that key emerging-market countries were not adequately included in the core of global economic discussion and governance. The G-20 is made up of the finance ministers and central bank governors of 19 countries and EU:

- Argentina
- Australia
- Brazil
- Canada
- China
- France
- Germany
- India
- Indonesia
- Italy
- Japan
- Mexico
- Russia
- Saudi Arabia
- South Africa
- Republic of Korea
- Turkey
- United Kingdom
- United States of America

To ensure global economic fora and institutions work together, the Managing Director of the International Monetary Fund (IMF) and the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in G-20 meetings on an ex-officio basis. Together, member countries represent around 90 per cent of global gross national product, 80 per cent of world trade (including EU intra-trade) as well as two-thirds of the world's population. The G-20's economic weight and broad membership gives it a high degree of legitimacy and influence over the management of the global economy and financial system.

To tackle the financial and economic crisis that spread across the globe in 2008, the G20 members were called upon to further strengthen international cooperation. Accordingly, the G20 Summits have been held in Washington in 2008, in London and Pittsburgh in 2009, and in Toronto and Seoul in 2010.

The concerted and decisive actions of the G20, with its balanced membership of developed and developing countries helped the world deal effectively with the financial and economic crisis, and the G20 has already delivered a number of significant and concrete outcomes:G-20 (like the G-7) has no permanent staff of its own. The G-20 chair rotates among members, and is selected from a different regional grouping of countries each year. In 2016 the G-20 chair was China. For 2017,it is Turkey. The **2018 G20 Buenos Aires summit** is the thirteenth meeting of Group of Twenty (G20). Location is the city of Buenos Aires (Argentina).

It is normal practice for the G-20 finance ministers and central bank governors to meet once a year.

G-20 and G-7

The G-7 was established in 1976 as an informal forum of seven major industrial economies: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States of America. Russia joined later. The G-7 conducts dialogue and seeks agreement on current economic issues on the basis of the comparable interests of those countries. The G-20 was established in 1999 and reflects the diverse interests of the systemically significant industrial and emerging-market economies. It has a high degree of representativeness and legitimacy on account of its geographical composition (members are drawn from all continents) and its large share of global population (two-thirds) and world GNP (around 90 per cent). The G-20's broad representation of countries at different stages of development gives its consensus outcomes greater impact than those of the G-7.

International Financial Architecture For The 21st Century

The institutions involved are:

- G-20
- FSB: In response to the global financial crisis, the international financial community established the Financial Stability Board (FSB). The FSB aims to address vulnerabilities and develop and implement strong regulatory, supervisory and other policies in the interest of financial stability.
- BIS, Basel.
- WB and ADB provide economic assistance so that the long term economic underpinings of global economy are strengthened
- IMF

ADB

ADB is an international development finance institution whose mission is to help its developing member countries reduce poverty and improve the quality of life of their people.

Headquartered in Manila, and established in 1966, ADB is owned and financed by its 67 members, of which 48 are from the asia and pacific and 19 are from other parts of the globe. ADB's main partners are governments, the private sector, nongovernment organizations, development agencies, community-based organizations, and foundations.

Under Strategy 2020, a long-term strategic framework adopted, ADB follows three complementary strategic agendas: inclusive growth, environmentally sustainable growth, and regional integration. In pursuing its vision, ADB's main instruments comprise loans, technical assistance, grants, advice, and knowledge. ADB President is Haruhiko Kuroda.

ECB

The eurozone (euro area) is a monetary union of 19 of the 28 European Union (EU) member states which have adopted the euro (€) as their common currency and sole legal tender. The other nine members of the European Union continue to use their own national currencies. The monetary authority of the eurozone is the ECB.

The European Central Bank (ECB) is the institution of the European Union (EU) which administers the monetary policy of the 19 EU Eurozone member states. It is thus one of the world's

most important central banks. The bank was established by the Treaty of Amsterdam in 1998, and is headquartered in Frankfurt, Germany.

OECD

The Organisation for Economic Co-operation and Development (OECD) is an international economic organisation of 34 developed countries to stimulate economic progress and world trade. It defines itself as a forum of countries committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identifying good practices, and co-ordinating domestic and international policies of its members. Its membership includes non-European states. The OECD's headquarters are in Paris. India is on the Governing Board of the OECD's Development Centre and it also participates as an observer in some OECD Committees.

NDB

The New Development Bank (NDB), BRICS Bank, is a multilateral development bank operated by the BRICS states. During the sixth BRICS Summit in Fortaleza (2014), the leaders signed the Agreement establishing the New Development Bank (NDB).In the Fortaleza Declaration, the leaders stressed that the NDB will strengthen cooperation among BRICS and will supplement the efforts of multilateral and regional financial institutions for global development, thus contributing to collective commitments for achieving the goal of strong, sustainable and balanced growth. NDB intends to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries

According to the Agreement on the NDB, "the Bank shall support public or private projects through loans, guarantees, equity participation and other financial instruments. "NDB" shall cooperate with international organizations and other financial entities, and provide technical assistance for projects to be supported by the Bank."

The initial authorized capital of the bank is $100 bln .The initial subscribed capital of the NDB is $50 bln which is equally distributed among the founding members. The Agreement on the NDB specifies that the voting power of each member will be equal to the number of its subscribed shares in the capital stock of the bank. K. V. Kamath, the President of the NDB. The bank is headquartered in Shanghai, China

The first president is from India. Inaugural Chairman of the Board of directors will come from Brazil Inaugural chairman of the Board of Governors will be Russian.

The 7th BRICS summit in July 2015 marked the entry into force of the Agreement. K. V. Kamath was appointed as President of the Bank.

The Loan Agreement for New Development Bank (NDB) financing of US$ 350 Million for Development and Upgradation of Major District Roads Project in Madhya Pradesh was signed between Government of India and the New Development Bank (NDB) in 2017. This is the First Loan Agreement for NDB assisted project in India.

AIIB

The AIIB was established as a new multilateral financial institution aimed at providing "financial support for infrastructure development and regional connectivity in Asia." It has its headquarters in Beijing. Its goals are also to boost economic development in the asia, create wealth, provide infrastructure and promote regional cooperation and partnership. AIIB will "provide or facilitate

financing to any member, or any agency, instrumentality or political subdivision thereof, or any entity or enterprise operating in the territory of a member, as well as to international or regional agencies or entities concerned with economic development of the Asia region."

The value of AIIB's authorized capital amounts to $100 billion, with almost $30 billion invested by China. At its launch in January 2016, there were 57 signatories to AIIB's Articles of Agreement, and in mid- 2017, it has 80. China, India and Russia are the three largest shareholders of AIIB with china holding almost 30% of the share and India about a quarter of china's holding.

The Board of Directors of the Asian Infrastructure Investment Bank (AIIB) approved a loan of US$160 million in support of the Andhra Pradesh – 24x7 Power for All project in 2017 with the objective to strengthen the power transmission and distribution system in the State of Andhra Pradesh.

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New Delhi

GATT AND WTO

The General Agreement on Tariffs and Trade (GATT) is an agreement that was arrived at in 1947 by 23 countries to establish a free and fair international trading regime among member countries based on dismantling of trade barriers -tariffs or non-tariff restrictions like quotas. It came into existence in 1948. India was a founding member. GATT progressed- expanded its scope in terms of areas covered - by a series of "trade rounds"- negotiations centered around a specific set of issues over a period of a few years leading to agreement among members are called a round. GATT was headquartered in Geneva, Switzerland.

Eight rounds of such negotiations were held under GATT:

1. Havana Round (1947) with 23 countries brought into being the. GATT.
2. Annecy (France) Round (1949) (France)
3. Torquay Round(England) (1950) (England)
4. Geneva Fourth Round (1956)
5. Dillon Round (1960-1961) was held in Geneva and were named after Under Secretary of State, Douglas Dillon, who first proposed the talks
6. Kennedy Round (1962-1967) was also held in Geneva but was named after the US President John F Kennedy, in his memory.
7. Tokyo Round (1973-1979)
8. Uruguay Round (1986-94)

WTO was set up as a result of the Uruguay Round. WTO came into existence in 1995. Doha Round is the first round under the WTO (2001). It is yet to complete. It is the 9th round.

As can be seen from the above, the Uruguay round lasted the longest (Doha round-2001 onwards, is taking longer) as it took place in a radically different set of circumstances- communism was collapsing; the model of western industrial democracies was becoming more acceptable to the developing countries; USSR disintegrated leaving the third world so much weaker in world diplomacy. New areas were brought into the agenda- intellectual property rights; agriculture; services; foreign direct investment and so on. Initially, the developing countries were reluctant and resisted the expansion of the agenda. But partly due to western force; lack of unity among the developing countries; and partly due to seeing benefits for themselves, they agreed. There was no agreement after protracted negotiations. The Director General of the GATT was asked to draft an agreement for the consideration of the members. It was called Dunkel Draft, named after the Director General Arthur Dunkel. After attaining consensus, it was made into the Marrakesh Treaty and was signed in Marrakesh (Morocco) in 1994 and paved the way for the establishment of World Trade Organization (WTO) at the beginning of 1995.

GATT and WTO

GATT is different from WTO in two essential respects- GATT is a treaty while WTO is an organization. GATT had no dispute settlement process while WTO has. The GATT was essentially concerned with traditional trade issues such as tariffs and quotas in international trade. WTO encompasses many more areas. GATT had only a relatively small secretariat with no institutional foundation to implement these rules.

The World Trade Organization that came into existence at the beginning of 1995 replaces the General Agreement on Tariffs and Trade (GATT). Like its predecessor, it is headquartered in

Geneva, Switzerland. It has 164 members (2017). Afghanistan became the 164th WTO member early in 2016. Liberia was the 163rd member. Kazakhstan was the 162nd member.

In addition to states, the European Union is a member. WTO members do not have to be full sovereign nation-members. Instead, they must be a customs territory with full autonomy in the conduct of their external commercial relations. Thus Hong Kong and Taiwan became WTO members. Iran is the biggest economy outside the WTO.

Roberto Azevedo from Brazil is the current Director-General of the World Trade Organization. DG term is 4 years.

The WTO states that its aims are to increase international trade by slashing trade barriers and providing a platform for the negotiation of trade and related issues. Basically, it sets up a rule based multilateral trading system to liberalise the regime and boost world trade.

Principles guiding the WTO are:

- non-discriminatory and rule-based trading system where foreign goods and services should receive the same treatment as domestically sourced ones
- trade barriers (tariffs and non-tariff barriers) should be dismantled and international trade should be free
- less developed countries should receive preferential terms of trade

Unlike other organizations like World bank and the International Monetary Fund(IMF) where there is weighted voting- a country has as much voting power as it contributes financially-, WTO has a 'one country one vote' system making it relatively democratic. Decisions are taken by consensus.

WTO is not part of the United Nations and acts autonomously at the behest of its membership. A global arrangement exists between the two, based on the relationship that had existed between the UN and the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). This includes provision and exchange of information, representation at each other's meetings and cooperation between the secretariats.

Structure of WTO

Highest level decision-making body of the WTO is the Ministerial Conference, which usually meets once every two years with each member country represented by the commerce minister. Next in authority is the General Council which carries out the decisions of the Ministerial Conferences. It is seated in Geneva. It has representatives (usually ambassadors or equivalent) from all member governments and has the authority to act on behalf of the ministerial conference

There are two other bodies apart from the General Council. They are the Dispute Settlement Body composed of all members, usually represented by ambassadors or equivalent; and Trade Policy Review Body (TPRB) - the WTO General Council meets as the Trade Policy Review Body to undertake trade policy reviews of Members.

Below the above three bodies, at the third level, there are Councils for Trade. The Councils for Trade work under the General Council. There are three councils - Council for Trade in Goods, Council for Trade-Related Aspects of Intellectual Property Rights, and Council for Trade in Services. Apart from these three councils, six other bodies report to the General Council on issues

such as trade and development, the environment, regional trading arrangements and administrative issues.

At the fourth level from the top, there are subsidiary bodies- various committees and working groups related to various fields.

Dispute Settlement

World Trade Organization (WTO) has a dispute settlement body (DSB) that settles trade disputes among members. Disputes can arise from trade policies of members that are violative of the WTO rules. WTO procedures require sixty days of 'consultations' among the disputants to resolve the dispute failing which a disputes panel is set up.

There is no separate DSB but the General Council which is the second highest body in the organization works as the DSB while giving verdict on the trade dispute. DSB conclusion can be challenged in an appellate body. After the ruling, the erring nation is directed to make changes in its laws to make them WTO-compliant within a reasonable time. If the 'erring country' does not correct its laws, the complainant country is allowed to take cross retaliatory measures.

On the face of it, it gives all member countries a level playing field as the process is multilateral. But the fact is that there is no punishment for the erring country and; poor countries can not retaliate against rich countries.

Chronology

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- 1986-1994 - Uruguay Round of GATT negotiations were deadlocked. Dunkel Draft was the basis for the resolution. It led to the Marrakesh Agreement (Morocco) that resulted in the WTO coming into force.
- January 1, 1995 - The WTO came into existence.
- 1996 - The first ministerial conference in Singapore. Birth of "Singapore issues".
- 1998 – Second ministerial conference in Geneva, Switzerland.
- 1999 – Third ministerial conference in Seattle, Washington, USA
- 2001 - Fourth ministerial conference in Doha, capital of Qatar. A new Round of trade talks begin called Doha Development Round.
- 2001 - The People's Republic of China joined the WTO after 15 years of negotiations 2002
- 2003 – Fifth ministerial conference in Cancún, Mexico. Formation of G20. Rejection of the 'overloading' of the Doha agenda with Singapore issues though trade facilitation which is one of the Singapore issues was accepted by all
- 2005 – Sixth Ministerial at Hong Kong once again failed to deliver results
- Seventh Ministerial 2009 in Geneva
- 8th in 2011 in Geneva
- 9th Ministerial in Bali 2013 December
- 10th Ministerial in 2015 December in Nairobi
- 11th Ministerial Conference in Buenos Aires, Argentina in 2017 December

There are three basic principles built into the WTO:

1. National treatment
2. Most favoured nation(MFN)
3. Special and differential treatment

National Treatment

National treatment is a basic principle of GATT/WTO that prohibits discrimination between imported and domestically produced goods with respect to internal taxation or other government regulation. The example is solar panels case of India in 2016.

MFN

In international trade, MFN treatment means normal trading relations between two countries. All WTO members are statutorily obliged to grant one another the MFN status. Favour one, favour all. MFN means treating one's trading partners equally on the principle of non-discrimination.

MFN is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Some exceptions are allowed. For example, countries can set up a free trade agreement that applies only to goods traded within the group — discriminating against goods from outside. Or they can give developing countries special access to their markets. Or a country can raise barriers against products that are considered to be traded unfairly from specific countries. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners — whether rich or poor, weak or strong.

MFN has benefits in line with the WTO aims Increases trade. A country that grants MFN on imports will source from the best country-cost and quality. But if the most efficient producer is outside the group of MFN and is charged higher rates of tariffs, the importer loses. This leads to economic costs for the importing country, which can outweigh the gains from free trade.

- Small and developing countries benefit as they are automatically granted MFN status and gain thus – a privilege that they can not get otherwise due to their weak bargaining power in global trade. They gain in imports and exports.
- having one set of tariffs for all countries simplifies the rules and makes them more transparent
- MFN prevents domestic special interests from obtaining protectionist measures.
- MFN clauses uphold non-discrimination and thus free trade .

There are exceptions to MFN. Regional trade blocs such as the European Union and the North American Free Trade Agreement (NAFTA), which have lowered or eliminated tariffs among the members while maintaining tariff walls between member nations and the rest of the world. Trade agreements usually allow for exceptions to allow for regional economic integration.

WTO allows departures from the MFN principle.

- imports from poor countries are allowed at lower/zero tariffs (Generalised System of Preferences GSP- (Read ahead)
- preferential and free trade arrangement among countries of a region and others are allowed- at concessional and free rates respectively

- Article XXIV of the GATT allows Pakistan and India to depart from particular provisions of the Agreement in their bilateral relations pending the establishment of trade ties between them on a definitive basis. It is under this clause that Pakistan has not given MFN status to India, though the latter has extended such status to the former.

India granted MFN status to Pakistan in 1996. Pakistan has not granted India MFN status but offered Non-Discriminatory Market Access (NDMA) agreement.

India, Pakistan and GATT Rules

Paragraph 11 of GATT Article XXIV says:
"Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement [i.e., GATT] shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.*

*Measures adopted by India and Pakistan in order to carry out definitive trade arrangements between them, once they have been agreed upon, might depart from particular provisions of this Agreement, but these measures would, in general, be consistent with the objectives of the Agreement."

Qatar

Qatar in 2017 has filed a legal complaint at the World Trade Organisation to challenge a trade boycott by Saudi Arabia and others but they cited national security as the reason which is allowed under WTO.

Russia, Ukraine and WTO

In 2017, Russia sent a request to the World Trade Organization seeking to hold consultations over Ukraine's sanctions against Moscow, in place since 2014. It was regarding restrictions on Russian goods, services, transit and other issues imposed by Ukraine in response to Russia's role in the Ukraine crisis. Ukraine justified them with reference to national security.

S&D Provisions

The WTO Agreements contain special provisions which give developing countries special rights and which give developed countries the possibility to treat developing countries more favourably than other WTO Members. These special provisions include, for example, longer time periods for implementing Agreements and commitments.They are referred to as "special and differential treatment" (S&D) provisions.

WTO Agreements

The WTO oversees about 60 different agreements which have the status of international legal texts. Member countries must sign and ratify all WTO agreements on accession. Important among the agreements are the following.

Agreement on Agriculture (AoA)

Its three pillars are:

- domestic support
- export subsidies
- market access

Domestic support refers to the subsidies that governments give to the farmers like food, fertilizer, power, water etc. The domestic subsidies are grouped into three classes called "boxes": Green Box, Amber Box and Blue Box- the first two being borrowed from the traffic light colours.

Green box includes subsidies on which there are no limits as they are not considered trade distorting.To qualify for the green box, WTO says a subsidy must not distort trade, or at most cause minimal distortion.These green box subsidies must be government-funded — not by charging consumers higher prices and they must not involve price support. They tend to be programs that are not directed at particular products, and they may include direct income supports for farmers that are decoupled from current production levels and/or prices. Examples: environmental and conservation programs, research funding, extension services, food stamps and disaster relief.

Amber box is used for all domestic support measures considered to distort production and trade.

WTO members are required to maintain their amber box supports to within five to 10 percent of their value of production- 5% for the developed countries and 10% for developing countries like India.Subsidies that are considered to be trade distorting and are subject to limitations and isciplines fall into the amber box.

Blue box subsidies are direct payments under a production limiting program. There is no limit on them.

India and the amber box

For some year now, India has been having difficulty at the WTO to continue to give agricultural subsidies. India has MSP, minimum support price, programme under which Government pays the farmer for the grain he sells to the Food Corporation of India which is used to run the Public Distribution System (PDS) under which low income and poor people are supplied grain at cheap rates. The subsidy involved thus is to make agriculture investment-worthy, food security, price stabilization and so on. But the WTO put a cap on the subsidy which India is accused of having exceeded. India questions the methodology of calculating the subsidy. But there is no permanent solution that WTO offered to India's challenge. At the 9th ministerial in Bali (2013), developed countries had agreed to a 'peace clause' for India's stockholding of grain under which even if we are not conforming to the rules, no member will challenge this until 2017.

India says export subsidies given by USA and Europe make their agricultural goods so cheap that their markets are virtually inaccessible to exports from developing countries. The earlier gains expected by the developing countries from a genuinely free international trade in agricultural goods have not come about as the advanced countries are least inclined to reduce the subsidies to the statutory levels. It is one of the 'implementational concerns' in WTO being discussed in the Doha round.

G33

The G33 ("Friends of Special Products" in agriculture) is a group of 48 developing countries including India and China. It came into existence before the 2003 Cancun ministerial conference.They have common concerns in agriculture.

It has interests of farmers and food production interests- "defensive" interests regarding agriculture in relation to World Trade Organisation negotiations. Its demands are

- limit the level of market opening to agri-imports of developing countries
- creation of a "special products" exemption, which would allow developing countries to exempt certain products from tariff reductions
- "special safeguard mechanism" which would permit tariff increases in response to import surges in agricultural goods

In 2017 the G-33 countries made two demands

a. MSP programmes to help farmers during times of distress should not be treated as trade-distorting
b. Calculation of the quantum of subsidies on the basis of market prices prevailing in 1986-1988 is flawed and does injustice and should be dropped.

However, countries like Australia, Pakistan, Peru, Thailand, Japan, Paraguay, Australia, Mexico and Russia said they could not accept unlimited market price support under the banner of 'public stockholding for food security'.

Export Subsidies

Agricultural export subsidies are to be limited by the developed countries either in value or volume terms so that international prices are not lowered below a point and exports and domestic markets of the developing countries are not priced out. Nairobi Ministerial in 2015 decided to phase them out.

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Market Access

Market access means all member countries should throw open their domestic market to agricultural imports by reduction of tariffs and removal of or non-tariff barriers. Countries should undertake

- 'tariffication'- to convert non–tariff barriers(like quotas) to tariffs and
- "bind" their tariffs- to agree to a limit that is the `bounded rate' and not increase the rates beyond them. The bounded rates are usually high

Special Products and Special Safeguard Mechanisms

Special Products (SP) and Special Safeguard Mechanisms (SSM) are key concerns of developing nations involved in WTO negotiations in agriculture. By using SP and SSM, these nations hope to ensure food security and protect small farmers and the rest of the poor from the vagaries and pressures of international trade in agriculture commodities.

Special Products (SPs)

Special Products (SPs) are agricultural products of particular importance to farming communities in developing countries for reasons of food security, livelihood security and rural development.

It was decided at the Doha Development Round of WTO negotiations that SPs would attract lower levels of tariff reduction commitment than other agricultural products. The rationale is that higher levels of protection on SP will allow developing countries to sustain and develop domestic

production of these products, thereby allowing them to protect and enhance livelihoods and food security in their domestic agriculture.

SP is a component of the WTO's Special and Differential (S&D) provision and is available only to developing country members of the WTO.

The Doha Ministerial Declaration recognised the non-trade concerns of developing countries and explicitly mentioned that the Doha Development Round of trade talks would include concessions that will "enable developing countries to effectively take account of their development needs, including food security and rural development".

Since the introduction of the concept of SP, discussions are going on about their selection and treatment. Essentially, the discussion centres on two issues:

- The number of products to be given SP status.
- The modalities to select SPs.

Special Safeguard Mechanisms (SSMs)

Special Safeguard Mechanisms or SSMs are a set of provisions through which a WTO member country can temporarily impose higher than bound tariff rates on the import of a particular agricultural product if there is a sudden surge in imports of that product into the country. The SSM provisions will be available to all developing and least developed country members of the WTO.

SSM is a trade defence mechanism to essentially counter the volatility of international commodity prices. Sudden and sharp declines in the international price of an agricultural commodity could lead to an import surge which, in turn, could damage the viability of domestic production. Countries may find it difficult to check these surges. In these cases, a temporary measure like SSM will allow developing countries to tide over crises. SSM will allow countries to raise tariffs above their bound levels for a limited duration.

A Ministerial Decision on a Special Safeguard Mechanism (SSM) for Developing Countries during the Nairobi ministerial in 2015 recognizes that developing members will have the right to temporarily increase tariffs in face of import surges by using an SSM.

To conclude, Special Products and Special Safeguards Mechanisms together can provide a reasonable level of protection to the agriculture sector of developing countries.

TRIPS

Intellectual property (IP) is the work of intellect or mind to create products that have commercial uses- products like drugs, literature, paintings etc. It is protected like the physical property with trademarks, patents etc. Holders of the patents etc are entitled to the commercial proceeds for a specified time period, exclusively

Types of intellectual property rights:

- A patent may be granted for a new, useful, and non-obvious invention, and gives the patent holder an exclusive right to commercially exploit the invention for a certain period of time (typically 20 years from the filing date of a patent application).

- Copyright is given for creative and artistic works (e.g. books, movies, music, paintings, photographs, and software) and give a copyright holder the exclusive right to control reproduction or adaptation of such works for a certain period of time.
- A trademark is a distinctive sign which is used to distinguish the products or services of different businesses.
- An industrial design right protects the form of appearance, style or design of an industrial object (e.g. spare parts, furniture, or textiles).

The need for agreement on TRIPS arises from the fact that IP generation takes substantial investment and should be incentivised; and the commercial proceeds from international trade in intellectual property are growing in worth.

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)

Agreement on TRIPS lays down legal standards for the member countries to protect intellectual property by way of copyright rights; geographical indications, industrial designs; integrated circuit layout-designs; patents; monopolies for the developers of new plant varieties; trademarks. It regulates dispute resolution procedures and enforcement procedures.

TRIPS and patents

A patent is an exclusionary right. It grants the right to exclude others from making use of the patented invention for the given period- 20 years from the filing date under TRIPS. In return for the patent, the inventor offers the knowledge with commercial use to be put in public domain after the expiry of the patent. Patent is an incentive to innovate and invent. It sustains research and development (R and D)

Product and process patents

Under WTO, patents can be granted for the process or product. Product patents provide for absolute protection of the product exhausting all the processes that may lead to the product, whereas process patents provide protection in respect of a specific process or method of manufacture. Protection for process patents would not prevent the manufacture of patented products by a process of reverse engineering, where a different process or method from that which has been invented (and patented) is used. For example, national legislation requiring only process patent protection has enabled manufacturers in certain countries to make generic versions of patented medicines. RE (Reverse engineering) made it possible in developing countries to sell medicines cheap. India is a prime example.

TRIPS agreement allows both process and product patents, though only product patents must be awarded for food, pharmaceuticals and chemicals. Patents should be valid for 20 years. Developing countries had 10 years to adopt the TRIPS agreement standards(by 2005) while the advanced countries adopted them by 1995 itself.

Developing countries that had apprehensions about the product patents agreed to it because they benefited under other agreements- for example, services etc. They agreed also because they received concessional terms under TRIPS- grace period of 10 years to adopt product patents in food, pharmaceutical and chemical fields.

Patents (Amendment) Act 2005

As mandated by the TRIPS, it introduced product patent regime for food, chemicals and pharmaceuticals.

Highlights of the Act

- Product patent protection to drugs, foods and chemicals
- availability of Pre-grant and Post-grant challenge
- Incremental innovation involving small scale improvements do ot qualify for new patents
- Introduction of a provision for enabling grant of compulsory license and parallel imports to meet public health crises as provided for in TRIPS

Prior to 1970, 85 per cent of medicines available in India were produced and distributed by multinational corporations (MNCs) and the prices of drugs in the country were among the highest in the world. The 1970 Patents Act of India provided for process patents for pharmaceuticals and agro-chemical products. This enabled the growth of a strong local generic drug industry, which produced the same drugs as the MNCs at relatively low prices. When Indian generic manufacturers such as Cipla, Ranbaxy etc began manufacturing drugs, especially for Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome (HIV/AIDS), at much lower prices, it served a public health cause .The demand for these drugs grew in countries that could not afford to buy these drugs from MNCs.

Indian government accepted TRIPS and product patents because Indian pharma industry is going global and TRIPS helps R and D to capture global pharma market. It attracts MNC investment also. TRIPS is a part of the larger WTO package.

There was a fear that prices of medicines would spiral due to product patents as it can lead to monopoly pricing. But on balance it was felt that because 97 per cent of all drugs manufactured in India are off-patent, prices would be protected. Add to that the fact that Government could control the prices of essential medicines, and the fears of price rise were seen to be largely unfounded.

The other criticism is that patents being given for 20 years will stunt technological development in India.

On the positive side, the Act modernizes the law. It helps Indian pharma companies to grow into MNCs. Indian companies can take up contract research. FDI will flow in with all the technological benefits. Safeguard provisions help meet public health concerns. Drug price Control order (DPCO) gives government the power to regulate the prices and make them affordable. Generic manufacturers can continue in India for product patented drugs by paying a reasonable fee. (Generic medicines are unbranded drugs. They have the same active chemical content as the patented drug. They can be produced for drugs for which either there is a process patent or the product patent expired.)

Public Health Concerns: TRIPS Agreement and Safeguards

In view of the fact that the above mentioned provisions for product patents have the potential to raise prices, safeguards have been built in the TRIPS Agreement called :"parallel imports" and "compulsory licensing."

Parallel importation is the importation of drugs from another country where they are sold at a lower price to meet a public health crisis. It can take place if there are no manufacturers in the

country facing the public health crisis and the pharma company that holds the patent for the drug is unwilling to price it affordably for the sake of the ailing public.

Compulsory licensing means Government of the country facing public health crisis can ask for production and sale of the drugs in the country at concessional price based on a compulsory license that it issues. If the patent holder is ready, it gets the license. If not, it allows a government to temporarily override a patent. Government may issue a compulsory license to any other company .This allows generic copies of a patented product to be produced domestically, with compensation paid to the patent holder. Generic copies of patented drugs are much cheaper than the branded drugs. By introducing generics, governments can bring down the price of a certain medicine, thereby ensuring an adequate, affordable stock of the essential drugs.

The compulsory licensing provision arms the government with the power to ensure that medicines are available to patients at affordable rates.

It gives the government the right to allow a generic drug maker to sell cheap but safe versions of patented drugs under certain conditions, without the consent of the patent owner.

Multinational drug companies had demanded strong safeguards against the liberal use of the provision when India's patent law was being framed, but the final legislation had kept the grounds for invoking this provision open-ended.

India's first ever compulsory license was granted by the Intellectual Property Appellate Board (IPAB) in 2012, to Natco Pharma for the production of generic version of Bayer's Nexavar, an anti-cancer agent used in the treatment of liver and kidney cancer. It was established in the Bayer vs Natco case that only 2% of the cancer patient population had an easy access to the drug and that the drug was being sold by Bayer at an exorbitant price of 2.8 lakh INR for a month's treatment. Nexavar was being imported into territory of India. IPAB issued a compulsory license to Natco Pharma, which assured that the tablets would be sold for Rs. 8,880/- per month. 6% of the net sales of the drug would be paid to Bayer by Natco Pharma as royalty.

Health experts and NGOs have welcomed the order saying it would deter innovator companies from selling their drugs at exorbitant prices.

It was the only case when compulsory licensing was invoked.

Incremental Innovations

The Intellectual Property Appellate Board (IPAB) in 2013 revoked GlaxoSmithKline's patent in India for its breast cancer drug Tykerb. IPAB ordered that the claimed invention, the salt version of the original drug, is "obvious" and, therefore, has been revoked.

Earlier in 2013, the Supreme Court in a landmark ruling rejected Swiss drug-maker Novartis' plea for a patent for its anti-cancer drug Glivec — beta crystalline of a known molecule called imatinib mesylate — saying it lacked novelty and failed to meet the country's patenting standards.Novartis enjoyed the patent for Glivec for 20 years and later without adequate value addition, it applied for a new patent for the same drug with mere incremental innovation.

This upholds India's policy stance that incremental innovations lacking "enhanced therapeutic efficacy" as assessed by the patenting authorities will not qualify for patents.

Voluntary Licensing

Gilead Sciences entered into licensing agreements with seven Indian generic manufacturers for its 'Sovaldi' (anti-Hepatitis C drug). This license allows the companies to manufacture and sell the drug in any of the 91 voluntary licence (VL) countries at their own price but at a 7% royalty rate on sales sales. The pool of 91 countries included in the deal comprise of 54 middle income countries and 37 low-middle income countries. It also includes complete technology transfer of Gilead's manufacturing process. A further term is that manufacture of the active pharmaceutical ingredients (APIs) must be in India. Criticism is that the license restricts export to only the 91 listed countries. This excludes many important middle income countries, including China and Brazil which is a serious concern as over 70% of HCV patients are in middle income countries

However, the consensus opinion is that Gilead's licences are an important victory for public health. Gilead leads the way for the rest of Big Pharma who sell life saving drugs and who may follow suit and ethically balance business with public health.

Anti-Counterfeiting Trade Agreement (ACTA)

It is a multinational treaty for the purpose of establishing international standards for intellectual property rights enforcement. The agreement aims to establish an international legal framework for targeting counterfeit goods, generic medicines and copyright infringement on the Internet, and would create a new governing body outside existing forums, such as the World Trade Organization, the World Intellectual Property Organization, or the United Nations.

The agreement was signed in 2011 EU, Australia, Canada, Japan, South Korea, United States and few of their friends.

Supporters have described the agreement as a response to "the increase in global trade of counterfeit goods and pirated copyright protected worksACTA has also been criticised by Doctors without Borders for endangering access to medicines in developing countries. European Union (EU) parliament in 2012 rejected ACTA.

It was a response to India asserting its rights like invocation of compulsory licensing and rejection of incremental innovations for new patents. India termed it piracy when India generics being sent to other developing countries were sought to be confiscated under ACTA.

Sui Generis System

TRIPS agreement provides sui generis option regarding patent laws. Sui generis means generating by itself or of itself. It is a choice given to members in the place of TRIPS norms. That is, they can protect inventions either on the basis of TRIPS pattern of patents or any other indigenous system (sui generis).

Geographical Indications

There are some goods that owe their properties to the region in which they originate and are nurtured. The climate, soil and the native efforts of the region account for their fame, utility and qualities. Some Indian examples are: Basmati Rice, Darjeeling Tea, Kanchipuram Silk Saree, Alphanso Mango, Nagpur Orange, Kolhapuri Chappal, Bikaneri Bhujia, Agra Petha,

Mysore silk, Nilgiri tea, Coorg coffee, Mysore sandal products, Malabar pepper etc.Such products are given Geographical Indications. GI means any indications which identify the goods as originating in the territory of a country or a region or locality in that territory. It is used to identify agricultural, natural or manufactured goods.The manufactured goods should be produced or processed or prepared in that territory. It should have a special quality or reputation or other characteristics

There are many benefits when a product or process is given a GI.

- It confers legal protection to Geographical Indications in India
- Prevents unauthorised use of a Registered Geographical Indication by others
- It provides legal protection to Indian Geographical Indications which in turn boost exports.
- Protects the consumers
- It promotes economic prosperity of producers of goods produced in a geographical territory.

There are rules as to who can apply for a GI. Any association of persons, producers, organisation or authority established by or under the law can apply but the applicant must represent the interest of the producers.It is generally not granted to an individual. It is given to a product for a specific period of time (10 years in India). It can be renewed from time to time for further period of 10 years each.

GIs prevent spurious goods from entering the market. It helps maintain quality. There is greater accountability, too. It boosts exports.

GI is different from a trade mark. A trade mark is a sign which is used in the course of trade and it distinguishes goods or services of one enterprise from those of other enterprises.Whereas a geographical indication is an indication used to identify goods having special characteristics originating from a definite geographical territory.

In 1999, the Parliament passed the Geographical Indications of Goods (Registration and Protection) Act, 1999. This Act seeks to provide for the registration and protection of geographical indications relating to goods in India. The Act is administered by the Controller General of Patents, Designs and Trade Marks- who is the Registrar of Geographical Indications. The Geographical Indications Registry is located at Chennai. The Geographical Indications of Goods (Registration and Protection) Act, 1999 came into force in 2003. This is a sui generic legislation intended to give better protection to GIs of India.
Hundreds of items items including Kancheepuram silk and Darjeeling tea from various states enjoy the protection.Some such products are: Nagpur orange, Kangra painting, Moradabad Metal Craft, Firozabad Glass, Kannauj Perfume, Kanpur saddlery, Saharanpur wood craft, Dharmavaram handloom pattu sarees and paavadas, Warli painting, Kolhapur jaggery, Thewa art work and three Manipur-based knit works Moirang phee, Wangkhei phee and Shaphee ianphee.

Himachal Pradesh's Kangra Arts Promotion Society sought GI saying the art form was invogue in the foothills of western Himalayas and pigments used in Kangra paintings are derived from organic and inorganic sources. The central theme of Kangra paintings is love and the recurring themes are six seasons or music or Krishna-Radha or Shiva-Parvati.

Manipur government's department of commerce has sought GI for Moirang phee, Wangkhei phee and Shaphee lanphee, which are shawls/fabric with unique needle work, to be worn as special recognition of honour.

Kolhapur jaggery seeks unique recognition for its white and golden chemical-free product having no added colour, chemicals, additives and flavours. Its application said the jiggery had natural sweetener and contained glucose, vitamins, calcium and minerals.

India has more than 300 GI products registered so far. Also known as the Bird's Eye Chilli, Mizo Chilli is given GI. The Hyderabad Haleem is one of the few Indian dish to have got a GI status. So is the famous traditional craft of Rajasthan: Blue Pottery made in Jaipur. Also, Pattachitra is a form of art that originated in Odisha. It is a pictorial narrative painted on a cloth-based scroll. Generally, the scrolls depict the tales of Hindu gods and goddesses.

Famous Banganapalle mangoes of Andhra Pradesh and Tulapanji rice of West Bengal are among the seven commodities that have been granted Geographical Indications 2017-18.The other five products which have received this tag this year include Pochampally Ikat of Telangana; Gobindobhog Rice of West Bengal; Durgi Stone Carvings and Etikoppaka Toys of Andhra Pradesh; and Chakshesang Shawl of Nagaland.In 2016-17, as many as 33 items got GI registration.

Karnataka with 32 GI products topped the national list followed by Tamil Nadu (24), Andhra Pradesh (22) and Kerala (20).

French champagne and cognac, the USA's Napa Valley, the UK's Scotch whisky and Mexican Tequila are among foreign products that have acquired GI tag in India.

Joynagarer moa is a seasonal Bengali sweetmeat delicacy made of puffed rice and palm jaggery which got a ***Geographical Indication*** tag in 2015.

Rasgolla

There was a legal issue over the origins of rasgolla between Odisha and West Bengal. Odisha has staked claim associating it with a centuries old ritual of Lord Jagannath. West Bengal always thought of rasagolla as its own.

Geographical Indications (GI) registry announced in November 2017 that the rosogolla originated in West Bengal.

Apeda

APEDA is a non-trading, statutory body created under the Agricultural and Processed Food Products Export Development Authority Act, 1985 ("the APEDA Act"), which provides for the development and promotion of export of certain agricultural and processed food products from India, including Basmati rice. The APEDA Act was amended in 2008 to confer it powers to protect intellectual property in special products such as Basmati rice. As such, APEDA is qualified to be an applicant under the Geographical Indications of Goods (Registration& Protection) Act, 1999 ("GI Act").

Basmati 2016

GI tag was given to APEDA.National Agricultural Research System, under the ministry of agriculture and cooperation has recognised only the states of Punjab, Haryana, Himachal Pradesh, Delhi and Uttarakhand, the western part of Uttar Pradesh and two districts of Jammu and Kashmir

(namely, Jammu and Kathua) as the traditional geographical indication for Basmati rice cultivation.

This means that the basmati rice produced in these regions are considered an intellectual property and will be acknowledged as Basmati rice, while the Basmati rice produced in other places will not be considered Basmati rice, as APEDA does not consider areas other than those with the GI tag for Basmati rice production. Madhya Pradesh contested the fact that it was excluded even as 13-14 districts in MP grow it.

IPR Policy 2016

GOI recently approved the National Intellectual Property Rights (IPR) Policy which lays down an institutional mechanism for implementation, monitoring and review. It aims to incorporate and adapt global best practices to the Indian scenario. This aims to bring together the strengths of the Government, research and development organizations, educational institutions, corporate entities including MSMEs, start-ups and other stakeholders in the creation of an innovation-conducive environment, which stimulates creativity and innovation across sectors, as also facilitates a stable, transparent and service-oriented IPR administration in the country.The National Intellectual Property Rights (IPR) Policy endeavors for a "Creative India; Innovative India

Objectives:

The Policy lays down the following seven objectives:

- IPR Awareness: Outreach and Promotion - To create public awareness about the economic, social and cultural benefits of IPRs among all sections of society.
- Generation of IPRs - To stimulate the generation of IPRs.
- Legal and Legislative Framework - To have strong and effective IPR laws, which balance the interests of rights owners with larger public interest.
- Administration and Management - To modernize and strengthen service-oriented IPR administration.
- Commercialization of IPRs - Get value for IPRs through commercialization.
- Enforcement and Adjudication - To strengthen the enforcement and adjudicatory mechanisms for combating IPR infringements.
- Human Capital Development - To strengthen and expand human resources, institutions and capacities for teaching, training, research and skill building in IPRs.

The action by different Ministries/ Departments shall be monitored by DIPP which shall be the nodal department to coordinate, guide and oversee implementation and future development of IPRs in India.

The Policy recognizes that India has a well-established TRIPS-compliant legislative, administrative and judicial framework to safeguard IPRs, which meets its international obligations while utilizing the flexibilities provided in the international regime to address its developmental concerns. It reiterates India's commitment to the Doha Development Agenda and the TRIPS agreement.

While IPRs are becoming increasingly important in the global arena, there is a need to increase awareness on IPRs in India, be it regarding the IPRs owned by oneself or respect for others' IPRs. The importance of IPRs as a marketable financial asset and economic tool also needs to be

recognised. For this, domestic IP filings, as also commercialization of patents granted, need to increase. Innovation and sub-optimal spending on R&D too are issues to be addressed.

The broad contours of the National IPR Policy are as follows:

Vision is to create an India where creativity and innovation are stimulated by Intellectual Property for the benefit of all; where intellectual property promotes advancement in science and technology, arts and culture, traditional knowledge and biodiversity resources; where knowledge is the main driver of development, and knowledge owned is transformed into knowledge shared.

Mission is to stimulate a dynamic, vibrant and balanced intellectual property rights system in India to:

- foster creativity and innovation and thereby, promote entrepreneurship and enhance socio-economic and cultural development, and
- focus on enhancing access to healthcare, food security and environmental protection, among other sectors of vital social, economic and technological importance.

PPVFR Act

The Protection of Plant Variety and Farmers Right Act, 2001 (PPVFR Act) was made to set up an effective system for protection of plant varieties, the rights of farmers and plant breeders, and to encourage the development and cultivation of new varieties of plants. The Act was enacted to grant intellectual property rights to plant breeders, researchers and farmers who have developed any new or extant plant varieties. The rights granted under this Act are heritable and assignable and only registration of a plant variety confers the right. Essentially Derived Varieties (EDV) can also be registered under this Act and it may be new or extant. Farmers are entitled to save, use, sow, re-sow, exchange or sell their farm produce including seed of a registered variety in an unbranded manner. Farmers' varieties are eligible for registration and farmers are totally exempted from payment of any fee in any proceedings under this Act. The period of protection for field crops is 15 years and for trees and vines is 18 years and for notified varieties it is 15 years . he rights granted under this Act are exclusive right to produce, sell, market, distribute, import and export the variety. Civil and criminal remedies are provided for enforcement of breeders' rights and provisions relating to benefit sharing and compulsory licence in case registered variety is not made available to the public at reasonable price are provided. Compensation is also provided for village or rural communities if any registered variety has been developed using any variety in whose evolution such village or local community has contributed significantly.

GATS

The General Agreement on Trade in Services (GATS) is the set of regulations that governs trade in services among the WTO countries. GATS, which is one of the three agreements along with AoA and agreement on TRIPS has rules that cover a broad range of economic activity such as health care, education, telecommunications, banking, insurance, business process offshoring (BPO), tourism and so on. India is interested in these fields due to its core competence.

With GATS, multilateral trading system extends to services for the first time. GATT, its predecessor did not cover services.

In services, members of the WTO offer one another most favoured nation (MFN) status as they do for physical goods. MFN means grant of non-discriminatory trade- normal trade.

GATS negotiations are conducted among members bilaterally on the basis of requests and offers.Requests can be made by any WTO member in any service sector to any member. Each member makes bilateral requests to its major trading. These requests ask for full market access and national treatment commitments.

The GATS agreement covers four modes of supply for the delivery of services in international trade:

	Criteria	Supplier Presence
Mode 1: Cross-border supply	Service delivered within the territory of the Member, from the territory of another Member	Service supplier not present within the territory of the member
Mode 2: Consumption abroad	Service delivered outside the territory of the Member, in the territory of another Member, to a service consumer of the Member	
Mode 3: Commercial presence	Service delivered within the territory of the Member, through the commercial presence of the supplier	Service supplier present within the territory of the Member
Mode 4: Presence of a natural person	Service delivered within the territory of the Member, with supplier present as a natural person	

Trade Negotiations

While WB and IMF operate on weighted voting basis, WTO decisions, such as adopting agreements (and revisions to them) are officially determined by consensus of all members. The advantage of consensus decision-making is that it encourages efforts to find the most widely acceptable decision. Small countries and low income countries also weigh for as much as rich countries.

In reality, WTO negotiations proceed not by consensus of all members, but by a process of informal negotiations between small groups of countries. Such negotiations are often called "Green Room" negotiations (after the colour of the WTO Director-General's Office in Geneva), or "Mini-Ministerials", when they occur in other countries.

WTO and safeguard duty

In the technical language of the World Trade Organization (WTO) system, a safeguard is used to restrain international trade in order to protect a certain home industry from foreign competition. A member may take a "safeguard" action (restrict import of a product temporarily) to protect a specific domestic industry from an increase in imports of any product which is causing, or which is threatening to cause, serious injury to the domestic industry that produces like or directly-

competitive products.Safeguards are usually seen as responses to fair trade behaviour, as opposed to unfair trade practices such as

- Dumping
- Subsidy that attracts countervailing duty

As such they are used only in very specific circumstances, with compensation, and on a universal basis, i.e., a member restricting imports for safeguard purposes will have to restrict imports from all other countries.

Safeguard duty in India

India imposed safeguard duty on steel imports as the country faced cheap steel imports flooding its market and thus protect the domestic steel sector in 2015. It aims to deter countries such as China, South Korea and Japan from undercutting local mills, the first such move in more than 15 years. The safeguard duty expires in 200 days from the day it comes into effect. Critics say that it is counter productive as it promotes inefficiency but the answer is that it is temporary.

Countervailing duties (CVDs)

Some countries subsidies their products and make them cheap to be exported. The importing country then takes recourse to CVDs. Thus, CVDs are known as anti-subsidy duties. CVDs are trade import duties imposed to neutralize the negative effects of subsidies. They are imposed after a domestic investigation finds that a foreign country subsidizes its exports, injuring domestic producers in the importing country. According to World Trade Organization rules, a country can launch its own investigation and decide to charge extra duties, provided such additional duties are in accordance with the GATT Article VI and the GATT Agreement on Subsidies and Countervailing Measures.

India resorted to CVDs on import of certain Chinese flat steel products for a period of five years in 2017. The Commerce Ministry's investigation arm - Directorate General of Anti-Dumping and Allied Duties (DGAD) - in its probe had concluded that the domestic steel industry has lost sales opportunities which is a direct consequence of subsidised imports from China.The decision to impose CVD was taken by the Finance Ministry after the DGAD's recommendation.

It is a country specific duty which is imposed to safeguard domestic industry against unfair trade subsidies provided by the local governments of the exporting nations. While DGAD recommends the duty, Finance Ministry imposes it.

Anti-Dumping Duty

Dumping refers to pricing a export. It is the act of charging a lower price in a foreign market for a product than the price of the same product in a domestic market or in a third country market. It is selling at less than "fair value". Under the World Trade Organization (WTO) Antidumping Agreement, dumping is prohibited if it causes or threatens to cause material injury to a domestic industry in the importing country. Otherwise it is not prohibited.

Dumping is a kind of predatory pricing in international trade. The objective of dumping may be to use the full capacity of the industry; get relieved of the extra stock; or to increase market share in a foreign market by driving out competition and thereby create a monopoly situation where the exporter will be able to unilaterally dictate price and quality of the product.

The anti-dumping laws in India in the Customs and Tariffs Act, 1975 (Amended 1995) and The Anti-dumping rules state that "If any article is exported from any country or territory to India at less than its normal value, then, upon the importation of such article into India, the central government may by notification in the official gazette, impose an anti-dumping duty not exceeding the margin of dumping in relation to such article." As of 2017, 353 anti-dumping cases had been initiated by Directorate General of Anti-Dumping and Allied Duties (DGAD) out of which in one hundred and thirty cases, anti-dumping measures are in force.

In October 2017, India imposed anti-dumping duty on stainless steel from US, EU and China. Although antidumping measure has been provided as a vital rule to promote free trade, some instances of antidumping practices suggest that antidumping measures have been used as a tool of protectionism, as "safety valves" – to ease competitive pressure in domestic market.

Doha Round

Doha Round of Trade talks under the WTO began in 2001 in Doha, the capital of Qatar. Doha was the fourth ministerial after the WTO came into force- Singapore, Geneva, Seattle and Doha being the earlier three. It is called Doha Round because the talks were started in Doha. It is called Doha Development Round as it promised to address the issues that were important to the developing countries like India. It has lasted the longest and is yet to complete (2014).

Developing countries believed that they received a raw deal under the Marrakesh Treaty in matters related to agriculture, patents and so on. So they needed additional inducements to agree to the new round of talks. Thus, naming the Round as a Development Round was to pacify the developing countries.

Doha Round aims at further liberalizing international trade for agriculture, industry and services. The need for expeditious completion of the round is because trade as an engine of growth is needed ever more in the present world when global recession has reduced incomes of hundreds of millions of people due to collapse of demand. Also, protectionism is being chosen as a politically convenient strategy by countries including USA. It is a threat to globalization of trade and hurts all members.

Bali Package 2013

The Bali Package is a trade agreement resulting from the Ninth Ministerial Conference of the World Trade Organization in Bali, Indonesia, 2013. It is aimed at lowering global trade barriers. The package includes provisions for lowering import tariffs and agricultural subsidies, with the intention of making it easier for developing countries to trade with the developed world in global markets. Another important target is reforming customs bureaucracies and formalities to facilitate trade. The package covers the following:

Trade facilitation: Agreement on Trade Facilitation will reduce red-tape and streamline customs. It will be legally binding, require some expense and a certain level of technology. LDCs will be supported in building capacities to implement the changes. Although, some critics worry governments may have to prioritize funds for trade facilitation over other important areas such as public health or education.

Agriculture: Covers food security in developing countries.

India and the Bali Package

India had not yielded on the food security issue in the WTO Bali ministerial and, in fact, secured some concessions on the trade facilitation agreement (TFA).

The Bali draft says that till a permanent solution is reached (on the question of issues of asymmetry in the Agreement on Agriculture), members would refrain from approaching the dispute-settlement body against breach of the 10% cap on price-support based food subsidy. This is the peace clause discussed above.

Nairobi 2015

At the Nairobi Ministerial, fissures emerged between the developed and developing countries.

Nairobi declaration: 'We recognise that many members reaffirm the Doha Development Agenda... Other members do not reaffirm the Doha mandates, as they believe new approaches are necessary to achieve meaningful outcomes in multilateral negotiations. Members have different views on how to address the negotiations.'

The outcome of WTO's ministerial conference at Nairobi was mixed. On a positive note, all members agreed for the first time to a legally binding deal to promote agricultural trade by removing subsidies for farm exports. As a net exporter of agricultural products, the deal on agriculture holds potential for India.

The Nairobi ministerial came at a turning point for global trade: Three major stakeholders among developed countries, the US, EU and Japan, have begun to stitch together far reaching regional trade deals. Consequently, their need for WTO and the extent of concessions they are willing to offer there is declining. This did not bode well for many developing countries such as India as WTO provides a better platform to secure a fair trade deal. Even if multilateral trade deals in WTO have been limited, the dispute settlement mechanism of the organisation has worked to the advantage of developing countries. WTO does indeed remain relevant.

The threat to WTO in 2017 is different: deglobalisation due to Donald Trump's isolationism, Brexit and nationalism rising in Europe are rolling back the progress.

Trade Facilitation

Trade facilitation looks at how procedures and controls governing the movement of goods across national borders can be improved to reduce associated cost burdens and maximise efficiency while safeguarding legitimate regulatory objectives. Trade facilitation is "the simplification, standardization and harmonisation of procedures and associated information flows required to move goods from seller to buyer and to make payment".Occasionally, the term trade facilitation is extended to address a wider agenda in economic development and trade to include: the improvement of transport infrastructure, the modernization of customs administration etc.

Some examples:

Fiscal: Collection of customs duties, excise duties and other indirect taxes; payment mechanisms.

Safety and security: Vehicle checks; immigration and visa formalities.

Environment and health: Phytosanitary, veterinary and hygiene controls; health and safety measures; **Consumer protection:** Product testing; labelling; conformity checks with marketing standards (e.g. fruit and vegetables)

Trade policy: Some organisations promoting trade facilitation emphasis the cutting of red tape in international trade as their main objective. Propagated ideas and concepts to reforming trade and customs procedures generally resonate around the following themes:

- Simple rules and procedures
- Avoidance of duplication
- Alignment of procedures and adherence to international conventions
- Transparent rules and procedures
- Mechanisms for corrections and appeals
- Fair and consistent enforcement
- Time-release measures
- Standardisation of documents and electronic data requirements
- Automation
- International electronic exchange of trade data
- Single Window System

A major milestone for the global trading system was reached on 22 February *2017* when the first multilateral deal concluded in the 21 year history of the ***World Trade Organization entered into force*** following its ratification by two-thirds of the ***WTO*** membership, including India.

West and the Doha Round

Developed countries wanted to walk away from the multilateral trading system for many reasons. It served their purpose and there was no point in keeping faith in it and it was time to scale up. Developing countries became assertive. They were insisting that the West should their side of the pact- scrapping of export subsidies on agricultural goods etc. Also, the public health concerns of the TRIPS were being invoked and that was hurting the commercial interests of their pharma giants. Developments in the WTO, especially in the Doha Round negotiations, were forcing the big powers to share the economic pie with the emerging economies.

Mega regionals like TPP and the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU held hope for them.

India and other developing countries argued for freer mobility of labour in global services trade and to therefore provide an opportunity to their workforce to benefit from trade.

World Trade Organization (WTO) and e-commerce

Advanced countries at WTO want negotiations for "e-commerce," but developing countries oppose it. Proponents say small- and medium-sized enterprises (SMEs) will benefit using e-commerce. But SMEs are the least likely to be able to compete with giant transnational corporations, which enjoy the benefits of scale, historic subsidies, technological advances, strong state-sponsored infrastructure.

The contentious issues are

- requirements to hold data locally
- taxation for digitally traded goods to pay tax

Data is now the most valuable resource. WTO will allow corporations to transfer data around the world without restrictions would deny the right of countries to benefit from their own data and intelligence in the future. It also has serious implications for both data privacy and consumer protection. What WTO proponents call "localization barriers" are actually the tools that countries use to ensure that they benefit from the presence of transnational corporations to advance their own development.

WTO members do not currently have a mandate to write new global rules on "e-commerce." India has been opposing attempts, mainly by the rich nations, to incorporate e-commerce in the ongoing Doha Round talks of the WTO on the grounds that it would lead to the 'dilution' of the 'development agenda' (that is to improve the trading prospects of developing countries) of the negotiations.While it is not against informal and non-binding discussions on issues like e-commerce, India has said these topics cannot be made part of the formal agenda of WTO negotiations without consensus among all the WTO member nations.

Indian companies have reservations regarding a global, regional or bilateral pact on e-commerce fearing it would favour multinational firms. It involves policies on cybersecurity and hacking, fake goods and piracy, net-neutrality as well as safeguards to protect consumer data and ensure privacy. Fear is that it could result in significant opening of markets for goods and services and curtail the policy space of governments to regulate and nurture its domestic producers.

In the context of discussions on ecommerce, small and medium enterprises (SMEs) have come into focus. Some are saying that it will lead to gains for the MSMEs. But critics warn that MSMEs in India and in other developing countries face insurmountable problems in embracing e-commerce especially for international trade due to lack of e-commerce readiness.

India faces serious challenges in four areas in facilitating e-commerce especially international/ cross border: hard and soft infrastructure, legal framework, taxes and administration. For enabling e-commerce the entire logistics handling at ports/ airports has to be strengthened.

TBT and SPS

The Agreement on Technical Barriers to Trade is an international treaty administered by the World Trade Organization.

TBT exists to ensure that technical regulations, standards, testing, and certification procedures do not create unnecessary obstacles to trade. The agreement prohibits technical requirements created in order to limit trade, as opposed to technical requirements created for legitimate purposes such as consumer or environmental protection. The TBT agreement is closely linked to the Agreement on the Application of Sanitary and Phytosanitary Measures.

The Agreement on the Application of Sanitary and Phytosanitary Measures - also known as the SPS Agreement is an international treaty of the World Trade Organization. Under the SPS agreement, the WTO sets constraints on member-states' policies relating to food safety (bacterial contaminants, pesticides, inspection and labelling) as well as animal and plant health (phytosanitary) about imported pests and diseases.

For example, Indian measures against imports of toys from China on safety considerations.

Singapore Issues

The first ministerial conference was held in Singapore in 1996. Rich countries introduced four issues that came to be known as the "Singapore issues"

- Investment by foreign companies on same terms as national companies
- Competition laws that deal with monopolies and cartels , price fixing, mergers etc
- Transparency in government procurement and creating a level playing field for all players- domestic and foreign
- trade facilitation: standardization and simplification of customs procedures

The last one came into force in 2017 but the other three continue to be opposed. Poor countries do not allow them to be brought into the agendas they feel that they might damage their economic interests.The opposition of the poor countries rests on the following grounds.

- Doha agenda should not be overloaded and the existing issues need to be implemented first like cutting agricultural subsidies.
- large, multinational corporations dominate and threaten the young and growing domestic firms
- they are too intrusive
- policy should be the prerogative of the government . It should be made at its own discretion because such policy depends on a country's unique market conditions

The common theme of three of the issues (investment, competition, government procurement) is to maximise the rights of foreign enterprises to have market access to developing countries through their products and investment; to reduce to a minimum the rights of the host government to regulate foreign investors; and to prohibit government from measures that support or encourage local enterprises.

U.S. and the E.U support the introduction of the Singapore issues arguing that unfair competition/investment and procurement policies distort trade as much as tariffs do, and therefore should be regulated by the WTO rather than left up to individual country governments. However, the US and other developed nations should first implement their commitments in agriculture before expanding the agenda.

India and BITs

A bilateral investment treaty (BIT) is an agreement establishing the terms and conditions for private investment by nationals and companies of one country in another . BITs are signed as part of trade pacts. Its terms include fair and equitable treatment, protection from expropriation and full protection and security. They document a country's obligations on the protection of foreign investment under international law. The distinctive feature of many BITs is that they allow for an alternative dispute resolution mechanism, whereby an investor whose rights under the BIT have been violated could have recourse to international arbitration, often under the auspices of the ICSID (International Center for the Settlement of Investment Disputes of World Bank Group),

rather than suing the host State in its own courts.This process is called investor-state dispute settlement.

India terminated the bilateral investment treaties (BITs) it had signed with 58 countries-they were allowed to expire on April 1, 2017. The reason behind the termination is that India wants to renegotiate its investment treaties based on India's new model BIT. The ministry of finance is the nodal body dealing with BITs.

The recently adopted Indian model BIT tilts the balance towards the host state's regulatory power by severely limiting the substantive and procedural protection to foreign investment. Even if there is no BIT in place, the country's laws will continue to protect all the investments.

The new model BIT has clauses that are progressive for out sovereignty and policy space: reducing the extent of most-favoured nation status and national treatment clauses. The contentious change is India's insistence that foreign firms can turn to investor-State dispute settlement mechanisms — in other words, outside arbitration — only after exhausting local judicial remedies. GOI says this is necessary to stop the hundreds of arbitration cases filed against the government by foreign firms. Foreign firms say the cases are filed because the government is filing taxation and retrospective taxation and other cases against them.

As per Indian BIT's, investors can access ICSID (International Centre for Settlement of Investment Disputes) or can approach for arbitration under UNCITRAL (United Nations Commission on International Trade Law) rules. As India is not a party to ICSID convention, the Foreign investors can access Additional Facility Rules of ICSID for dispute resolution.

GOI set up a High Level Committee (HLC) in the Ministry of Law and Justice under **Mr. Justice B N Srikrishna, Retired Judge, Supreme Court in 2016** based on the Government's commitment to speedy resolution of commercial disputes and to make India an international hub of arbitration. The terms of reference of the Committee required it to examine the effectiveness of existing arbitration mechanisms, studying the functioning and performance of arbitral institutions in India and identifying gaps regarding manpower, skills, infrastructure, and funding in such institutions. Report was submitted in 2017.

Solar Panels

National Solar Mission is one of the several initiatives that are part of the National Action Plan on Climate Change with a solar power capacity target of 100 GW by 2022.

Guidelines for solar thermal mandated 30% project to have domestic content. A controversy emerged between power project developers and solar PV equipment manufacturers. The former camp prefers to source modules by accessing highly competitive global market to attain flexible pricing, better quality, predictable delivery and use of latest technologies.The latter camp prefers a controlled/planned environment to force developers to purchase modules from a small, albeit growing, group of module manufacturers in India. Manufacturers want to avoid competition with global players at this nascent stage of development and the government is convinced that to incentivise growth of local industry.

US Trade Representative has filed a complaint at World Trade Organization challenging India's domestic content requirements, citing discrimination against US exports and that industry in US which has invested hugely will be at loss. US insists that such restrictions are prohibited by WTO.

India however claims that it is only an attempt to grow local potential and to ensure self sustenance and reduce dependence. In 2016, WTO rejected India's case thus upholding national treatment clause of its charter.

H1B Visa Fee Hike and WTO-Compatibility

India launched a complaint against the US at the World Trade Organisation over changes to visas for skilled workers. USA changed rules to raise fees for L1 and H1B working visas and also placed more restrictions on the number of those visas awarded. The move is the first step in initiating a dispute at the WTO.

India's complaint centres on a doubling in the fees for H1B and L1 visas that was passed by Congress in 2015 as well as a congressionally mandated cap that limits the number of visas awarded to 65,000 each year.

India alleged that the U.S. is violating its obligations under General Agreement on Trade in Services (GATS), a binding agreement for all WTO member countries, as well as the GATS Annex on Movement of Natural Persons Supplying Services, to not discriminate against or between non-U.S. service providers. India contends that the 2010 and 2015 fee increases do not comply with "most-favoured-nation (MFN) treatment" under the GATS, which generally prohibits a WTO member from treating the services and service suppliers of one WTO member less favorably than it treats comparable services and suppliers of another. While the fee hike does not specifically mention Indian companies, such a provision has been tailored in such a manner that it impacts only Indian IT companies, India alleged.

The H-1B is a visa in the United States under the Immigration and Nationality Act which allows U.S. employers to employ foreign workers in specialty occupations like biotechnology, physical sciences, social sciences, medicine and health, etc in which foreign worker must possess at least a bachelor's degree .H-1B work-authorization is strictly limited to employment by the sponsoring employer.

An L-1 visa is a visa document used to enter the United States for the purpose of work.

L-1 visas are available to employees of an international company with offices in both the United States and abroad. The visa allows such foreign workers to relocate to the corporation's US office after having worked abroad for the company.

Generalized System of Preferences (GSP) and India

Generalized System of Preferences (GSP) is a preferential tariff system extended by developed countries to developing countries. It involves reduced MFN Tariffs or duty-free entry of eligible products exported by beneficiary countries to the markets of donor countries.

Indian exporters benefit by way of reduced tariff or duty free entry of eligible Indian products

Reduction or removal of import duty on an Indian product makes it more competitive to the importer - other things (e.g. quality) being equal.

This tariff preference helps new exporters to penetrate a market and established exporters to increase their market share and to improve upon the profit margins, in the donor country.

Rules of Origin

A. Rules of origin comprise a set of requirements laid down by the importing country, which must be fulfilled by a product to be eligible for preferential tariff treatment upon import in that country. In sum, they are a set of criteria that define nationality of traded products.

The rules of origin are aimed at reserving, as far as possible, the benefit of the preferential system to the country for which it is intended, and to prevent third countries' goods from unduly exploiting the system.

For example, each SAFTA country retains its external tariffs vis-à-vis non-members' goods and levies a lower tariff on the goods "originating" from the other SAFTA members. Rules of origin provide the basis for customs officials to make determinations about which goods are entitled preferential tariff treatment under the SAFTA.

Unless certain value addition is made in the member countries, FTAs and PTAs do not accord tariff concession.

Regional Trading Arrangements (RTA) and Multilateralism under WTO
PTA/FTAs should be understood in the context of economic integration among countries- usually in a geographical region like EU, Asean, NAFTA, SAFTA etc.

Preferential Trade Arrangement is the first step towards integration wherein the members agree to trade with one another at a concessional tariff. The same concessional tariff is denied to non-members.

The next step is duty-free trade and elimination of quotas. It is called FTA.

The customs union is a form of economic integration involving two or more sovereign states that stipulates that there be free trade between the member states and a common tariff policy on trade with non-member states.

Later comes common market where there is a free movement of labour, capital, goods and services.

If the common market has the same currency, it is called a monetary union.

The last stage is the economic union in which members have a common currency and fiscal and monetary policies. Presently, the EU is the only example of a monetary and economic union.

RTAs are allowed under the WTO. Most of the main RTAs today were there when WTO was born in 1995. The reason is that the aims of the two are the same: economic integration on a wider and deeper scale.Tariffs being a barrier to trade, reducing and removing them boosts trade

- complementarities are established among the regional members
- trade creation is another argument- that is, due to free trade among members more trade is created
- higher production and greater efficiency due to enhanced competition

- free trade within a region is a beginning towards globalization as it prepares the countries to face global competition and secure benefits
- in fact, FTAs catalyse globalization as the benefits at the regional level will accelerate the pace towards a larger scale
- non-economic factors are another major incentive as more peaceful relations among the regional countries will have a a virtuous effect.

The following are the problems

- Trade diversion takes place. It means trade is not created but is merely diverted. Imports are made from the FTA member due to price advantage ,even if a non-member is more efficient
- Also, these arrangements have other undesirable fallout like loss of revenue due to tariff reduction or removal and

Regional economic integration without prejudicing globalization and multilateralism is carried forward with 'open regionalism'. "Open regionalism" is defined as external liberalization by trade blocs (PTAs and FTAs) that is, the reduction in barriers on imports from non-member countries that is undertaken when member countries liberalize the trade among themselves. Even as tariffs are reduced for the non-member countries, the level of reduction need not be the same as it is among the member countries.

While the regional trade blocs erode the MFN principle, the following arguments are advanced to show that they promote globalization

- regional free trade is easier to implement in comparison to globalization as the latter is difficult to accept by the people of the country
- domestic lobbies for protectionism can be resisted more successfully by the government at the regional level initially and later at the global level
- scope for deeper integration at the regional level- not only trade but also comprehensive economic cooperation(investment, collaborations etc)
- open regionalism is a step towards making regional trade blocs global.

Some regional trading arrangements in force and in negotiations:

- The **Transatlantic Trade and Investment Partnership** (also known as the Transatlantic Free Trade Area) is a proposed free-trade agreement between the European Union and the United States. The deal is estimated to boost the EU's economy by €120 billion, the US economy by €90 billion and the rest of the world by €100 billion. Talks began in July 2013 and may be finalized by the end of 2014.
- **Regional Comprehensive Economic Partnership (RCEP)** is a Free Trade Agreement (FTA) scheme of the 10 ASEAN Member States and its FTA Partners (Australia, China, India, Japan, Korea and New Zealand).
- **Trans-Pacific Partnership (TPP)** is a trade agreement under negotiation Australia, Brunei, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The TPP is intended to be a "high-standard" agreement aimed at emerging trade issues in the 21st century. Trump pulled USA out of it.

- ASEAN Free Trade Area (AFTA) with Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Cambodia, Laos, Myanmar, Vietnam.
- European Free Trade Association (EFTA) between Iceland, Norway, Switzerland and Liechtenstein
- North American Free Trade Agreement (NAFTA) between Canada, U.S. and Mexico
- South Asia Free Trade Agreement (SAFTA) between India, Pakistan, Nepal, Sri Lanka, Bangladesh, Bhutan and the Maldives
- Mercosur is a Regional Trade Agreement (RTA) between Brazil, Argentina, Uruguay and Paraguay, founded in 1991 by the Treaty of Asunción, which was later amended and updated by the 1994 Treaty of Ouro Preto. Its purpose is to promote free trade and the fluid movement of goods, peoples, and currency
- The Andean Community of Nations (CAN) is a trade bloc comprising the South American countries like of Bolivia, Colombia, Ecuador and Peru. Its headquarters are located in Lima, Peru.
- The Economic Community of West African States (ECOWAS) is a regional group initially of sixteen countries, founded in 1975.on the basis of Treaty of Lagos.
- The Southern African Development Community (SADC) seeks to further socio-economic cooperation and integration as well as political and security cooperation among 14 southern African countries.

Groups

G-10 are major food-importing economies like Japan, South Korea, Taiwan, Norway, Switzerland Israel etc. It has rich and poor representatives (Bulgaria etc)

Group of 20 (also called **G20+**) is a bloc of developing nations established in the 5th Ministerial WTO conference, held in Cancun in 2013. It stands for drastic reduction in agricultural subsidies by industrialized nations and opposed further liberalization.

G-33 comprises developing countries like India, Indonesia etc with defensive farm interests that involves protecting farmers from imports. It is an alliance of developing countries on Special Products (SP) and Special Safeguard Mechanism (SSM) in the ongoing agriculture negotiations. It has 42 members including India, Indonesia etc .They are net-food importing developing countries.

While G-20 consists of developing countries with exporting interests as well as defensive interests, the G-33 includes only those developing countries with defensive interest in agriculture.

G-90 is the group of Least developed countries (LDCs) along with other countries from Africa, the Caribbean and Pacific formed G-90 during the Cancun conference in 2003.

What has India gained from the WTO?

- MFN status in the 164 member body
- Rule based trading system
- Impartial trade dispute settlement process unlike earlier when there was bilateral pressures and threats to fall in line(Super and Special 301 of the USA)