SRIRAM'S IAS

Old Rajinder Nagar
SRIRAM'S IAS
General Studies
Mukherji Nagar

GENERAL STUDIES

INDIAN ECONOMY

11A/22; 1st Floor; Old Rajender Nagar;New Delhi -60
ph. 011-25825591; 42437002; 9958671553
73-75; 1st Floor; Ring Road ;Beside GTB Metro Station
Kingsway Camp;New Delhi.
Ph. 08447273027

Indian Economy
Contents

Economics: An Introduction

Definition of economics

Economics as a word comes from the Greek : oikos means 'family, household, or estate', and nomos stands for 'custom, law' etc. Thus, "household management" or management of scarce resources is the essential meaning of economics. Economic logic is applied to any problem that involves choice under scarcity.

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 Bill, 2012 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).**

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

Initially, economics focused on "wealth" and later "welfare". That is, it did not deter economists from advocating maximum production regardless of who benefited from it and how much misery it produced. Later, by the late 19^{th} century, there was hue and cry about children being made to overwork and receive paltry payment for their work, to give one example.

As a policy science, economics is always confronted with trade offs as scarcity of resources is the basis of the discipline. Trade offs involve making choices in policy making 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, 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 then poor and weak. It may mean more borrowings and thus some fiscal excess but not too much. 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 5.1% of GDP(2012-13).

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 is the cost of foregoing an opportunity 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 emphasize production and consumption, and do not deal with the economic activities of those not significantly involved in these two processes ,for example, 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 the 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. Economics since then involved study of social action connected with the attainment of human well being.

Beyond, wealth, welfare and trade offs, there has been an intense search in the discipline for right foci- sustainable development, green economy, well being, national happiness and so on.

Economics is usually divided into two main branches:

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.

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 behavoir or a firm or consumer or household depends upon the state of the national and global economy and vice versa.

'Mesoeconomics' studies the intermediate level of economic organization in between the micro and the macro economics 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	Production/output in individual industries and businesses and consumer and behaviour How much steel How much office space How many cars Consumer behaviour
Macroeconomics	National production/output Gross domestic product employment Poverty Inflation BOP

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

- Keynesian macroeconomics based on the theories of twentieth-century British economist John Maynard Keynes. It says that the state can stimulate economic growth and restore stability in the economy through expansionary policies. For example through massive programme of spending on infrastructure when the demand is low and growth rate is falling. In the recessionary phase that the economies of the western world in particular and rest of the world in general are going through due to 2008 financial crisis, the relevance of Keynes is growing. The intervention by State is only when the economic cycle turns down and growth slows down or is negative. 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 Union Budget. The theories of Keynesian economics were first presented in The General Theory of Employment, Interest and Money(1936).

  Neoliberalism refers to advocacy of policies such as individual liberty, free markets, and free trade. 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".With the communist model of economic management through state ownership of economy failing by the mid-1980s and industrial democracies registering a history victory over it with their free market model, market forces returned as the winning format for economic success. It is the return of the liberalism of the Adam Smith era and is refered to as neo-liberalsim in its present form since mid-1980s. India's economic reforms are largely centred around it. The expression of neoliberalism is used by some as leaving too much role to the market forces and can be detrimental to genuine human and sustainable growth.

- In distinction to the above, there is the school of socialist economics based on public (State) ownership of means of production to achieve greater equality 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.It may also establish fully centrally planned economy which is also called command economy- economy is at the command of the State. Private ownership of assets is not allowed . For example, erstwhile USSR, Cuba etc. The latter (no private property, total economy being owned by the state etc) is known as communist model.
- Development economics is a branch of economics which deals with not only promoting economic growth and structural change but also improving the well being of the population as a whole through focus on health and education and workplace conditions, whether through public or private channels. Its thrust is mainly on low i come countries. The most prominent contemporary development economists are Nobel laureates Amartya Sen and Joseph Stiglitz.

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. For example, a subsistence economy is transformed into commercial economy or a regulated mixed economy is liberalized. An insulated and prtectionist 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.

Green economics focuses on and supports the harmonious interaction between humans and nature, and attempts to reconcile the two. It is refered by many names like sustainable development, green economy(Rio Plus 20 ,2012)

Economic growth

Economic growth is the change- increase or decrease, in the value of goods and services produced by an economy. If it is positive ,it means an increase in the output and the income of a country. It is generally shown as the increase in percentage terms of real gross domestic product(GDP adjusted to inflation) or real GDP.

Measuring Growth

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 is used almost synonymously with GDP.

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 prices. Real GDP refers to the current year production of goods and service valued at base year prices. Base year prices are constant prices.

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.

To explain further, 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.Similarly, transfer payments(pensions, scholarships etc) are excluded as there is income received but no good or service produced in return.

However, not all goods and services from productive activities enter into market transactions. Hence, imputations are made for these non-marketed but productive activities :for example, imputed rental for owner-occupied housing.

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.

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.

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

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 really 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 ie within the walls of the firms, plants etc in an economy.

Transfer Payments

Transfer payment refers to payments made by government to individuals for which there no economic activity is produced in return by these individuals. Examples of transfer are scholarship, pension.

Estimating GDP/GNP

Three approaches

There are three different ways of calculating GDP. The expenditure approach adds consumption, investment, government expenditure and net exports(exports minus imports). On the other hand, 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

6

(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

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.

Gross 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 deflators- it helps take out the contribution of inflation to the value of the output. Errors can occur in the process of deflating the figure based on which deflator is used. GDP data for the first quarter of 2010-11 was miscalculated because the price deflator was wrongly used. For GDP by output and expenditure figures, two different deflators were used and the shrinkage went wrong. For one figure, CPI was used as deflator and for the other GDP figure, WPI was used.

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 aborad or vice versa. That is meant by net foreign income. GNP adds net out 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. The wages of the American workers would be part of US GDP, while the wages of any German workers on the site would be part of German GNP.

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.

Japan used to belong in the last category. Until the mid-1990s, the difference between Japan's GDP and GNP amounted to less than one percentage point of GDP. With only limited numbers of people doing business abroad, the GDP and GNP were essentially the same thing.

8

Presently, Japan's GNP tends to be around 2 percentage points larger than its GDP. Japanese economy is globalised with Japanese investment in China, USA, Europe etc.In stark contrast to the Japanese case, there are other nations where the difference between GDP and GNP is not only large, but inverted as well. That is to say, GDP is larger than GNP.Ireland is a case in point. That country's GDP has tended over recent years to eclipse its GNP by as much as 20 percent.

This is typical of a very small and very open economy. When such a country manages to attract a lot of foreign direct investment, domestic economic activity expands quite quickly. But the earnings from all that economic activity, if they are sent home by the companies in question, may not leave the country richer at all.

Analysts tend to say that GDP is a better measure than GNP, and that now seems to have been accepted by all the major industrial countries. The reason is that GDP is domestic production where employment is created; inflation is modeated; tax revenues are more 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.

There are other related concepts too.

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.

9

The growth of GDP at constant price shows an annual real growth.

The real GDP per capita of an economy is often used as an indicator of the average standard of living of individuals in that country, and economic growth is therefore often seen as indicating an increase in the average standard of living.

Base year

For examining the performance of the economy in real terms through the measurement of Gross Domestic Product (GDP), national income, consumption expenditure, capital formation etc., estimates are prepared at the prices of selected year known as base year. Base year is a specific year from which the economic growth is measured .It is allocated the value of 100 in an index. The estimates at the prevailing prices of the current year are termed as "at current prices", while those prepared at base year prices are termed "at constant prices". The comparison of the two estimates gives the measure of real growth. It means the production of the current year is valued at base year prices so that the real growth is worked out by deducting the impact of inflation or deflation.That is, the increase in the value of the GDP due to inflation is excluded and the 'real increase' is found out.

The base year of the national accounts is changed periodically to take into account the structural changes which take place in the economy and to depict a true picture of the economy through measures like GDP.

The first official estimates of national income were prepared by the Central Statistical Office (CSO) with base year 1948-49 for the estimates at constant prices. These estimates were published in the publication, "Estimates of National Income" in 1956. With the gradual improvement in the availability of basic data over the years, a comprehensive review of methodology for national accounts statistics has constantly been undertaken with a view to updating the database and shifting the base year to a more recent year. As a result, base years of the National Accounts Statistics series have been shifted from 1948-49 to 2004-05 which is the new series of national accounts being followed from 2010.

Normally, when the base year of national accounts statistics is changed, there is some change in the levels of GDP estimates. This happens due to widening the coverage.

A base year has to be a normal year without large fluctuations in production, trade and prices of commodities in general. Reliable price data should be available for it . It should be as recent as possible. The National Statistical Commission wants that the base year should be revised every five years.

10

GDP deflator

GDP Deflator is a comprehens ive measure of inflation, implicitly derived from national accounts data as a ratio of GDP at current prices to constant prices.It encompasses the entire spectrum of domestic economic activities including services, it is available on a quarterly basis with a lag of two months since 1996. Given the delay involved in obtaining the GDP deflator, national income aggregates extensively use WPI for deflating nominal price estimates to derive real price estimates.

The formula used to calculate the deflator is:

$$\text{GDP deflator} = \frac{\text{Nominal GDP}}{\text{Real GDP}} \times 100$$

Dividing the nominal GDP by the GDP deflator and multiplying it by 100 would then give the figure for real GDP, hence deflating the nominal GDP into a real measure.

A price deflator of 200 means that the current-year price of this computing power is twice its base-year price - price inflation. A price deflator of 50 means that the current-year price is half the base year price - price deflation.

Unlike some price indexes, the GDP deflator is not based on a fixed basket of goods and services. It covers the whole economy.

Specifically, for GDP, the "basket" in each year is the set of all goods that were produced domestically, weighted by the market value of the total consumption of each good. Therefore, new expenditure patterns are allowed to show up in the deflator as people respond to changing prices. The advantage of this approach is that the GDP deflator reflects up to date expenditure patterns.

The CSO uses the price indices to reach the base year/ reference year figure from the current year one. In September 2010, for the first quarterly figure, it made a mistake while applying the deflator- for the GDP by output figure, it used one price index and for the GDP by expenditure number, it used another. It led to huge discrepancy which was later corrected.

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 2004-05 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 (Per Capita Net National Product at factor cost). 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.

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
- 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

Problems in calculating National Income

The measurement of national income encounters many problems. The problem of double-counting has already bee noted. Though there are some corrective measures, it is difficult to eliminate double-counting altogether. And there are many such problems and the following are some of them.

12

Black Money

Illegal activities like smuggling and 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.

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.

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. When recession takes place, it may not be of the same intensity every time. For example, the 2008 global financial meltdown is the deepest since the WW2 and is called the Great Recession. If recession deepens, it is called depression and occurred only once in the last century in 1930's. All economies experience economic cycles.

13

Explaining and preventing these fluctuations is one of the main focuses of macroeconomics.

Recession may end with the corrective measures taken by the government and the market. One such measure is stimulus. 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 is 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. Greece in 2012 is in depression with 50% of the young people out of work.

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 the NREGA are a direct result of the tax buoyancy of growth the country experienced since 2003 till 2011. It sets up the positive spiral :rising demand encourages investment in new capital machinery which helps accelerate economic growth and t 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.

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 GNP 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 For example, Indian economy grew at 8.4% in 2010-2011 but the food inflation was over 14% causing immesirization of the lower classes

14

- Gender disparities are not indicated
- 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 rather that (all other things being equal) 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), Index of Sustainable Economic Welfare (ISEW), Genuine Progress Indicator (GPI) and Sustainable National Income (SNI), 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

Some economists have attempted to create a replacements for GDP which attempt to address many of the above criticisms regarding GDP. Other nations such as Bhutan have advocated gross national happiness as a standard of living, claiming itself as the world's happiest nation.(Read ahead for Recent advances in the concept)

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.

India ranks at 134 among 187 countries in terms of the human development index (HDI) in 2011. It is placed in the "medium" category.India's ranking in 2010 was 119 out of 169 countries.

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).

HPI

An alternative measure, focusing on the amount of poverty in a country, is the Human Poverty Index.The Human Poverty Index is an indication of the standard of living in a country, developed by the United Nations.

Indicators used are:

- Life span
- functional literacy skills
- Long-term unemployment
- Relative poverty (poverty with reference to the average per capita income)

16

GPI

The Genuine Progress Indicator (GPI) is a concept in green economics and welfare economics that has been suggested as a replacement metric for gross domestic product (GDP) to measure economic growth. Unlike GDP it is claimed by its advocates to more reliably distinguish uneconomic growth - harmful economic growth under which inequalities pile up and environmental damage is huge.

A GPI is an attempt to measure whether or not a country's growth, increased production of goods, and expanding services have actually resulted in the improvement of the welfare (or well-being) of the people in the country.

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.

17

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 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, Wen Jiabao, the Chinese premier, announced that the green GDP index would replace the Chinese GDP index. But the effort was dropped in 2007 as green GDP figures shrank the size of the GDP to unimpressive levels.

India and green accounting

India aims to factor the use of natural resources in its economic growth estimates by 2015 -to make "green accounting" part of government policy on economic growth.

The green GDP estimates account for the consumption of natural resources as well. This would help find out how much of a natural resource is being consumed in the course of economic growth, how much being degraded and how much being replenished.

In the calculation of Green GDP,there are methodological concerns about how to monetize the loss of biodiversity;how to measure the economic impacts of climate change due to green house gas emissions etc.

Sarkozy's for an Alternative metric

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.

18

Reflecting these concerns, President Sarkozy has decided to establish this Commission, to look at the entire range of issues. Its aim is 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 is 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 GDP may be a poor measure of well-being, or even of market activity, has, of course, long been recognized.

More recent developments

Details ,discussion and dictation in the class

Moral economy

"Moral economy" is a name given in economics, sociology and anthropology to the interplay between cultural mores and economic activity. It describes the various ways in which custom and social pressure coerce economic actors in a society to conform to traditional norms even at the expense of profit. It is also an economy in which the stake holders like workers expect respect and dignity along with salary and working conditions- the latter not being all, the former being quite important as well. If moral economy breaks down, industrial unrest may result.

Laissez-faire

A market economy is an economic system in which goods and services are traded, with the price being determined by demand and supply.

Laissez-faire is a French phrase meaning "let do, let go, let pass." Its proponents make arguments against government interference with economy and trade. It is

19

synonymous with free market economics .It is generally understood to be a doctrine opposing economic interventionism by the state beyond the extent which is perceived to be necessary to maintain peace and property rights.

Supporters of a market economy generally hold that the pursuit of self-interest is actually in the best interest of society. Adam Smith says:

"By pursuing his own interest [an individual] frequently promotes that of the society more effectually than when he really intends to promote it. " (Wealth of Nations)

Adam Smith calls it the invisible hand- the force that combines the individual self interest into a collective social interest. However, as we have seen in the melt down of the western economies since 2008 and as Nobel laureate Joseph Stiglitz commented, invisible hand may not exist. That is why it is invisible!

There are a variety of critics of market as an organizing principle of an economy. These critics range from those who reject markets entirely, in favor of a planned economy, such as that advocated by communism to those who wish to see them regulated to various degrees. One prominent practical objection is the environmental pollution generated . Another is the claim that through the creation of monopolies, markets sow the seeds of their own destruction. Still another, since 2008, is the excessive speculation and financialization of the market and its crash.

Social market

Some proponents of market economies believe that government should intervene to prevent market failure while preserving the general character of a market economy.

It seeks an alternative economic system other than socialism and laissez-faire economy. combining private enterprise with measures of the state to establish fair competition, low inflation, low levels of unemployment, good working conditions, and social welfare.

Market economy and poverty

Free market economists argue that the only way to solve poverty is by creating new wealth. According to them,planned economies and welfare will not solve poverty problems but only make them worse. Low levels of government regulation and interference, free trade, and tax reform are the way to achieve growth. Open economy. competition and innovation generate growth and employment.

Advocates of the third way -social market solutions to poverty- believe that there is a legitimate role the government can play in fighting poverty. They believe this can be

20

achieved through the creation of social safety nets such as social security and workers compensation.

Most modern industrialized nations today are not typically representative of Laissez-faire principles, as they usually involve significant amounts of government intervention in the economy. This intervention includes minimum wages to increase the standard of living, anti-monopoly regulation to prevent monopolies, progressive income taxes, welfare programs to provide a safety net for those without the capacity to find work ,disability assistance, subsidy programs for businesses and agricultural products to stabilize prices - protect jobs within a country, government ownership of some industry, regulation of market competition to ensure fair standards and practices to protect the consumer and worker, and economic trade barriers in the form of protective tariffs - quotas on imports - or internal regulation favoring domestic industry.

Market and Government failure

The inability of an unregulated market to achieve allocative efficiency is known as market failure. The main types of market failure are: monopoly, steep inequality, pollution etc. The western economic recession since 2008 is the result of market failure where excessive speculation and borrowings have disoriented the economies with huge human and economic cost.

Government failure is the public sector analogy to market failure and occurs when government does not efficiently allocate goods and/or resources consumers. Just as with market failures, there are many different kinds of government failures. Inefficient use of resources, wastage and retarded economic growth due to government monopolies and regulation are the results of government failure. Often, the performance of the public sector in India is cited to exemplify government failure. The sickness of Air India resulting from its mismanagement is an example of government failure.

Structural composition of the economy

The three-sector hypothesis is an economic theory which divides economies into three sectors of activity: extraction of raw materials (primary), manufacturing (secondary), and services (tertiary).Following is the table of the components of the Indian economy since the fifties in % terms.

21

Year	Agri.	Ind.	Svcs.
1951-52	55.4	15.4	29.3
1961-62	49.4	19.5	31.1
1971-72	43.1	22.5	34.5
1981-82	37.6	24.6	37.9
1991-92	30.3	25.6	44.1
2001-02	24.0	25.0	51.0
2009-10	14.6	28.5	56.9

According to the theory, the main focus of an economy's activity shifts from the primary. through the secondary and finally to the tertiary sector. The increase in quality of life, social security, growth of education and culture and avoidance of unemployment with reduction of poverty are the effects of such transition.

Countries with a low per capita income are in an early state of development; the main part of their national income is achieved through production in the primary sector. Countries in a more advanced state of development, with a medium national income, generate their income mostly in the secondary sector. In highly developed countries with a high income, the tertiary sector dominates the total output of the economy.

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. Major businesses in this sector include 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.

22

Light industry is usually less capital intensive than heavy industry, and is more consumer-oriented than business-oriented (i.e., most light industry products are produced for end users rather than as intermediates for use by other industries).Examples of light industries include the manufacture of clothes, shoes, furniture and household items (e.g. consumer electronics).

Heavy industry means: traditional production **industries** in the auto, steel, rubber, petroleum, and similar areas, requiring high capitalization and producing large quantities. Some more examples are heavy machinery, big factories, chemical plants, production of construction equipment such as cranes and bulldozers.

The tertiary sector of economy (also known as the service sector) is defined by exclusion of the two other sectors. Services are defined in conventional economic literature as "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 as may happen in wholesaling and retailing, or may involve the provision of a service, such as or entertainment. The service sector consists of the "soft" parts of the economy such as insurance, government, tourism, banking, retail, education, and social services.Examples of service may include retail, insurance, and government.

The quaternary sector of the economy is an extension of the three-sector hypothesis. It principally concerns the intellectual services: information generation, information sharing, consultation and research and development. It is sometimes incorporated into the tertiary sector but many argue that intellectual services are distinct enough to warrant a separate sector.The quaternary sector can be seen as the sector in which companies invest in order to ensure further expansion. Research will be directed into cutting costs, tapping into markets, producing innovative ideas, new production methods and methods of manufacture, amongst others. 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.

The quinary sector of the economy is the sector suggested by some economists as comprising health, education, culture, police, fire service, and other government industries not intended to make a profit. The quinary sector also includes domestic activities such as those performed by stay-at-home parents or homemakers. These activities are not measured by monetary amounts but make a considerable contribution to the economy.

23

Some terms

A developing country is a country that has not reached the Western-style standards of democratic governments, free market economies, industrialization, social programs, and human rights guarantees for their citizens.

Countries with more advanced economies than other developing nations, but which have not yet fully demonstrated the signs of a developed country, are grouped under the term newly industrialized countries.

Development entails a modern infrastructure (both physical and institutional), and a move away from low value added sectors such as agriculture and natural resource extraction. Developed countries, in comparison, usually have economic systems based on economic growth in the secondary, tertiary and quaternary sectors and high standards of living.

The category of newly industrialized country (NIC) is a socioeconomic classification applied to several countries around the world.

NICs are countries whose economies have not yet reached first world status but have, in a macroeconomic sense, outpaced their developing counterparts. Another characterization of NICs is that of nations who were till a decade or so back had regulated economies but are open now and are undergoing rapid economic growth. Incipient or ongoing industrialization is an important indicator of a NIC. In many NICs, social upheaval can occur as primarily rural, agricultural populations migrate to the cities, where the growth of manufacturing concerns and factories can draw many thousands of laborers.

NICs usually share some other common features, including:

- A switch from agricultural to industrial economies, especially in the manufacturing sector.
- An increasingly open-market economy, allowing free trade with other nations in the world.
- Emerging MNCs
- Strong capital investment from foreign countries.

A **high-income economy** is defined by the World Bank as a country with a per capita income of US$12,476 or more in 2011. While the term "high income" may be used interchangeably with "First World" and "developed country," the technical definitions of these terms differ. 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. Countries not fitting this definition may be referred to as developing countries.

This level of economic development usually translates into a high income per capita and a high Human Development Index (HDI) rating. Countries with high gross domestic product (GDP) per capita often fit the above description of a developed economy. However, anomalies exist when determining "developed" status by the factor GDP per capita alone.

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 or Fourth World countries) 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. A country is classified as a Least Developed Country if it meets three criteria based on:

- low-income (three-year average per capita income of less than US $905, which must exceed $1,086 to leave the list(2012)
- 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 and the percentage of population displaced by natural disasters)

The classification currently applies to 48 countries.

Vital Statistics

The per capita income of Indians for the first time crossed the Rs 50,000-mark in 2010-11. although using current prices as the barometer. According to the revised GDP data for the 2010-11 financial year, per capita income is estimated to

25

have risen 16.9% to Rs 53,331 compared to Rs 46,117 in the previous year.

The huge figure is seen to be illusionary as economists prefer to use factor cost at constant prices to weed out the impact of inflation. Based on 2004-05 prices, per capita income saw a modest 6.4% increase and reached Rs 35,993 in 2010-11, compared to Rs 33,843 in the previous year.

Thus,the Rs 50,000-mark is not a great milestone to celebrate. Kit may be the other way as inflation actually hurt the poor and the low income groups rather than cushioning themasthe higher figure shows.

Based on current prices, GDP rose by 18.8% in 2010-11, data released by the Central Statistics Office shows. But it is the real GDP—which factors in the impact of inflation—that is used to gauge economic expansion. By that measure, the Indian economy grew 8.4%.

Growth and the value of output

India's economic growth rate slipped to 5.3% in the fourth quarter of 2011-12.This is the lowest in nearly 9years due to poor performance of the manufacturing and farm sectors.

The Central Statistics Office (CSO), Ministry of Statistics and Programme Implementation, that released the quarterly estimates of Gross Domestic Product (GDP) for the fourth quarter (January-March) of 2011-12 showed that growth moderated to 6.5% from 8.4% in the 2010-11.

The GDP factor cost at constant (2004-05) and current prices in the year 2011-12 is estimated at Rs. 52,02514 crore. GDP at factor cost at current prices in the year 2011-12 is estimated at Rs. 82,32,652 crore,

CSO Estimate of GDP, 2011-12 (At 2004-05 prices)

DOMESTIC PRODUCT (Rs. Crore)

Gross domestic product (GDP) at factor cost - 52,02,514
Gross domestic product (GDP) at market prices – 55,958,56
Net domestic product (NDP) at factor cost – 46,01,480
Per capita GDP at factor cost (Rs.) -43,282

GDP Estimate 2011-12 (At current prices)
DOMESTIC PRODUCT (Rs. Crore)
Gross domestic product (GDP) at factor cost 8,232,652
Gross domestic product (GDP) at market prices 8,855,797
Net domestic product (NDP) at factor cost 7,368,223
Per capita GDP at factor cost(Rs.)- 68,491

26

Socio-Economic Planning

In the earlier part of the Industrial revolution era, government did not interfere in the economy- it provided public goods like law and order and allowed market forces of demand and supply a free play. There was private sector only owned and operated by the individual companies and the aim was to make profits as much as possible. It led to exploitation of labour and children. In a democracy, it was not acceptable. Therefore, the government gradually started regulating the economy. In course of time, it developed into a welfare state.

In ex-colonial national economies like ours, the devastation that the economy went through had to be rapidly undone. Left to market forces, welfare was feared tobe the casualty even while growth might be assured. The leaders of the freedom struggle like Nehru preferred to opt for a planned economy to make growth rapid and pro-people. Also, priorities of growth should be determined for national benefit and not for the benefit of the MNCs. Thus was born the national commitment to socio economic planning.

In a planned economy, State owns- partly or wholly- the economy. If the whole economy is oned by the government, it is communist command economy. If there is adequate room for private market forces, it is called mixed economy where the government and market complement each other for social good.

Centrally planned economies may be like India or China or so many emerging economies. They are characterised by

- Important role for the government in the management of the economy
- Goals are set by the government and the private investors together
- Investment is shared by the two according to their capacity
- There is largely a welfare-orientation to the economy

In a market economy, 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(see ahead) is one 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.

The difference between planned economy and command economy is that in the former there may be mixed economy while in the latter Government owns and regulates economy to near monopolistic limit.

Command economies were 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: The beginnings

India being devastated economically after more than 2 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.

Visionary engineer Sir Mokshagundam Visvesvarayya. pointed to the success of Japan and insisted that 'industries and trade do not grow of themselves, but have to be willed, planned and systematically developed' – in his book titled "Planned Economy for India"(1934) Expert economists and businessmen were to do the planning. The goal was poverty eradication through growth.

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.

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. It sought to double India's per capita income in 15 years.

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, follower of Mahatma Gandhi published Gandhian Plan that emphasized on decentralization; agricultural development; employment; cottage industries etc.

Planning Goals

After Independence in 1947, India launched the five year plans for rapid growth. The first FYP began in 1951. Planning has the following long term goals

- Growth
- Modernization
- self-reliance and
- social justice*

Economic growth is the increase in value of the goods and services produced by an economy. It is conventionally measured as the percent rate of increase in real gross domestic product. or real GDP- real means adjusted to inflation. Growth measures quantitative increase in goods and services.

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

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.

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 aims for self-reliance as MNCs could exploit the country and siphon its resources. Long term development is not possible unless there is a large degree of self-reliance. Nehru-Mahalanobis model of growth that closed Indian economy and relied on basic industries is the main plank for self-reliance.

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 flows; 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.

History of Planning

First FYP (1951- 56)

The First Plan stressed more 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 estimated as 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 FYP (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.

Third FYP (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- 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 FYP (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 FYP (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. But officially, the history of planning since 1951 counts the FYP in the normal period of 1974-79.

The financial year of 1979-80 is again a plan holiday.

Sixth FYP (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 unlike the earlier strategy of trickledown effect where the growth of economy was expected to benefit all in course of time- trickle by trickle. Since it did not work, direct attack was adopted.

Seventh FYP (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 FYP(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.

Ninth FYP (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%

Tenth FYP(2002-2007)

- Tenth Five Year Plan proposes schooling to be compulsory for children, by the year 2003.
- The mortality rate of children must be reduced to 45 per 1000 livings births and 28 per 1000 livings births by 2007 and 2012 respectively
- All main rivers should be cleaned up between 2007 and 2012
- Reducing the poverty ratio by at least five percentage points, by 2007
- Making provision for useful and lucrative employments to the population, which are of the best qualities
- According to the Plan, it is mandatory that all infants complete at least five years in schools by 2007.
- By 2007, there should be a decrease in gender discriminations in the spheres of wage rate and literacy, by a minimum of 50%
- Taking up of extensive afforestation measures, by planting more trees and enhance the forest and tree areas to 25% by 2007 and 33% by 2012
- Ensuring persistent availability of pure drinking water in the rural areas of India, even in the remote parts

5

- The alarming rate at which the Indian population is growing must be checked and fixed to 16.2%, between a time frame of 2001 and 2011
- The rate of literacy must be increased by at least 75%, within the tenure of the Tenth Five Year Plan.

Growth rate targeted was 8% and achieved was 7.8%. It was the best till then and since then.

11th Five Year Plan (2007-2012)

The eleventh plan has the following objectives:

1. Income & Poverty

    - Accelerate GDP growth from 8% to 10% and then maintain at 10% in the 12th Plan in order to double per capita income by 2016-17
    - Rs.36,44,000 lakh crores ($910 billion) is the investment
    - gross budgetary support (GBS) is Rs 14,21,711 crore, double of the last plan
    - Increase agricultural growth rate to 4% per year to ensure broad-based development
    - Create 70 million new work opportunities.
    - Reduce educated unemployment to below 5%.
    - Raise real wage rate of unskilled workers by 20 percent.
    - Reduce poverty by 10 percentage points
    - industrial and services sector growth to 9-11 per cent
    - investment rate to be at 36.7 per cent

2. Education

    - Reduce dropout rates of children from elementary school from 52.2% in 2003-04 to 20% by 2011-12
    - Develop minimum standards of educational attainment in elementary school, and by regular testing monitor effectiveness of education to ensure quality
    - Increase literacy rate for persons of age 7 years or more to 85%
    - Lower gender gap in literacy to 10 percentage points

3. Health
    - Reduce infant mortality rate to 28 and maternal mortality ratio to 1 per 1000 live births
    - Reduce Total Fertility Rate to 2.1
    - Provide clean drinking water for all by 2009 and ensure that there are no slip-backs
    - Reduce malnutrition among children of age group 0-3 to half its present level
    - Reduce anaemia among women and girls by 50% by the end of the plan

6

4. Women and Children

- Raise the sex ratio for age group 0-6 to 935 by 2011-12 and to 950 by 2016-17
- Ensure that at least 33 percent of the direct and indirect beneficiaries of all government schemes are women and girl children
- Ensure that all children enjoy a safe childhood, without any compulsion to work

5. Infrastructure

- Ensure electricity connection to all villages and BPL households by 2009 and round-the-clock power.
- Ensure all-weather road connection to all habitation with population 1000 and above (500 in hilly and tribal areas) by 2009, and ensure coverage of all significant habitation by 2015
- Connect every village by telephone by November 2007 and provide broadband connectivity to all villages by 2012
- Provide homestead sites to all by 2012 and step up the pace of house construction for rural poor to cover all the poor by 2016-17

6. Environment

- Increase forest and tree cover by 5 percentage points.
- Attain WHO standards of air quality in all major cities by 2011-12.
- Treat all urban waste water by 2011-12 to clean river waters.
- Increase energy efficiency by 20 percentage points by 2016-17.

Target growth:8.33% Growth achieved:7.94%

Mid-term review of the 11th FYP

The mid-term review was approved by the NDC in its 55th meting in 2010. In the mid-term review document, the Commission had lowered the growth rate target to 8.1 per cent from 9 per cent in the wake of the global financial crisis that slowed the rate of country's economic expansion.

Following the global financial meltdown, the growth rate had slipped to 6.7 per cent in 2008-09 from over 9 per cent in the preceding three years. Thereafter, the growth recovered to 8.4 per cent. The slippage is due to global financial crisis and in the year 2009-10, it is due to bad monsoon that dragged agricultural growth rate of 0.2%.

To achieve a high growth rate, the Commission suggested focussing on fiscal consolidation and to maintain an investor-friendly economic environment.

Another major concern is the power sector, where the plan panel had to scale down the generation capacity addition target to 62,374 MW from 78,577 MW in its mid-term-review.

National Development Council (NDC) is the highest deliberative and decision-making forum on development issues that comprises the prime minister, chief ministers, lieutenant governors and members of the Planning Commission.

It gives a national character to planning, functions as an instrument of cooperative federalism and looks at policies on infrastructure, rural development, investment, fund mobilisation, labour, food security, agriculture, environment and regional balance.

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)	8.1(revised 2010)	7.94%

Summary of 11th FYP Growth

The MTR- Mid Term Review- document said the economy exceeded expectations in 2007-08, with a growth rate of 9 per cent, but the momentum was interrupted in 2008-09 because of the global financial crisis. Following the global meltdown, the growth rate slipped to 6.7 per cent in 2008-09 from over 9 per cent in the preceding three years. In the year 2009-10, the growth rate was 8.4%.Same rate continued in 2010-11 as well but fell to 6.5% in the terminal year. The reasons for the deceleration are not difficult to explain: world economy was in recessionary grip; fiscal stimulus was gradually wound down to 5.7% of GDP in 2011-12(revised) ;tight monetary policy in the country; policy deficit due to coalitional compulsions and regional elections;high inflation ate into savings and investment;

Twelfth FYP(2012-17)

Consultations have always accompanied the lengthy drafting process which culminates in a five year plan document. Since the 1990s, these have become more "inclusive-consultations with academic institutions, trade unions (not any more, sadly), industry associations and trade representations.

From the approach paper to the Twelfth Plan however, the Planning Commission expanded the coverage of consultations even more . A Facebook page, a dedicated website for online consultations and a discussion forum to debate the Commission's 12 "challenges" – that is the engaging approach taken by India's primary planning body for social and economic development.

The Planning Commission has started the process of preparing an Approach to the 12th Five Year Plan and is adopting a new and more consultative approach. In addition to consultations conducted across the country by organizations representing various citizens' groups e.g., women, dalits and youth, the Planning Commission has for the first time adopted consultation from interested stake holders via the Commission's web-site," said the deputy chairman of the Commission.

Important Macro Numbers
Broad targets in approach paper to 12th Plan (2012-13 to 2016-17)

ECONOMY:
9% average annual growth

AGRICULTURE:
4% average annual growth

INDUSTRY:
9.6% average annual growth

SERVICES:
10% average annual growth

INVESTMENT RATE:
38.7% of GDP (up from estimated 36.4% in 11th Plan)

SAVINGS RATE: 36.2% of GDP (up from estimated 34% in 11th Plan)

WPI: Average 4.5-5% (down from 6% expected in 11th Plan)

FISCAL DEFICIT: 3.25% of GDP (average annual)

(Don't these figures sound very familiar- every FYP sought to do the same and never did. Therefore, the joke that this is the Twelfth approach to the same Plan!)

By mid-2012, Planning Commission Deputy Chairperson expressed the view that the Government was expected to lower its feasible growth rate target for the five-year period (2012-17) from an earlier projection of 9% to 8%, given the global and domestic slowdown.

Planning Commission

The Planning Commission was constituted in March, 1950 by a Resolution of the Government of India, and works under the overall guidance of the National Development Council. The Planning Commission consults the Central Ministries and the State Governments while formulating Five Year Plans and Annual Plans and also oversees their implementation. The Commission also functions as an advisory body at the apex level.

The 1950 resolution setting up the Planning Commission outlined its functions as to:

- Make an assessment of the material, capital and human resources of the country, including technical personnel, and investigate the possibilities of augmenting such of these resources as are found to be deficient in relation to the nation's requirement;
- Formulate a Plan for the most effective and balanced utilisation of country's resources;
- On a determination of priorities, define the stages in which the Plan should be carried out and propose the allocation of resources for the due completion of each stage;
- Indicate the factors which are tending to retard economic development, and determine the conditions which, in view of the current social and political situation, should be established for the successful execution of the Plan;
- Determine the nature of the machinery which will be necessary for securing the successful implementation of each stage of the Plan in all its aspects;
- Appraise from time to time the progress achieved in the execution of each stage of the Plan and recommend the adjustments of policy and measures that such appraisal may show to be necessary; and
- Make such interim or ancillary recommendations as appear to it to be appropriate either for facilitating the discharge of the duties assigned to it, or on a consideration of prevailing economic conditions, current policies, measures and development programmes or on an examination of such specific problems as may be referred to it for advice by Central or State Governments.

The Prime Minister is the ex officio Chairman of the Planning Commission. Deputy Chairperson enjoys the rank of a cabinet minister. A member of the Planning Commission enjoys the rank of a Minister of State in the Union Government. Cabinet Ministers with certain important portfolios act as part-time members.

The Deputy Chairman and the full time Members of the Planning Commission function as a composite body in the matter of detailed plan formulation. They provide advice and guidance to the subject Divisions of the Commission in the various exercises undertaken for the formulation of Approach to the Five Year Plans, and Annual Plans. Their expert guidance is also available to the subject Divisions for monitoring and evaluating the Plan programmes, projects and schemes.

The Planning Commission functions through several technical/subject Divisions. Each Division is headed by a Senior Officer designated as Pr. Adviser/Adviser/Addl. Adviser/Jt. Secretary/Jt. Adviser.

The various Divisions in the Commission fall under two broad categories:

- General Divisions which are concerned with aspects of the entire economy; and
- Subject Divisions which are concerned with specified fields of development.

The General Divisions functioning in the Planning Commission are:

- Development Policy Division,
- Financial Resources Division,
- International Economics Division,
- Labour, Employment and Manpower Division,
- Perspective Planning Division,
- Plan Coordination Division,
- Project Appraisal and Management Division,
- Socio-Economic Research Unit,
- State Plan Division, including Multi Level Planning,Border Area Development Programme, Hill Area Development and North Eastern Region (NER), and
- Statistics and Surveys Division,
- Monitoring Cell.

The Subject Divisions are:

- Agriculture Division,
- Backward Classes Division,
- Communication & Information Division,
- Education Division,
- Environment and Forests Division,
- Health & Family Welfare Division,
- Housing, Urban Development & Water Supply Division,
- Industry & Minerals Division,
- Irrigation & Command Area Development Division,
- Power & Energy Division (including Rural Energy, Non-Conventional Energy Sources and Energy Policy Cell)
- Rural Development Division,
- Science & Technology Division,
- Social Welfare & Nutrition Division,
- Transport Division,
- Village & Small Industries Division, and
- Western Ghats Secretariat.

The Programme Evaluation Organisation undertakes evaluation studies to assess the impact of selected Plan Programmes/ Schemes in order to provide useful feedback to planners and implementing agencies.

The Commission is a corner-stone of our federal structure. a think-tank ; helps to balance the priorities and expenditures of the Ministries of the Union Government ; throws up ideas on policies for structural and perspective changes ; and is a reservoir of research."

Relevance of Planning

There has been a national debate about the relevance of planning in the era of liberalization where the state controls and regulations are dismantled to a great extent and market forces are given larger role.The investment of the government for the five year plans is also on decline. The trend began in the 7th plan and strengthens into the 12th FYP.

It is true that the quantitative aspects of planning in terms of control over economy are being selectively phased out and the nature of planning process is undergoing a qualitative change. Planning is important for the following reasons in the era of liberalization

- In a federal democracy like ours, the principal task of planning is to evolve a shared vision among not only the federal units but also among other economic agents so that the efforts of all the actors become convergent towards the national priorities. The role of planning is to develop a common policy stance for center and states. Also, the task of federal policy coordination is central to Indian Planning. For example, the need to invite foreign investment in infrastructure areas like power need center – state coordination as the necessary legislation and administrative changes involve both.FDI in retail also requires the centre and the states to work together- centre allows into the nation and states into their respective territories
- While the growth process can be made the responsibility of the corporate sector to a greater degree, its direction and distribution are to be steered by planned public intervention so that regional imbalances are reduced and socio economic inequities are set right. For example, directing the growth of the large industry into the backward areas and technology intensive areas to realize national goals.
- The nature of instruments available to planners in the implementation has changed. Quantitative controls have yielded place to qualitative ones – from licenses .The planning process has to focus on the need for planning for policy.
- planning at the grass roots level that is participatory is very crucial for improving the delivery systems and proper use of the resources. The role of the government is thus to facilitate participatory planning.
- Environmental priorities are a major concern of planning
- planning is necessary for the sectors like energy. communication, transport and so on as private sector needs to be guided into the national plan.
- In the era of globalization where corporates are not expected to plan beyond the growth of a particular unit, the role of safeguarding national interest is that of planning by the State. For example , being subjected to various discriminative trade practices by EU, USA and so on, the Indian farmers, manufacturers and exporters have to fight sophisticated battles in the WTO for which the legal services and information and building up bargaining power are best provided by the State.

Thus, planning continues to be relevant and ever more so for the following reasons

- Federal cooperation and coordination
- Equitable growth
- Environment friendly development
- Defending national interest in the age of globalization
- Inter-sectoral balance in growth

Changing Role of Planning Commission

From a highly centralized planning system, the Indian economy is gradually moving onwards indicative planning where hard planning is no longer undertaken. The role of the Planning Commission accordingly changes. The Commission concerns itself with the building of a long term strategic vision of the future and decide on priorities of nation. It works out sectoral targets and provides promotional stimulus to the economy to grow in the desired direction.

Planning Commission plays an integrative role in evolving a national plan in critical areas of human and economic development. In the social sector, Planning Commission helps in schemes which require coordination and synergy like rural health, drinking water, rural energy needs, literacy and environment protection.

When planning in a vast federal country like India involves multiplicity of agencies, a high powered body like the PC can help in evolution of an integrated approach for better results at much lower costs.

In our transitional economy, Planning Commission attempts to play a systems change role and provide consultancy within the Government for developing better systems. It has to ensure smooth management of the change and help in creating a culture of high productivity and efficiency in the Government

In order to spread the gains of experience more widely, Planning Commission also plays an information dissemination role.

With the emergence of severe constraints on available budgetary resources, the resource allocation system between the States and Ministries of the Central Government is under strain. This requires the Planning Commission to play a mediatory and facilitating role, keeping in view the best interest of all concerned.

From Planning Commission to Systems Reforms Commission

There has been a significant change in the role of the PC since its inception in 1950. In the beginning, Planning Commission was all powerful and had the final say and the veto over every aspect – related to growth and socio-economic development- of the functioning of the Union Ministries and the State Governments:The manner of raising and utilising resources; specific allocations to particular schemes and programmes; location of enterprises; expansion and reduction of capacities; application of technologies; sources of supplies; modalities of implementation; priorities, phasing, pricing, targets and time-frames; nature of the instrumentalities; qualifications and strength of personnel of organisations; staff emoluments etc.

Since 1991, India adopted the indicative planning model , away from the kind of centralised planning on the Soviet model envisaged by Jawaharlal Nehru. Now Ministries and Departments, as well as the corporate entities in the private sector, enjoy a lot of functional, financial and operational autonomy.

In the era of liberalisation, the economic players should properly be left to decide for themselves what they consider to be the appropriate courses of action on the various issues coming up before them, whether they relate to policies, schemes or investments.

The government intends to convert the Planning Commission into a think-tank to generate original ideas in the very broad domain of economic policy for the government to then act on. It will also be the government agency responsible for acting as an interface with other independent think-tanks and NGOs. The PM would like the commission to engage more directly with the "polity", presumably with various ministries in the Central and state governments, and be able to persuade them to implement certain ideas or "plans" generated by the government's own think tank. That isn't radically different from its existing role — the Planning Commission has few direct powers of execution in any case and must rely on the power of persuasion to sell its ideas to the Centre and states.

Interestingly enough, the new role sought for the Planning Commission seems to be very similar to the role played by the National Advisory Council, which also generates ideas within, coordinates with NGOs and civil society and then tries to "persuade" the government to act. NAC's focus so far has been social sectors whereas a systems reforms commission can take on a broader gambit of issues, including public finances, infrastructure and so on.

The government's move to revamp and gradually transform the Planning Commission into a System Reforms Commission is a major step that can make the institution more relevant to a market economy. The idea is to metamorphose the plan panel from a reactive agency into a strategic thinking group, which maps out risks and opportunities by focusing on issues

The shrinking role of the government in mobilising and controlling investments has pushed the Planning Commission to focus more on issues related to enforcing fiscal discipline in the central and state governments, including in the various ministries, departments and public sector enterprises.

According to Arun Maira, PC member, the Planning Commission will gradually transform itself into a Systems Reforms Commission for resolving the systemic problems of the 21st Century over the next two-three years as desired by Prime Minister Manmohan Singh. It will restructure itself to serve three essential functions: build a larger network around its members with think tanks and opinion makers, produce thought papers at a faster pace and communicate more lucidly with polity.

Arun Maira, Plan panel member heads the task of revamping the Planning Commission.

National Development Council

The National Development Council is not a Constitutional body nor a statutory body (not set up by an Act of the Parliament). Union Cabinet set up the NDC in 1952 with the following functions

- To prescribe guidelines for the formulation of the national plan.
- To consider the national plans formulated by the Planning Commission.
- To assess the resources for the plan and recommend a strategy for mobilizing the resources.
- To consider important questions of socio-economic policy affecting development of the nation.
- To review the progress of the five year plan mid-course and suggest measures for achieving the original targets.

NDC is headed by the Prime Minister of India and comprising of all Union Cabinet Ministers, Chief Ministers of all the States and Administrators of Union Territories and Members of the Planning Commission. Ministers of State with independent charge are also invited to the deliberations of the Council.

The National Development Council (NDC) has a special role in our federal polity.
It is the apex body for decision making and deliberations on development matters.
It has the explicit mandate to study and approve the Approach Plan to the Five year Plans and the Five Year Plan documents. The mid-term reviews of the Five year Plans are considered by the NDC. In fact, without the NDC approving, the Five Year Plan does not come into effect.

55th meeting of NDC was held in July 2010 to approve the MTR of the 11th FYP.

The CMP of the UPA Government (2004) says that NDC will be activated. It will meet at least three times in a year and in different state capitals . It will be developed as an effective instrument of cooperative federalism.

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 liberalisation) and a public sector controlled almost entirely by the government. 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, various phases have seen nationalisation of such areas as banking, thus bringing them into the public sector, on one hand, and privatisation of some of the Public Sector Undertakings during the liberalisation period on the other

Financial resources for the Five year Plans

The resources for the Plan come from

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

A Note on Gross Budgetary Support

Resources of the Centre consist of both budgetary resources including external assistance routed through the budget and the Internal & Extra Budgetary Resources (IEBR) of Central Public Sector Enterprises (CPSEs). The quantum of budgetary resources of the Centre which is available for providing overall budgetary support to the plan is divided into two parts viz. budgetary support for Central Plan (including U.Ts without Legislature) and Central Assistance for States' Plans (including U.Ts with Legislature). A part of the budgetary resources allocated as budgetary support for the Central Plan is used for providing necessary support to CPSEs.

GBS is the amount from the central Budget that goes to fund the plan investments during the plan period.

Achievements of Planning

- In the last about 60 years since India became a Republic, the National Income has increased many times. Today, India is the third largest economy in Asia with about Rs.82,000,00 lakh crores- China and Japan; is the 11th largest economy in the world. India is the fourth largest in the world as measured by purchasing power parity (PPP), with a gross domestic product (GDP) of about $4 trillion- USA, China, Japan, India, in the descending order.

- In the face of global recession, India posted 6.7%,8.4%,8.4% and 6.5% rate of growth in last four years of the 11^{th} FYP and thus is the second fastest growing major economy after China.

- Per capita income increased to over Rs.60,000 though in nominal terms,annually.
- Exports crossed $300b in 2011-12.
- Social indicators improved though there is a long way to go- IMR, MMR, literacy, disease eradication etc.
- The industrial infrastructure is relatively strong – cement, steel ,fertilizers, chemicals, etc Agricultural growth is also gaining momentum with food grains production at 252 mt in 2011-12.
- Forex reserves are $286 b(July 2012) which is a dramatic turnaround from 1991 when we had a billion dollars.
- More than 2 lakh MW of power capacity is installed by the beginning of the 12^{th} FYP (2012).

- India has emerged as a backoffice of the world and its prowess in software is growing
- India ranks fourteenth worldwide in factory output.
- India ranks fifteenth worldwide in services' output.
- There has been considerable expansion of higher education. At the time of Independence there were 20 universities and 591 colleges, while today, there are almost 550 universities and 31,000 colleges(2012). Literacy levels are 74% by 2011 census.

The failures of planning are equally clear

- Poverty still plagues about 360million (Tendulkar)
- Inflation and particularly food inflation is in double digits hurting the low income groups severely since 2008. It is at over **10%** on the CPI in mid 2012.
- Sex ratio is consistently going against girls and women - The decline in child sex ratio (0-6 years) from 945 in 1991 to 927 in 2001 and further to 914 females per 1,000 males in 2011 — the lowest since independence is disconcerting. The **sex ratio in India**, according to the Census of 2011, stands at 940 which is a marginal increase from 933, but is alarming.
- Hunger and malnutrition are still plaguing India as HUNGaMA report of 2012 shows(read ahead)
- Unemployment is high
- Regional imbalances are intensifying

Indicative planning

Indicative planning was adopted since 8th five year plan(1992-97). It is characterized by an economy where the private sector is given a substantial role. State would perform the role of a facilitator from that of a controller and regulator.

The need to have markets as a collaborator rather than subordinate to state arises from the fact that the market investment is more than 50% for the plan goals and therefore, cooperation is the only viable way. Together, markets and state would set the goals, make investments and achieve goals. The role of the government pertains to

- Providing a strategic direction to the economy
- Make its own share of investments and
- Ensure consistent, irreversible,predictable and growth oriented policies.

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, 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 private sector encouragement to achieve growth in areas where the country has inherent strengths-pharma, IT, enginnering goods and so on for India. 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. 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.

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 famous book' Asian Drama') recommended it for developing countries in his book - Indian Economic Planning in Its Broader Setting.

In this type, every year three new plans are made and implemented- annual plan that includes annual budget ; five year plan that is changed every year in response to the economic demands; and perspective plan for 10 or 15 years into which the other two plans are dovetailed annually. Rolling plan becomes necessary in circumstances that are fluid.

Financial Planning cash → target

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 target → cash

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

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; unproductive agriculture etc.

Thus, the turning point in India's planning strategy came with the second five-year (1956-61) plan. The model adopted for the plan is known as the Nehru-Mahalanobis strategy of development as it 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 recalling 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 are goods that are used to make further goods; the goods that make up the industrial market like machines, tools, factories, etc). It is based on the premise that it would attract all round investment and result in a higher rate of growth of output. That will develop small scale and ancillary industry to 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 efect'- 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 criticism is one sided as in the given context, the Mahalanobis model was correct for growth and self-reliance.

Rao-Man Mohan Singh Model of Growth

The launching of economic reforms by the government in 1991 is driven by 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 leaving the BOP crisis in history; taming of inflation; and the foreign flows- FDI and FII increased.

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 since 2004) 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. 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.

Misgivings About Economic Reforms

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 attractive
- Large scale unemployment due to capital intensity of growth process.
- 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 inability to compete.

Some fears have indeed come true- jobless growth and uncertainty in farming. Inflation is high etc. But by and large, reforms have done well. Achievements in terms of growth rates, external sector strength, consumer choices etc are the direct positive outcomes of reforms. Public sector is also doing better than earlier.

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 flagsips 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 \$286b forex reserves(2012 July)

- Services sector (tertiary sector) has grown in importance and today contributes almost 57% of GDP emerging as a global player-India being the global back office.
- Exports have performed well and have recovered handsomely even while the world continues to be trapped in near recession conditions. It accounting for many jobs and quality Indian products
- Resilience of the economy in the face of Great Recession which is still not resolved
- Consumer choice has increased
- Tax-GDP ratio is at 10.1% of GDP(2011-12) while the combined centre and states tax ratio to GDP is 16%
- 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 has picked up.
- Indian corporates have acquired global majors like Jaguar and Anglo-Dutch steel maker Corus; Bharti 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 233mtt(2010), 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
- Globalization has exposed India to imported inflation due to commodity price rise.

Second Generation Reforms

The economic reforms that were launched in 1991 benefited all- FDI,FII, white goods production being stepped up, disinvestment in PSUs, fiscal consolidation, floating the rupee etc.

Some of them needed only administrative action and did not touch the common man- reduction SLR,CRR etc.

The reforms that would affect the common man were kept pending because they needed political consensus. The idea was that once the first wave of reforms show success , the second round could be relatively easily undertaken. The second(next) generation reforms are labour sector reforms(easier exit policy for the owner of the company so that he can lay off excess labour without rigid labour laws); FDI in retail; privatization of PSEs etc.

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
- Agroreforms may mean small and marginal farmers' resistance

Recession and depression

Recession

The standard definition of a recession is a decline in the real Gross Domestic Product (GDP) for two or more consecutive quarters.

Depression

Before the Great Depression of the 1930s any downturn in economic activity was referred to as a depression. The term recession was developed in this period to differentiate periods like the 1930s from smaller economic declines that occurred earlier. This leads to the simple definition of a depression as a recession that lasts longer and has a larger decline in business activity.- more unemployment, deflation, negative growth.

How can we tell the difference between a recession and a depression A depression is any economic downturn where real GDP declines by more than 10 percent. A recession is an economic downturn that is less severe. Greece in mid-2012 is said to be in depression. Greece is in a "Great Depression" similar to the American one in the 1930s.By the end of this year Greek GDP is expected to have shrunk by about a fifth in five consecutive years of recession since 2008, hammered by tax hikes, spending cuts and wage reductions required by two EU-IMF bailouts.Unemployment climbed to a record 22.6 per cent in the first quarter.

There is an old joke among economists: A recession is when your neighbour loses his job. A depression is when you lose your job.

Great Recession 2008-

The late-2000s recession, more often called the Great Recession, was a severe economic recession that began in the United States in 2007 and is still there but in a muted form relatively- heightened degrees of unemployment and economic hardship remain a reality even today.

The financial crisis is linked to reckless lending practices by financial institutions and the growing trend of securitization of real estate mortgages in the United States. Money was lent to people with high risk credit record. Money was lent for any number of houses on the assumption that the prices would always go up and there was no risk. The papers associated with the lending- mortgage documents were securitised and financialised- sold as assets and resolt. When the loanees did not return the money as they could not due to their bad economic condition, the pack of cards fell- investment banks lost money; commercial banks from whom they borrowed and lent went sick and some bankrupt; stock markets dived as a result; savings of people were washed out; insurance companies went into sickness etc.

A global recession has 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(asset price bubbles) 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 has 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. Economists advise that the stimulus should be withdrawn as soon as the economies recover enough to "chart a path to sustainable growth". Indian withdrawal from stimulus began in 2010-11 Union Budget and the money policy is becoming tight gradually.

Among the various imbalances in which the U.S. monetary policy contributed by excessive money creation, leading to negative household savings and a huge U.S. trade deficit, dollar volatility and public deficits.

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

HUNGaMA report 2012

The HUNGaMA (Hunger and Malnutrition) Survey conducted across 112 rural districts of India in 2011 provides reliable estimates of child nutrition covering nearly 20% of Indian children. Of the 112 districts surveyed, 100 were selected from the bottom of a child development district index developed for UNICEF India in 2009, referred to as the 100 Focus Districts in this report. These 100 districts are located in 6 states.

The HUNGaMA Survey shows that positive change for child nutrition in India is happening, including in the 100 Focus Districts. However rates of child malnutrition are still unacceptably high particularly in these Focus Districts where over 40 per cent of children are underweight and almost 60 per cent are stunted.

It was based on a survey of the height and weight of more than one lakh children across six States and has found that as many as 42 per cent of under-fives are severely or moderately underweight and that 59 per cent of them suffer from moderate to severe stunting, meaning their height is much lower than the median height-for-age of the reference population.

The findings – contained in the Hunger and Malnutrition (HUNGaMA) report by the Naandi Foundation – were described by Prime Minister Manmohan Singh as a "national shame. Despite impressive growth in India's Gross Domestic Product (GDP) in recent years, the level of under-nutrition is unacceptably high.

The report also found that of the stunted children, about half are severely stunted and about half of all children are underweight or stunted by the time they are two years. However, the number of underweight children has decreased from 53 to 42 per cent in the past seven years – the last study on the subject was done in 2004.

However, what is of concern is that 42 per cent of our children are still underweight. This is an unacceptably high occurrence.

Conducted across 112 rural districts, the survey found "positive change for child nutrition in India is happening, including in the 100 Focussed Districts."

The 100 Focus Districts are located across Bihar, Jharkhand, Madhya Pradesh, Orissa, Rajasthan and Uttar Pradesh – states which perform the worst on child nutrition.

The survey notes that the prevalence of malnutrition is significantly higher among children from low-income families. It found that children from Muslim or SC/ST households generally had worse nutrition indicators.

Birth weight is an important risk-factor for child malnutrition, says the report.

The prevalence of underweight in children born with a weight below 2.5 kg is 50 per cent, while that among children born with a weight above 2.5 kg is 34 per cent.

The survey found that awareness among mothers about nutrition is low — "92 per cent mothers had never heard the word malnutrition."

Highlighting the negligence shown towards girl children even in their early childhood, the report says the nutrition advantage girls have over boys in the first months of life seems to be reversed over time as they grow older.
According to the survey, the mothers' education level also determines children's nutrition. More findings are:

- There are significant inequalities across various socio-economic, demographic groups and across geographic regions: Rural vs Urban (50% vs 38%), Girls vs Boys (49% vs 46%), SCs:STs:Other castes (53%:56%:44%).
- 5 states and 50% of the villages constitute for 80% of the malnutrition cases.

These studies also highlight the potential long term consequences affecting overall socio-economic development and inclusive growth. Malnutrition in childhood leads to greater morbidity and mortality, reduced capability of learning, reduced labour productivity and subsequently reduced economic growth and increased poverty. In a way this perpetuates the vicious cycle of poverty which is one of the causes and also an effect of malnutrition.

There is a need for a concerted effort from various stakeholders viz: Government, Civil society organizations and Parents in following areas:

- More emphasis should be laid on increasing the quality of implementation of existing schemes rather than just increasing the no. of schemes which are predominantly driven by political populism.
- The focus should be more on family based feeding and caring behaviour rather than distributing food.
- Greater emphasis should be laid on breast feeding in first 6 months: the primary source of colostrum which has lasting impact on the health and growth of an individual throughout the life.
- Involving communities and citizen groups in increasing awareness, implementation and monitoring of ICDS.
- Bringing in more resources to anganwadi centres targeting both children and adolescent women.
- Discouraging the practise of early marriage of adolescent girls (which though illegal is still being practised) which affects not only personal health but also that of newborns. Measures should also be taken to mitigate the prevalence of Anaemia which is as high as 60% among adolescent women.
- Priority should be on dissemination of funds which are targeted and directed towards more vulnerable groups (children below 3 yrs and adolescent women) and villages with high prevalence.
- Monitoring and evaluation though timely collection of relevant and high quality info which further leads to greater accountability and performance.

Acknowledging the gravity of the issue some of the steps on above areas have been initiated by organizations like Naandi Foundation and the recently formed Citizen's alliance against malnutrition (spearheaded by parliamentarian Baijayant Panda). Also, it's encouraging to see a responsible role played by celebrities like Amir Khan, Rahul Bose and Prasoon Joshi in increasing the awareness among masses through various campaigns. It is high time that all the citizens acknowledge the grave reality and play their part in ensuring a healthy and better future for our children and Nation.

Excerpts from PM's speech:

"There are nearly 16 crore children in the country below the age of 6 years. In the years to come, these children will join our work-force as scientists, as farmers, as teachers, as data operators, as artisans, as service providers. The health of our economy and society lies in the health of this generation. We cannot hope for a healthy future for our country with a large number of malnourished children.

We have always believed that a mother's education level, the economic status of the family, the provision of sanitation and hygiene, the status of women in the family, breastfeeding and other good child-rearing practices do affect children's nutrition. The HUNGaMA survey has broadly validated these hypotheses.

Though the ICDS continues to be our most important tool to fight malnutrition, we can no longer rely solely on it. We need to focus on districts where malnutrition levels are high and where conditions causing malnutrition prevail. Policy makers and programme implementers need to clearly understand many linkages -- between education and health, between sanitation and hygiene, between drinking water and nutrition – and then shape their responses accordingly.

These sectors can no longer work in isolation of each other. Health professionals cannot solely concentrate on curative care. Drinking water and sanitation providers cannot be oblivious to the positive externality of their actions. The school teacher needs to be aware of the nutritional needs of the adolescent girl. And above all, the Anganwadi workers should be aware of their contribution to nation-building by focusing on the care of our young citizens.

I chair a National Council on India's Nutrition Challenges, which met a year ago and decided upon four things:

- To launch a strengthened and restructured ICDS,
- To start a multi-sectoral programme for 200 high-burden districts.
- To initiate a nationwide communication campaign against malnutrition.
- And to bring nutrition focus to key programmes of agricultural development, research and development in agriculture, the Public Distribution System, the mid-day-meals programme, drinking water, sanitation, health and the latest on the horizon is the Food Security Bill etc.

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.

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 synonymous with consumption and non-development , in general. But in the case of India , the social sector expenditure – flag ship schemes like NREGA is in the revenue expenditure, though as a part of the Plan expenditure(see budget as a glance for further clarity. It is given elsewhere in this Chapter) It is targeted at 3.4% of GDP for 2012-13. FRBMA 2003 says that RD should be zero by the end of 2008-09. The objective is to fund for consumption from government's own resources and not borrowing. In fact, if the FRBM was implemented well, there would have been revenue surplus from 2009-10 onwards that could be used for capital expenditure. But the Great Recession of 2008 made it necessary for the government to borrow more and stimulate the economy thus disrupting the FRBM targets.(more in the classroom)

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 5.1% of GDP in 2012-13.

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

Difference must be between Gross FD and Net FD. Net Central Fiscal Deficit is calculated by deducting from the GFD the financial assistance (loans and grants) that the States are given.

Budget deficit considers only the difference between the total budgeted receipts and the expenditure. 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

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 deliberate 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; increase government's debt burden and thus divert resources from plan to non-plan; burden future generations with unduly high taxation and thus disrupt inter generational parity; and crowd out private investment. Then Reserve Bank of India prints money . 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.

The concept of budget deficit was dropped from 1997 budget and as a result deficit financing also was stopped. 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. But the economic conditions having become adverse since 2008-09, Government is forced to abandon the FRBM rules and is spending well beyond the limits set by the Act. Keynesian stimuli that the government resorted to since 2008 October includes massive borrowing by the Government- from the markets and RBI- to arrest slowdown and stimulate growth.

The beneficial contribution of deficit financing in the early stages of independent 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 that 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 consumption, 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.

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, 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.

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 Europe and the fiscal woes of USA are the result of unsustainably high debt and borrowing.(More in the classroom)

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 in Eurozone(2010 onwards) and particularly the Greece economy is due to excessive FD. It borrowed and spent excessively . Taxes were not collected efficiently and there was large scale evasion. The stimulus package did not work. Government expenditure did not reduce but revenues fell drastically due to recession and tax leakages. The need for massive borrowing and spending increased. But the 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 debt and 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.Tax collections should be efficient. Accounts of government should be properly maintained and not dressed up.

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 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 macro economic 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. It is because tax revenues went down and expenditure demands were higher. The gap inevitably widened. 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 2007-08 to 6.2 per cent of GDP in 2008-09. This fiscal stimulus at 3.5% of GDP amounted to Rs. 1,86,000 crore. 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 fiscal stimulus packages

To counter the adverse effects of global recession, government announced the first package in October 2008- tax cuts and additional spending by the government .The package benefited all the sectors – especially textile, housing and real estate sectors. Most significant of the package is the CENVAT rate cut of 4%.

The second stimulus package

The government in January 2009 announced the second round of fiscal stimulus package with a view to revive economy. The package includes measures such as higher public spending. RBI stepped in easing liquidity for further lending at lower interest rates etc.

The third stimulus package

The third stimulus package for the economy was announced in February 2009 cutting excise duty and service tax two percentage points.

Service tax was cut across the board from 12 per cent to 10 per cent.

The packages increased the fiscal deficit.

Financing the FD

The deficit was financed by raising Internal Debt and from Public Account surplus cash.

The unsustainably high fiscal deficit could not be continued 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.

Kelkar Task Force in its report on implementing FRBMA (2004) said that plan expenditure should be enhanced and the way to cut deficit is by enhancing revenues(taxes) and rationalize non-asset creating expenditure like subsidies which should be targeted better.

The global recession from 2008 onwards has made the government breach the FRBM targets vastly. We are still gross breach of it .Fiscal 2011-12 saw a fiscal deficit of 5.8% of GDP due to excess expenditure on subsidies, lower divestment receipts and tax receipts.

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, 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

Fiscal consolidation

The FRBM targets were more or less followed till the fiscal year 2007-08. But from 2008-09, as global economic conditions turned bad and Indian economy was also affected negatively – slow down in growth rate-, the Government necessarily had to pump prime the economy with an expansionary fiscal policy- tax reliefs and massive public investment-infrastructure spending, NREGA being stepped up etc. As a result , the FRBM targets could not be complied with . However, the recovery plan has been made with statutory commitments in 2012-13.(More in the classroom)

13th Finance Commission and Fiscal Consolidation

In shaping the fiscal policy since the Union Budget for 2010-11, govt acted on the recommendations of the Thirteenth Finance Commission that has recommended a calibrated exit strategy from the expansionary fiscal stance of the previous two years. The Commission recommended a capping of the combined debt of the Centre and the States at 68 per cent of the GDP to be achieved by 2014-15.

As a part of the fiscal consolidation process, government for the first time GOI targeted an explicit reduction in its domestic public debt-GDP ratio.

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. 'Plan' expenditures, as the name implies, relate to expenditures on 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.

'Non-plan' expenditure is a generic term, which is used to cover all expenditures of government not included in its annual plan programmes . But essentially covers consumption and maintenance expenditure. Non plan expenditures has the following items

- Interest payments
- Subsidies
- Defence
- Public admn

It is important to mention that not only that maintenance expenditures subsequent to the completion of plan programmes are non-plan, but even "expenditures on research projects and operating expenses of power stations are classified as non-plan.

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. 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.

Kelkar Task Force to implement FRBMA 2003 recommend reexamination of the distinction between Plan and Non-plan expenditure.

Rangarajan panel on public expenditure 2012

An 18-member 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.

This committee 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 mid-2011 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.
- While the Planning Commission should be responsible for formulation of the Five-Year Plan, the task of firming up annual budgets should be entrusted to the Finance Ministry based on inputs from the Plan panel
- "Plan and Non-Plan distinction in the budget is neither able to provide a satisfactory classification of developmental and non-developmental dimensions of government expenditure. It has therefore become dysfunctional.The committee, therefore, it recommends that Plan and Non-Plan distinction in the budget should be removed..
- The report suggested a basic shift in budgeting approach from "..from input based budget to outputs and outcomes".
- As regards the new roles of key entities, it said, the Planning Commission should be made "responsible for consolidation of Five-Year Plan over all services based on the input from the Ministry of Finance...(while) Ministry of Finance (be) made responsible for the preparation of Annual Budget based on the inputs from the Planning Commission".
- The report also called for modification in accounting classification with a view to strengthening the framework for transfer of funds from centre to the states."The proposed classification should provide uniform codes for central programmes, sub-programmes and schemes being implemented in the states"
- 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.

Public debt

Public debt includes internal debt comprising borrowings inside the country like market loans; borrowing from the RBI on the basis of treasury bills ; and external debt comprising loans from foreign countries, international financial institutions, NRI deposits etc. In the expression `public debt and "other liabilities" , "other liabilities" include outstandings against the various small saving schemes, provident funds etc. It includes private sector borrowings too.

(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.

The combined government debt- both the central and state governments at 80% of the GDP in 2010-11 for India is to be brought down 68% by the year 2014-15 on the basis of the recommendation of the 13th Finance Commission.

External Debt

India's external debt, as at end-March 2012, was placed at US $ 345.8 billion (20.0 per cent of GDP) on account of significant increase in commercial borrowings, short-term trade credits, and rupee denominated Non-resident Indian deposits. The share of commercial borrowings stood highest at 30.2 per cent followed by short-term debt (22.6 per cent), NRI deposits (16.9 per cent) and multilateral debt (14.6 per cent).

- The short-term debt increased on account of rise in short-term trade credits, FII investment in T-bills and commercial banks borrowings.
- The debt service ratio increased to 5.6 per cent during 2011-12 .
- Based on residual maturity, short-term debt accounted for 42.7 per cent of the total external debt. Whereas the share of short-term debt, by original maturity, was 22.6 per cent of the total external debt stock.
- The ratio of short-term debt (residual maturity) to foreign exchange reserves at 50.1 per cent
- The US dollar denominated debt accounted for 55.0 per cent of the total external debt stock as at end-March 2012 followed by Indian rupee (21.4 per cent) and Japanese Yen (9.1 per cent).
- India's foreign exchange reserves provided a cover of 85.1 per cent to the external debt stock.

External debt includes both the government and private debt as can be seen from the above given highlights of the external debt profile.

The share of non-government debt in total external debt is about 75%.

The strategy of the government in external debt management consists of emphasis on raising sovereign loans on concessional terms with longer maturities, regulating the levels of commercial borrowing and their end-use, rationalising interest rates on NRI deposits, monitoring short term debt and encouraging non-debt creating capital flows.

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 exchange inflows.

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

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

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.

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. It is abolished in the Union Budget 2009-10.

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

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.

Fiscal neutrality

When the net effect of taxation and public spending is neutral, neither stimulating nor dampening demand- a balanced budget. It is neutral, as total tax revenue equals total public spending.

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. If the government deploys the funds well, it may have a `crowding in effect': the infrastructure built can have a multiplier effect on investment, tax collections and growth.

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- approximately 8%. They are called small savings as savings are made in small amounts by low income and other groups.

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. They are completely onlent to the state in which they are collected.

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.

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)

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.

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 as 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(2010 onwards in India). 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.Initially, the Reserve Bank of India announced all its monetary measures twice a year in the Monetary and Credit Policy. However, since monetary Policy has become dynamic in nature, RBI reserves its right to alter it from time to time, depending on the state of the economy. Also, with the share of credit to agriculture coming down and credit towards the industry being granted whole year around, the RBI since 1998-99 has been making the policy in April. A review of the policy takes place every quarter. Within the quarter at any time, there can be changes- major and minor, depending on the need.

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. Last time it was set was in 2003 when the 6% rate was fixed. In 2011, the bank rate was aligned with the newly introduced marginal standing facility. Today it stands at 9%(2012).Bank Rate is aligned with Marginal Standing Facility (MSF) rate, which, in turn, is linked to the policy repo rate.This should be viewed and understood as one-time technical adjustment to align the Bank Rate with the MSF rate rather than a change in the monetary policy stance.The Bank Rate has been kept unchanged at 6 per cent since 2003. This was mainly for the reason that monetary policy signalling was done through changes in the repo.The Bank Rate 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 8% presently(2012)

Reverse repo is when RBI borrows from the market (absorbs excess liquidity) with the sale of securities and repurchases them the next day or after a few days. The rate at which it borrows is called reverse repo rate as it is the reverse of the repo operation. Reverse repo rate 100% basis points(1%) below the repo rate.

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

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

Reserve Bank of India (RBI) hiked repo rates 13 times between March 2010 and October 2011 before pausing and lowering because inflation was rising and was stubbornly high.

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 1% more than the repo rate. It is meant to ease liquidity in the market. Banks can use the repo route for the securities over and above the mandatory SLR holdings- 24% of bank deposits. MSF is open to the banks that want to borrow from the RBI even if the credit is costlier by a percentage point. MSF can be availed with securities above the 24% SLR limit or even below. Totally, 1% of the value of deposits is the limit for the MSF window for each bank. It was raised to 2% in 2012. The aim is ease liquidity in a graded manner.It helps in monetary transmission also.

MSF is the penal rate- because the repo limit is exhausted and also 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.

MSF window also has become necessary because the repo operations are limited to a specific period during the day.

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.

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(SLR), 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 24% (2012).

Banks need more liquidity to lend at lower rates in the current economic downturn. Therefore, RBI reduced the SLR by 1% to 24% temporarily after the global financial crisis erupted and it was restored to 25% in 2009. But in 2010, it was lowered to 24% to augment liquidity in a growing economy. 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.

The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 fixed the floor and cap on SLR at 25% and 40% respectively. But the amendment made in these statutes 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.

CRR

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

The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 fixed the floor and cap on CRR at 3% and 20% respectively. But the amendment made in these statutes 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 4.75%(2012), having been reduced by the RBI in 2012 twice . If inflation is high, money supply needs to be taken out and so CRR is generally increased. But in a regime of moderate inflation , low CRR is in place.

RBI increases CRR to tighten credit 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.

Open Market Operations Of RBI

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. Purchases 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 .

Selective Credit Controls

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

Moral suasion

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

The Growing Importance of Monetary Policy

The growing importance of monetary policy in the management of the economy during the era of globalization is a fact.. Generally, democratically elected governments resist to use fiscal policy to fight inflation as it requires government to take unpopular actions like reducing spending or raising taxes. The option of cutting indirect taxes is a limited one and is used rarely as it was done in 2009 . Political realities favor a bigger role for monetary policy during times of inflation and deflation/disinflation(deflation is drop in prices and disinflation is drop in the rate of growth of prices).

Fiscal policy may be more suited to fighting unemployment as the government can step up spending to create public works and in the process jobs; while monetary policy may be more effective in fighting inflation/deflation. There is a limit to how much monetary policy can do to help.the economy during a period of severe economic crisis.

The monetary policy remedy to economic decline is to increase the amount of money in circulation by cutting interest rates and increasing the money supply: for example, during the post-Lehman crisis period in 2008-09.

But once interest rates reach zero or near zero, the central bank can do no more-economists call it the "liquidity trap," what Japan did during the late 1990s. That is, liquidity is trapped in banks- banks do not want to lend as credit may turn into bad asset. Businesses do not want to borrow as demand has slumped. It is a classical case of liquidity trap and was seen all over the world including India in the period of 2008-09 in India and the world is til going through it.

When reduced rates do not help, unconventional step are taken as in the USA where the Federal Reserve(its central bank) resorted to quantitative easing.(discussed in the class).

Monetary policy must now take into account such diverse factors as:

- Signals to the economy by way of rate and reserve adjustment
- exchange rates;
- credit quality;
- international capital flows of money on large scales;

With globalization and the increase in the flow of funds- highly speculative in character , monetary policy acquires unprecedented importance for the country. The following will illustrate the point further that globalization challenges monetary policy:

Management of the exchange is a crucial part of the monetary policy as exchange rate holds the key to many important macro economic goals and dictates foreign flows- inflows and outflows. The steep fall in the exchange rate of the rupee against US dollar since late 2011 and continuing in 2012 is a major challenge for the RBI as also for the Government. It has a close bearing on money supply and inflation and interest rates. For instance, if foreign inflows flood the country, in order to maintain its monetary stability, RBI has buy the foreign currency to save the rupee from excessive appreciation. The rupee that is printed has to be sucked out with Government securities as otherwise it will be inflationary.

Similarly when the Fed of the USA takes up quantitative easing, foreign inflows can create huge challenges for us.

The Market Stabilization Bond Scheme in India was started as a sterilization attempt in 2004. Under the MSS, RBI generates government securities to sterilize excess liquidity in the market to prevent inflation. Such sterilization can be expensive as the money so sucked out costs by way of the interest paid on it. Thus, the purpose of stemming rupee appreciation leads to excess of money supply which could inflate the economy unless sterilised with the direct intervention(selling MSBs) which is a costly process. Hike in interest rates and CRR may also become necessary- it hurts growth even as it stabilises inflation. The latter is the case in India till the beginning of 2012.

After the 2008 global financial crisis, monetary policy faces another challenge- financial stability as banks go bankrupt and other financial institutions are destabilized.

Thus, monetary policy acquires enormous importance during globalization.

Market Stabilization Bonds

In 2004, RBI began floating Government securities and T-Bills, as a part of the Market Stabilization Scheme, to absorb excess liquidity from the market. 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 called base money or reserve money or high powered money) that was caused for buying dollar. Therefore, the MSS was started.

Developing countries and Monetary Policy

Developing countries have problems operating monetary policy effectively. The primary difficulty is that fiscal policy of the Government sets priorities and the Central bank is not actively involved in decisions related to money supply through borrowings. The welfare schemes; foreign trade policy, tax policy etc are the privilege of the central government and the central bank largely acts to support the same. Further, very few developing countries have deep markets in government debt. Thus, the OMOs have limited value.

RBI may change the policy rates but interest rates may not change unless the government borrowing programme complements the same. For example, the cut in CRR twice in 2012 did not translate to lower rates as the government borrowing programme did not allow it.

In India, situation is improving with RBI being given importance after economic reforms started early in the 1990's. The introduction of WMAs for the central government; FRBM Act 2003 etc gave autonomy to the RBI and a consultative role to it.So does the FSDC set up in 2010- Financial Stability and Development Council.

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 -; and rates charged from the borrowers 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:
- 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 were increased in 2012 to attract their dollar deposits

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; populism through regulation can be prevented; 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.

Interest rates came down for a decade from 1994 to promote growth; dropped further since the beginning of the last decade for more growth; climbed up since 2004 till mid-2008 to beat inflation; and dropped rapidly since mid-2008 as inflation eased and growth requirements demanded. Since 2010, they are being hiked again as growth is high and inflation is also a worry- food inflation being even worse.

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 foal. 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 Inflation for more)

Reserve Bank of India

The central bank of the country is the Reserve Bank of India (RBI). It was established in 1935 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

The Reserve Bank of India Act, 1934 came into effect in 1935. The Act provides the statutory basis of the functioning of the Bank.

Reserve Bank of India
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. However, the amount of currency that the RBI can print depends upon the need of the economy. The only restriction 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.

Bankers' 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 changing the instruments available to it(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.

The Reserve Bank of India is armed with many more powers to control the Indian money market. Every bank has to get a license from the Reserve Bank of India to do banking business within India, the license can be cancelled by the Reserve Bank of certain stipulated conditions are not fulfilled. Every bank has to get the permission of the Reserve Bank before it can open a new branch. Each scheduled bank must send a periodical return to the Reserve Bank showing, in detail, its assets and liabilities. This power of the Bank to call for information is also intended to give it effective control of the credit system. The Reserve Bank has also the power to inspect the accounts of any commercial bank.

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.

Functions 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 is done twice a day.

The RBI acts as a lender of last resort or emergency fund provider to the other member banks. As such, 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.

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 286 b of forex reserves (2012) 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 drive, RBI watches the movement to ensure order and normalcy and there is no volatility. Thus, it maintains exchange rate oversight

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.

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 was asked to promote banking habit, extend banking facilities to rural and semi-urban areas, and establish and promote new specialised financing agencies. Accordingly, the Reserve Bank has 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 the 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 also 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.

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 SLR and Cash Reserve Ratio (CRR). It removed the floor and cap on CRR and floor on statutory liquidity ratio (SLR) to provide flexibility to RBI to manage liquidity.This would result in better liquidity management in the system.

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 expenditure and schemes that the political leadership may be tempted to indulge in. 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, fixing CRR and SLR as deems fit with the amendments to the RBI Act in 2006.

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
- FSDC 2010

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
- monetary credibility is high in public perception if professionals manage it.

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 where autonomy should be linked to performance like in the policy of 'inflation targeting' where the central bank should justify its autonomy with performance in the field of management of prices at reasonable levels.

Money Supply

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

Monetary and fiscal policy

Two important tools of macroeconomic policy are monetary policy and fiscal policy. Both have same goals. Fiscal policy is made by Government while the architect of monetary policy is the central bank.

The monetary policy aims to maintain price stability, exchange rate stability, full employment and economic growth.

Reserve Bank of India can increase or decrease the supply of money as well as interest rate, carry out open market operations, control credit and vary the reserve requirements to achieve these objectives.

Monetary policy is different from fiscal policy as the former brings about a change in the economy by changing money supply and interest rate, whereas fiscal policy is a broader tool with the government. Fiscal policy relates to taxation and other means of raising money and setting expenditure priorities. It can be used to direct economic growth in a desirable direction; provide social welfare; fight recession(pump prime the economy) and create employment.

For instance, at the time of recession the government can increase expenditures or cut taxes in order to generate demand, or do both.. The three fiscal stimulus packages given by government since October 2008 are the examples of stimuli where tax reliefs and public investment are the main features. On the other hand, the government can reduce its expenditure when the economy is doing well.

Supply side economics is resorted to boost economy- it means cutting taxes to boost consumption and investment. It is also called Reaganomics, after the former US President Ronald Reagan.

Monetary policy also has same goals as fiscal policy- growth, employment,price stability etc. Its tools are different.

The two policies need to work for convergence as their objectives are the same. The 1997 initiative to replace ad hoc treasury bills with WMAs is an example of the harmonization of the two policies. Another example is the FRBM Act.FSDC set up in 2010 is a prime example as in this institutions the government of India and the RBI, among others, are represented for macroprudential regulation.

If the fiscal policy borrows excessively, the resultant higher interest rates and inflation can not be managed by the RBI. Therefore, the need is for convergence. The challenge to enable convergence between the two has never been felt more than it is since the global meltdown of 2008 when the government borrowed heavily to stimulate the economy while the RBI eased the monetary policy to lend more and buoy up the economy.

Quantitative easing

The term quantitative easing describes an extreme form of monetary easing used to stimulate an economy where interest rates are either at, or close to, zero and are still not working to revive the economy. Central bank uses unconventional means, other than the usual monetary policy tools, to flood the financial system with new money through quantitative easing.

In practical terms, the central bank purchases financial assets, including treasuries and corporate bonds, from financial institutions (such as banks) using money it has created. Fedral Reserve of the US used quantitative easing to overcome the liquidity crisis since the fall of Lehman Brothers in 2008 September when credit froze. It has worked as US came out of recession.

Credit crunch/liquidity crunch/ liquidity crisis

Credit/Liquidity crunch refers to a state in which there is a short supply of money to lend to businesses and consumers and interest rates are high. It may happen when the government borrows heavily and there is crowding out of the corporate sector.

It may also refer to a serious crisis of confidence in the financial system (as in 2008) when banks refuse to lend to even genuine businesses fearing default and credit turning into bad debt.

In such a situation, banks may have liquidity but would not lend as fear grips them.

Monetary expansion/easing/stimulus

The current global recession is being overcome through stimulus packages of which the monetary stimulus by the central banks is an important part. It operates through reduction of rates- policy rates of repo and reverse repo; and reserve ratios- SLR and CRR. The goal is to make enough liquidity available to the banks so that they reduce the rates and lend more for making more investment possible and growth can be revived.

Another aspect of the monetary stimulus we have witnessed is the quantitative easing.

In countries like Japan, all these efforts have not yielded results as liquidity trap is the best description for the recessionary situation there. In India, however, the stimulus package is working and there is a cautious and calibrated exit from it since 2010.

Words

Monetary base is also called the reserve money. It is the sum of the currency in the hands of the public and the currency commercial banks keep as reserves with the central bank(RBI). It is also known as High-powered Money. In sum it is : Reserves + Currency with the public

Prime Lending Rate (PLR) is the rate at which banks lend to the best customers. It is replaced with base rate since 2010(see elsewhere for a detailed account)

Basis point: Changes in interest rates and other variables are expressed in terms of basis points to magnify and express the importance of changes. One basis point is 1% of 1%.

LTRO of the ECB and more (In the class)

Taxation in India: Concepts and Policies

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. 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.

Funds provided by taxation are used by governments to carry out the functions such as:

- military defense
- enforcement of law and order
- redistribution of wealth
- economic infrastructure - roads, ports etc
- social welfare
- social infrastructure like education, health etc
- social security measures like pensions for the elderly, unemployment benefits

Taxation System in India

India has a well developed tax structure. Being a federal country, the authority to levy taxes is divided between the central government and the state governments. The central government levies direct taxes such as personal income tax and corporate tax, and indirect taxes like customs duties, excise duties and central sales tax(CST). CST is assigned to the States in which it is collected. (Art.269). The states have the constitutional power to levy sales tax apart from various other local taxes like entry tax, octroi, etc.

Taxation has always played an important role in the formulation of the government's economic policy. Taxation policy in a developing country like India can play an important part to raise resources for growth; to bring in reduction in inequalities; to direct growth in backward regions; to reduce consumption of luxury goods; to direct investment into small scale sector; to promote savings etc. In the wake of the economic reforms. the tax structure and procedures have been rationalised and simplified. Since 1991, the tax system in India has undergone substantial rationalization- reduced rates and slabs and better administration.

Some of the changes 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%
- Lowering of corporate tax rates to 30%
- Rationalizing the personal income tax rates and slabs starting from 1997 `dream budget'
- Sales tax reforms at the State level as a preliminary step towards their integration into GST
- introduction of VAT from 2005 at the state level;GST is expected to be introduced in 2011
- Simplifying income tax return filing procedures. For example, Saral, Towards better taxpayer services, in 2011-12, the IT department has introduced simple and user friendly SAHAJ (Form) for individual salary tax-payers; SUGAM for small tax-payers availing presumptive tax scheme.(For presumptive tax, see ahead)

Tax revenue as a percentage of GDP decreased initially, after reforms began in 1991, as rates came down and growth of economy was not very robust. Compliance also did not increase proportionate to rate reduction . Since the Tenth Plan period, there has been a consistent rise in tax collections but it dipped due to global financial crisis of post-2008 period. GOI expects Rs.1.24 lakh crore for service tax collection during 2012-13 due to wider coverage and higher rate(12%).

Government expects to increase its gross tax revenue by 19.5% to Rs 10.77 trillion in the financial year 2012-13.

The gross tax revenue is estimated at 10.6% of the gross domestic product (GDP) in the Budget estimates 2012-13.

Revenue from corporation tax is expected to be the highest contributor at Rs 3.73 trillion to the government's total revenue, while income tax, customs, union excise duties, and service tax will yield Rs 1.95 trillion, Rs 1.86 trillion, Rs 1.94 trillion and Rs 1.24 trillion, respectively.

Direct tax revenue growth is estimated at Rs 5.7 trillion, up 13.9% and indirect tax revenue growth is estimated at Rs 5.05 trillion, up 26.7%.

The government targets a net tax revenue of Rs 7.71 trillion in 2012-13, after devolution to the states.

The non-tax revenue receipts are estimated at Rs 1.64 trillion and non-debt capital receipts are estimated at Rs 416.5 billion.

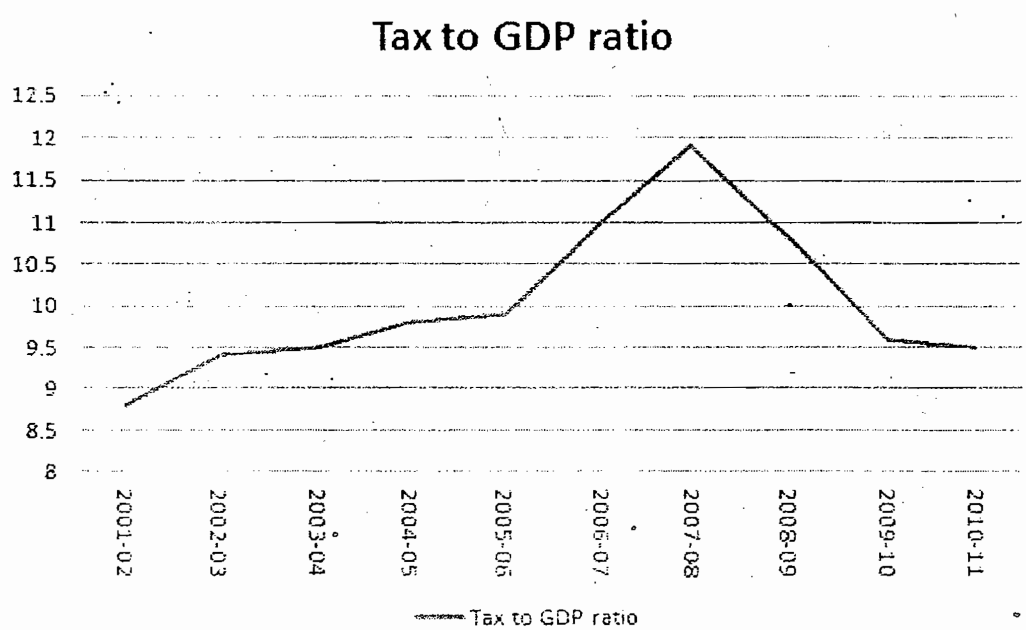
Expenditure:

- The government's total expenditure is budgeted at Rs 14.9 trillion for 2012-13.
- Of this, the plan expenditure is projected 22.13% higher at Rs 5.21 trillion.
- Non-plan expenditure for 2012-13 is budgeted at Rs 9.69 trillion.

Measures for broadening tax base, strengthening compliance and simplification

- Rates and slabs are rationalized
- Negative list of services for taxation from 2012 at 12%
- adoption of VAT by almost all the states
- GST introduction
- Tax to be deducted at source on various items like interest on bank deposits; dividend distribution etc
- Quoting of permanent account number made compulsory for many transactions so more people can be brought into tax net
- securities transactions tax

Other measures suggested are: minimizing exemptions and concessions; drastic simplification of laws and procedures; building a proper information system and computerization of tax returns, and a thorough revamping and modernization of the administrative and enforcement machinery.



[illegible]

(In Rs crore)

	1990-91	2000-01	2007-08	2008-09	2009-10 (BE)	2009-10 (RE)	2010-11 (BE)
DIRECT*	11024	68306	295938	319859	370000	380608	422500
Income	5371	31764	102644	106046	112850	125021	120566
Corporation	5335	35696	192911	213395	256725	255076	301331
INDIRECT	45158	118681	278945	269433	269477	244677	315000
Excise	24514	68526	123425	108613	106477	102000	132000
Customs	20644	47542	104119	99879	98000	84477	115000
Service	Nil	2613	51301	60941	65000	58000	68000
TOTAL**	57576	188603	593147	605298	641079	633095	746651
DIRECT %	19.15	36.22	49.89	52.84	57.72	60.12	56.59
TAX-GDP %	10.11	8.97	11.99	10.86	10.95	10.27	10.77

*Includes taxes on interest, expenditure, estate, gift and wealth;
**Includes 'other taxes & duties' and 'taxes of Union Territories';
BE: Budget Estimates; RE: Revised Estimates.

Tax collections 2012-13

As can be seen from the table above, Government of India's tax receipts are growing healthily though not at such scorching pace as did till 2011.It helps government spend more on social projects.

The reasons for the tax collections being so healthy are

- economy is growing at a satisfactory pace- 6.5% in 2011-12
- incomes of individuals have gone up
- lower tax rates help compliance
- procedures are simple and citizen-friendly
- base has been widened
- a drive has been mounted to bring more people to pay income tax with proper investigation

Direct and Indirect Taxes In India: The Changing Scenario

As can be seen from table , direct tax collections are more than indirect tax collections. In 1990-91, less than a fifth of the Centre's gross tax revenues came from direct taxes.

The biggest taxation source of the Centre now is corporate tax and next is income tax .

The general level of prosperity in the country is increasing making more people have taxable incomes. Also, when companies are growing in number and also in their profitability, corporate tax collections increase. Global opportunities mean more profits. Stock market transactions and wealth build-up also contribute to direct tax collections by way of STT, capital gains tax, income tax. .Apart from the above reasons, the Government's measures as given below also helped increase the direct tax collections

- reduction of peak income tax rates that helps compliance
- reduction in the number of slabs
- strengthening the administration- e-governance etc
- simplification of laws(Saral etc)
- promote voluntary compliance

The increase in the relative share of direct tax collections shows that the tax system is becoming more progressive as direct taxes are paid by the well off in general while the indirect taxes are paid equally by all consumers. Direct taxes can be used to promote growth with equity.

Direct taxes help in income redistribution. Decline in the relative share of indirect taxes is also seen as good because it promotes the competitive nature of Indian economy-attracts investment.

By taxing earnings of individuals and corporates rather than production and trade, there is less stifling of economic activity and there is employment generation.

In developed countries, direct taxes contribute more to the tax collections.

Cost of direct tax collection

Buoyant economic growth along with higher tax compliance have led to a desirable decline in the cost of direct tax collections as a proportion of total direct tax collections: all-time low of 0.54 per cent in 2007-08.That is, the income-tax department spends 54 paise for every Rs 100 direct tax collected by it, which is among the lowest in the world. The income tax department has a tax base of 3.5 crore assesses..

Income-tax slabs and rates

10 per cent rate on a slab extending up to Rs 5 lakh. Likewise, the 20 per cent rate will now apply on income slabs beyond Rs 5 lakh and up to Rs 8 lakh. The maximum marginal rate of 30 per cent on an income slab of above Rs 8 lakh.

Service Tax

Service tax was first imposed in 1994. A new service tax regime, based on a negative list of exempted services, came into effect in July 2012.

With this, all services — except the 38 activities put on the negative list — came under the tax at the increased rate of 12 per cent, as announced in the Union budget 2012-13.

Till June 2012, service tax was being levied on 119 services based on a positive list. The switch-over to a negative list-based approach is aimed at aligning the indirect taxation system to the proposed Goods and Services Tax (GST) regime, which is sought to be introduced to unify the levies of the Centre and the States into a composite system.

With the services sector now accounting for 60 per cent of the gross domestic product, the Finance Ministry has set a target of Rs.1.24 lakh crore for service tax collection during 2012-13. This is significantly higher than the Rs.97,000 crore mopped up during the previous fiscal.

As per the negative list-based approach, services such as metered taxis, auto-rickshaws, transport of goods or passengers and transmission and distribution of electricity by distribution companies will not come under the service tax net.

Other important services exempted from the levy are solemn activities such as funeral, burial and transport of deceased. In the education sector, school and university courses, as also approved vocational studies, have been exempted.

Likewise, auxiliary educational services and renting of immovable property by educational institutions in respect of education will not be taxed. However, coaching classes and training institutions will be taxed.

Among the other services included in the negative list are those provided to government, local authorities or a government authority for repair and maintenance of an aircraft. Likewise, services provided by advocates to other advocates and business entities up to a turnover of Rs. 10 lakh in the preceding financial year will be exempt from the tax.

Services provided by way of public convenience, such as bathroom, washroom, urinals or toilets, are included in the negative list, just as services relating to work contracts for a scheme under the Jawaharlal Nehru National Rural Urban Renewal Mission or the Rajiv Awas Yojana.

The service sector has emerged as an important area of economic activity. Reasons for taxing services

- Its share in the country's Gross Domestic Product (GDP) has increased from about 28% in 1951, to 55% (2011).
- Taxing services is important to raise resources and increasing the tax-GDP ratio
- service providers should share the tax burden with others-industry - there should be horizontal equity that is all sectors of the economy should bear the tax burden equitably.
- as the share of industry in GDP decreases while that of services expands, the tax base shrinks unless services are taxed.
- failure to tax services distorts consumer choices, encouraging spending on services at the expense of goods and savings.
- as most of the services that are likely to become taxable are positively correlated with expenditure of high income households, subjecting them to taxation will improve equity.

Service Tax and Indian Constitution

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) amended Article 270 (made it divisible)and inserted in the Union List (List l) entry No. 92C — `taxes on services'.

The amendment to the Constitution places services tax formally under the Union List. This will pave the way for the Centre to levy and collect the tax.

The amendment becomes redundant with the introduction of GST in ~~2011~~ where the services will be jointly taxed by Centre and States.

The amendment did not come into effect as it has never been notified and thus services are still taxed on a residuary basis.

GST

Goods and Services Tax is a multi-point sales tax with set off for tax paid on purchases of inputs. There is no 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.

India introduced VAT at the state level in 2005. Before that, union excise duties were renamed Central Vat(Cenvat). But when states called their slaes tax Vat, centre reverted to the earlier name of excise duty. 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.

Cenvat in replacement of central excise duties came into effect earlier in the decade. VAT as a replacement for state sales tax was adopted from the beginning of the fiscal year 2005-2006.Cenvat has come back to being called union excise duty to prevent confusion.

Need for GST

In the Union Budget for the year 2006-2007, Finance Minister proposed that India should move towards national level Goods and Services Tax that should be shared between the Centre and the States. World over, goods and services are integrated and taxed as a comprehensive domestic indirect taxation system based on value addition. They attract the same rate of tax. That is the foundation of a GST.The basis of GST is value addition.

The goods and service tax (GST) is proposed to be a comprehensive indirect tax levy on manufacture and sale of goods as well as services at a national level. Integration of goods and services taxation would give India a world class tax system and improve tax collections. It would end the long standing distortions of differential treatments of manufacturing and service sector. The introduction of goods and services tax will lead to the abolition of taxes such as octroi, Central sales tax, State level sales tax, entry tax, etc and eliminate the cascading effects tax on tax.

It is aimed at forging 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

GST: Questions and Answers

The central and state governments moved closer to ushering in a nationwide goods and services tax on April 1, 2011, a reform intended to cut business costs and boost government revenue. The reform would eliminate multiple indirect taxes levied by states and the central government, leading to a reduction in the average tax burden on companies and a rise in the country's tax-to-GDP ratio.

Q. HOW WILL THE GST WORK?

Ans. The GST is an indirect tax that would replace existing levies such as excise duty, service tax, and value-added tax (VAT).Both the states and the central government would impose the tax on almost all goods and services produced in India or imported. Exports would not be subject to GST. For the first two years of operation, the proposal is for two rates both at the federal and state levels, converging to a single rate in the third year. Producers would receive credits for tax paid earlier, which would eliminate multiple taxation on the same product or service. Direct taxes, such as income tax, corporate tax and capital gains tax would not be affected.

Q. WHAT'S THE RATIONALE FOR THE GST?

Ans. Eliminating a multiplicity of existing indirect taxes would simplify the tax structure, broaden the tax base, and create a common market across states and centrally administered districts.

Increased compliance and fewer exemptions to GST would lift India's federal tax-to-GDP ratio.

At the same time GST would lower the average tax burden for companies that now pay "cascading" taxes on top of taxes through the production process.

By lowering business costs it would boost economic growth and increase exports, proponents argue, and bring India in line with practices in many developed economies.

Reducing production costs would make exporters more competitive.

The GST may usher in the possibility of a collective gain for industry, trade, agriculture and common consumers as well as for the central government and the state governments for reasons cited above.

Black money and evasion will reduce as GST is transparent.

Q. WHAT ARE THE PROPOSED GST RATES?

Ans. For the first year: 10 percent of CGST of Centre and 10% of SGST of states for goods and 6 percent each for essential items. 8% each for services. Thus, it is dual rate. Also, goods and services are taxed separately initially.

The higher rate would come down to 9 percent in the second year, and the two rates would converge at 8 percent in the third year.

Q. ARE THERE EXEMPTIONS PROPOSED?

Ans. Yes. Goods deemed necessary or of basic importance would be taxed at a lower rate. The government will review the various lists of exempted goods to align them at the federal and state levels.

Alcohol, petroleum and electricity would not come under GST.

Q. WILL THE STATES LOSE OUT?

Ans. GOI will compensate states for potential lost revenue and central government has assured states that if needed, it would increase a 50,000 crore - rupee ($10.6 billion) fund that the 13th Finance Commission recommended as an incentive for the states to buy into GST.

Q. WHAT HAPPENS NEXT?

Ans. The legislation to make constitutional amendments needs to be finalised and the mechanism for administering the tax needs to be created. The government also needs to set up the technology infrastructure to manage the tax- TAGUP (see ahead)

Q. WHAT IS THE REVENUE IMPACT?

Ans. The GST is initially intended to be revenue-neutral but is eventually expected to increase the tax collections due to more efficient collection, expanded base, transparency and increased compliance.

Q. WHAT ABOUT THE ECONOMIC IMPACT?

Ans. Implementation of a comprehensive GST would lift India's economy of over $1 trillion by between 0.9 percent and 1.7 percent, according to a report by the New Delhi-based economic think tank the National Council of Applied Economic Research. Exports would rise by between 3.2 percent and 6.3 percent, while imports would increase 2.4 percent to 4.7 percent, the study found.

Constitutional Amendment for GST

Constitution (One Hundred and Fifteenth Amendment), Bill, 2011 (GST Bill)

Constitution (One Hundred and Fifteenth Amendment), Bill, 2011 (GST Bill) was introduced in the Parliament in the budget session in March 2011, deals with GST. The Bill seeks to introduce Goods and Services Tax (GST) and the GST Council. As per the existing structure of indirect taxation, the Parliament has the power to make laws on the manufacture of goods and the provision of services (Union List) while the State Legislatures have the power to make laws on the sale and purchase of goods within their respective states (State List). The Parliament has retained the exclusivity to make laws pertaining to sale of goods in the course of inter-state trade or commerce.

Definition of Goods and Services – Article 366

1. The above Article which defines 'Goods and Services Tax' to mean, any tax on supply of goods or services or both except taxes on the supply of petroleum products and alcohol

> Seventh Schedule

1. The Union Government has the exclusive power to levy excise duty on the manufacture or production of

- Petroleum Crude
- High Speed diesel
- Petrol
- Natural Gas
- Aviation Turbine Fuel
- Tobacco and Tobacco Products

The State Governments shall have the power to levy tax on the sale (other than in the course of inter-state trade or commerce) of petroleum crude, high speed diesel, petrol, natural gas, aviation turbine fuel and alcoholic liquor for human consumption.

Article 249

The Parliament has been vested with the power to make laws pertaining to GST on behalf of the state Legislature in circumstances of national interest. The power to make such laws would be pursuant to a resolution passed by the Council of States supported by not less than a two-thirds majority of the members present and voting. Power of Parliament to make laws on subjects in State List in the case of Emergency

Article 250

The Parliament has been vested with the power to makes laws pertaining to GST on behalf of the State Legislature when there is a proclamation of Emergency.

GST Council – Article 279A

The President shall constitute a GST Council within sixty days from the Commencement of the GST Act.

Membership of the GST Council

The Union Finance Minster would be the Chairperson, the Union Minister of State for Revenue shall be one of the members, the Finance Minister or any other minister nominated by each State Government shall be the members of the GST Council. The Members of the GST Council shall decide on the Vice-Chairperson of the GST Council for such period as decided by the members.

Functions of the GST Council

The GST Council while being guided by the need for a harmonized structure goods and services tax and for the development of a harmonised national market for goods and services shall make recommendations to the Union and the States on:

> Taxes, cesses and surcharges levied by the Union and the States and local bodies which may be subsumed within the GST
> Exemptions from GST for such goods and services
> Threshold limit of turnover below which GST may be exempted
> The GST rates
> Any other matter relating to GST

Every decision of the GST Council taken at a meeting shall be with the consensus of all the members present at the meeting.

GST Dispute Settlement Authority – Article 279B

The Parliament, by law, will provide for the creation of a Goods and Services Tax Dispute Settlement Authority (DSA) which shall adjudicate any dispute or complaint referred to the DSA by the State Government or the Union Government arising out of deviation from any recommendation of the GST Council which results in the loss of revenue to the State Government of the Union Government or affects the harmonised structure of the GST.

The DSA shall consist of three members namely, the Chairperson, who has been a Supreme Court Judge or the Chief Justice of a High Court, appointed by the President, recommended by the Chief Justice of India; the remaining members shall be persons who shall have expertise in the field of law, economics or public affairs appointed by the President recommended by the GST Council.
The DSA shall pass suitable orders including interim orders.
Only the Supreme Court shall exercise jurisdiction over such adjudication or dispute or complaint.

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 cannot 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 cannot change rates according to their fiscal needs
- all states cannot have the same rates
- 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. However, in case o

Contentious federal issues on GST

GST rates, the division of taxing powers between the Centre and the states, compensation amount; exemptions and on certain design elements of the GST.

Goods and Services Tax (GST): Challenges for implementation

The GST is a necessary condition for a common market to exists, this permits free and unimpeded movement of goods and services across a federation, thus encouraging efficient regional specialization.

Such harmonization will significantly reduce the vertical imbalance between the Centre and the states by enhancing the tax base of the states. It is going to be the biggest ever tax reform in India.

Challenges to address:

- Integration of a large number of Central & State Taxes
- multiplicity of taxes and tax rates to be unified
- federal distribution of powers to levy and collect taxes
- necessary constitutional amendments.
- Rationalisation of thresholds and exemption limits.
- Standardisation of systems and procedures.
- Broad based computerizations across the Nation.
- Dispute settlement procedure and machinery.
- Training of tax administrators and assessee.
- Protecting and balancing the present and future revenues of the Centre and the States.
- Safeguarding the interests of less developed States with lower revenue potential.
- Taxing of Alcohol, tobacco, petroleum products which are out of the GST regime.

GST and fiscal federalism

Being the largest indirect tax reform requiring the centre and the states to adjust their constitutional taxing powers, GST has opened up fiscal federal challenges like never before. There is mutual surrender of powers to a uniform national taxation system where both gain. But there are apprehensions of loss of fiscal autonomy by states and central dominance as mentioned above.

The Constitutional changes proposed and being debated by the Empowered Committee of State Finance Ministers are likely to bring the federal units together for a new and innovative system of fiscal federal sharing and cooperation

Technology Advisory Group for Unique Projects (TAGUP)

An effective tax administration and financial governance system calls for creation of IT projects which are reliable, secure and efficient. IT projects like Tax Information Network, New Pension Scheme, National Treasury Management Agency, Expenditure Information Network, Goods and Service Tax, are in different stages of roll out. To look into various technological and systemic issues, Finance Minister announced in the Union Budget 2010-11 to set up a Technology Advisory Group for Unique Projects under the Chairmanship of Shri Nandan Nilekani. It has been set up in mid-2010.

GST and tax efficiency

In the system existing now, the rates, tax imposition and collection are inefficient. Rates are not efficient as they depend on lobbying and there is no transparent basis. Exemptions are also similarly granted. Thus, deployment of labour and land along with capital and enterprise becomes subject to lower returns and waste- GST is expected to lead to efficient allocation of factors of production thus leading to gains in GDP and exports. This would translate into enhanced economic welfare and returns to the factors of production, viz. land, labour and capital. In an earlier taxation system, people paid taxes at various levels. There was no system of getting a rebate on the taxes paid previously while paying the inputs. This is also called as cascading effect. It is irrational as there is tax on tax. Ideally the taxes should be based on value addition and the producer should pay taxes on whatever value he adds to the product. In the absence of such a system, producers ended up paying much higher taxes. Higher taxes are a barrier for business and discourage business activity.

High taxes also lead to lobbying activities where producers of a certain sector ask the government to lower/waiver taxes for their sector. This also leads to multiple taxation rates for multiple products and further increases inefficiency in the system.

Before VAT States had sales taxes with multiple rates. States were often seen in a sales tax war with other states- rate war as it is called . In the war states competed with each other offering lower tax rates to certain industries to set units in their states. This resulted in revenue loss for both the states and investment decisions wre determined by tax rates in states and not other merit factors.

However, the design of VAT system in each state has also been done in a uniform fashion keeping the distinctive state economy in mind.

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
    - investment flows

On the direct tax front, the reforms are the following:

- Reduction and rationalization of rates- there are only three rates of income tax today with the highest rate at 30%
- Simplification of procedures
- Strengthening of administration
- Widening of the tax base to include more tax payers in the tax net
- Exemptions are gradually being withdrawn.
- MAT was introduced for the 'zero tax' companies
- The Direct Tax Code of 2010 is meant to replace the outdated Income Tax Code of 1961

Indirect Taxes

- Reduction in the peak tariff rates- 10% is the peak customs duty today which was more than a 90% reduction since 1991.
- The number of slabs has come down drastically
- There is a progressive change from specific duty to ad valorem tax
- VAT is introduced
- GST is being rolled out
- Negative list of service tax from 2012

Tax expenditure

Tax expenditure refers to revenue forgone as a result of exemptions and concessions (personal, corporate, indirect tax). It was introduced for the first time in 2006-07 Union Budget. The revenue foregone due to tax incentives in 2009-10 is estimated at Rs 5,40,269 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. These 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 nmore 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.

Tax havens and G20

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. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people and/or companies. For example, income tax, wealth tax or corporate tax etc.

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
- self-promotion as an offshore financial center.

Switzerland, 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 their banking secrecy. Among the sanctions being considered by the G20 are the scrapping of tax treaty arrangements, imposing additional taxes on companies that operate in non-compliant countries, and tougher disclosure requirements for individuals and businesses that use shelters.

Words

Tax-incidence: It shows the entity on whom tax is imposed. It is different from the tax burden as shown below: if government increases tax on petrol, oil companies may absorb it if competition is intense or they may pass it on to private motorists. Tax incidence here refers is on companies and the burden may be on the consumer.

Tax Burden: It means those who actually pay taxes- from whom tax is collected. Depending on the market forces involved, a tax can be absorbed by the seller or by the buyer (in the form of higher prices), or by a third party like sellers' employees in the form of lower wages.

Tax Base : The value of goods , services and incomes on which tax is imposed. When economists 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.

Tax rate: It indicates how much tax is due from each source. Some tax systems have high rates but have a narrow base allowing generous deduction of business expenses. Other tax systems have a wide base with few exemptions and lower rates.

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.

Difference between tax avoidance and tax evasion: There are provisions in the law that allow one to save and invest in a manner that leads to reduction in taxable income. If these provisions are used for the benefit, it is called tax avoidance. It is lawful to take all available tax deductions.
Tax evasion, on the other hand, is a punishable offence. Tax evasion typically involves failing to report income, or improperly claiming deductions that are not authorized.

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.

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 will send financial aid to a person who files an income tax return reporting an income below a certain level.

Pigovian tax

The Pigovian tax is imposed on bodies 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. Example of negative externality is 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. Carbon tax is one example in the context of the need to discourage fossil fuels and encourage renewable sources due to climate change threat.

Octroi: Entry 52 of the State List, VII Schedule, which specifies tax on the entry of goods into a local area is the octroi. Octroi has been a main source of revenue for most of the urban local bodies in India. It is criticized for the fact that it is an obsolete method of tax collection; and involves stoppage of vehicles at the check posts outside the city limits, thereby obstructing a free flow of vehicular traffic; waste of business hours; loss of fuel etc.

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.

Tobin tax

James Tobin, an economist, proposed 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 attributed to the `dynamics of hot money'(portfolio investments or FII flows).

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 a 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. Angele Merkel and Francois Hollande both want it.

India and FTT

Group of 20 saw the European countries like Germany and France propose a tax on their transactions so that fund could be mobilised in order to bail out future bank failures. The idea is to avoid taxing ordinary people. India along with Brazil and other countries opposed it on the following grounds

- Regulation is the remedy
- Banks can pay the tax and not shed their reckless behavior

- It may in fact induce them to be more reckless as there is a ready fund available and bailout is guaranteed
- India has a well regulated banking system and so did not suffer the same fate as the banks in developed economies. The problems of the advanced countries should not be imposed on others
- banks, as private entities, would simply push the added costs onto consumers.

India has a similar tax though not for the same purpose- securities transaction tax

(STT)

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% (2012).

Book profit is Profit which is notional made but not yet realized through a transaction, such as a stock which has risen in value but is still being held. It is also called unrealized gain or unrealized profit or paper gain or paper profit.

Presumptive Tax

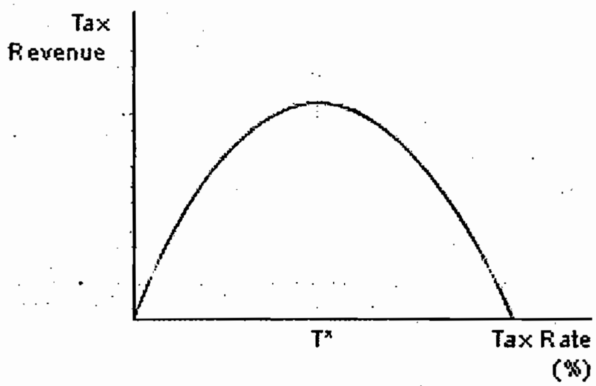
Presumptive Tax: the Estimated Income Method of assessment for certain categories of businesses is prevalent in several countries. Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term presumptive is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method.

The reason for the presumptive tax is 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.

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.

Inverted duty structure

Higher import duty on the raw materials than on the finished product are called inverted duty structure .It puts the domestic manufacturers at a disadvantage making them uncompetitive. For instance, compact fluorescent lamps (CFLs), where the import duty on raw materials for manufacturing CFLs is 9.7 per cent more than on finished bulbs. This skewed duty structure makes domestic CFL manufacturers uncompetitive.

There is no Basic Customs Duty for import of solar cells and modules. However, under the existing duty structure, the inputs (like EVA, Tedlar, Toughened Glass) which go into the manufacturing of solar cells and modules attract duty .This results in an inverted duty structure, which favours the import of the cells / modules and puts the domestic manufacturers to a disadvantage.

Similarly, if rubber is imported at a higher duty than tyre, manufacturing in India is discouraged..

The Economic Survey(2010-11) said FTAs also lead to a new type of inverted duty structure with duties for final products being lower from FTA partners compared to duties for the previous-stage 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," the Survey said.

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. 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. For short term capital gains(less than one year), it is 15% for shares.

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.

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.

Transfer Pricing

Transfer pricing involves charging for goods supplied to the subsidiary. The international norm in this regard is the 'arms length principle' which means that when two related parties deal in goods and services, pricing must be done objectively and commercially. If the principle is not followed, it means losses for the government.

For example, an MNC has a subsidiary in India and elsewhere. The corporate tax rates are high in India. Therefore, the price of goods sold by the MNC to the two subsidiaries in the two countries is shown differently- higher in India and less in the other country. In that case, Indian subsidiary shows less profits or more losses and tax liability (corporate tax) is less.

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 introduction of Advance Pricing Agreement (APA) under Transfer Pricing Regulations in the union budget of year 2012 -13 is positive step to reduce the litigation as it will be based on bilateral understanding between two countries.
According to the memorandum of union budget, Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. The APAs offer better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach.

Rupee is raised and spent like this

For every rupee in government kitty, 29 paise will come from market borrowing in 2012-13.

The government's dependence on debt has gone up from 27 paise in the previous Budget to 29 paise in the coming year, reflecting the pressure on revenue collections.

The net borrowings of the government in 2012-13 are pegged at Rs 4.79 lakh crore against Rs 4.36 lakh crore for the current fiscal.

On the expenditure side, central Plan will account for an outgo of 22 paise, followed by 18 paise of interest payments.

Defence allocation has been maintained at 11 paise. As the single largest source of revenue income, the collection from corporate tax has decreased to 21 paise to 24 paise as a per centage of every rupee earned, indicating the sluggish growth in the industry.

However, with increase in the service tax rate, the government expects revenue collection from service tax and others to go up to 7 paise against 6 paise in 2011-12.

Besides, other indirect tax component excise and customs would earn 21 paise for the government.

Despite tax incentives given to individuals, direct tax contribution has been retained at 9 paise.

With rising crude oil price due to global economic uncertainty, the subsidy burden on the government would go up 10 paisa against 9 paise for the year ending March 2012.

At the same time, other non-plan expenditure is expected to account for 11 paise of every rupee spent by the government in 2012-13, while the states' share of taxes and duties would amount to 17 paise of every rupee earned.

Plan assistance to states and Union Territories has been retained at 7 paise in 2012-13.

Cess

The term cess is generally used to mean a tax. It is an additional levy on a tax. It is different from surcharge as the latter is general while the former is specific. Collections from the latter can be used for any purpose while cess collections can be used for designated ends only- education cess etc.

Questions

- 'Tax system that supports growth is the need of the hour. ' Discuss: Dictated in the class.
- What is Laffer curve? If tax rates are rationalised, will higher compliance be automatic?
- " ..a system of tax that ensures efficiencies in factor utilization is the need of the hour." Comment.

Direct Tax Code

The DTC Bill was introduced in the Lok Sabha in 2010 and was refered to the Standing Committee whose recommendations are being incorporated. Following are the highlights of the Direct Taxes Code bill :

- Income tax exemption limit proposed at Rs 2 lakh per annum, up from Rs 1.6 lakh
- 10 per cent tax on annual income between Rs 2-5 lakh, 20 per cent on between Rs 5-10 lakh, 30 per cent for above Rs 10 lakh
- Proposal to raise tax exemption for senior citizens to Rs 2.5 lakh from Rs 2.4 lakh currently
- No mention about tax exemption to women in proposed bill
- Corporate tax to remain at 30 per cent but without surcharge and cess
- MAT to be 20 per cent of book profit, up from 18 per cent
- Proposal to levy dividend distribution tax at 15 per cent * Exemption for investment in approved funds and insurance schemes proposed at Rs 1.5 lakh annually, against Rs 1.2 lakh currently
- Wealth tax at Rs.1 crore and above at 1%. Read the following graphic

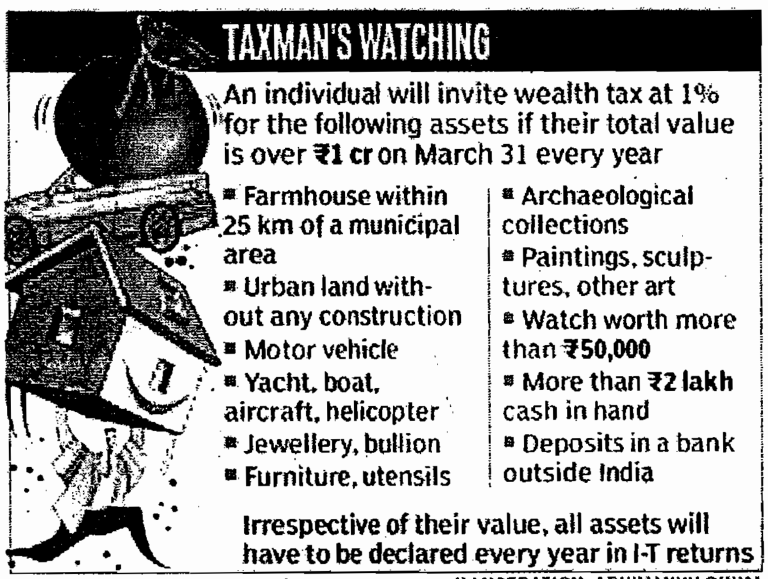


ILLUSTRATION: ABHIMANYU SINHA

Proposed bill has 319 sections and 22 schedules against 298 sections and 14 schedules in existing IT Act .Once enacted, DTC will replace archaic Income Tax Act.

DTC and GAAR

GAAR provisions that are there in the Finance Act 2012 will find their place in the DTC Bill 2012 that is expected to come into effect in 2013. They are , briefly

- To come into effect from 2013

- Onus of proof lies on the tax department
- Independent member in the GAAR panel
- Minimum threshold to be specified
- No retrospective application
  (see the note on GAAR)

DTC as it is found in Union Budget 2012

Changes in tax slabs

The basic threshold has been increased to . 2 lakh for all individuals below 60 years. This eliminates the preferential slab to women and also set the peak rate of 30% over income exceeding . 10 lakh.

Age for senior citizens

Budget 2012 dropped the age limit to 60 for claiming specified deductions like medical premiums.

Wealth tax

DTC proposed wealth tax limits at . 1 crore as against the existing . 30 lakh and various new assets like work of art, bank deposits outside India, among others, have been added.

Gaar was introduced

GST and CST

As mentioned in the GST note above, CST is being phased out , having been reduced from 4% to 2% and likely to be made zero. The losing states wil be compensated. Part of the compensation is monetary and the rest is as follows:

1. states to partly make up their loss will levy taxes on tobacco, sugar and textiles
2. Another was restructuring the VAT rates by increasing it to six per cent from 2009.

Taxation

GAAR

The aim of the Gaar provisions is to codify the doctrine of 'substance over form' where the real intention of the parties and purpose of an arrangement is taken into account for determining the tax consequences, irrespective of the legal structure of the concerned transaction or arrangement.

It essentially comes into effect where an arrangement is entered into with the main purpose of obtaining a tax benefit and exhibits the following features

- it results in misuse or abuse of provisions of tax laws
- lacks commercial substance
- it is not carried out in a bona fide manner.

Thus, if the GAAR panel made up of senior IT commissioners believes that the main purpose or one of the main purposes of an arrangement is to obtain a tax benefit and any one of the above features is satisfied, he has powers to declare it as an impermissible avoidance arrangement.

An arrangement will be deemed to lack commercial substance under Gaar if it involves the location of an asset or of a transaction or of the place of residence of any party that would not have been so located for any substantial commercial purpose other than obtaining tax benefit.

FAQ on General Anti Avoidance Rules (GAAR)

What are general anti-avoidance rules?

These rules. originally proposed in the Direct Taxes Code 2011 , are targeted at arrangements or transactions made specifically to avoid taxes. Gaar provisions will check treaty-shopping by the taxpayer for avoidance of payment of tax in India.The aim is t check tax evasion in the guise of tax avoidance; prevent India from becoming a tax haven; prevent double tax avoidance treaties(DTAA) from being abused. More than 30 countries have introduced GAAR provisions in their respective tax codes to check evasion.

How does it operate?

GAAR allows tax authorities to call a business arrangement or a transaction 'impermissible avoidance arrangement' if they feel it has been primarily entered into to avoid taxes.(please read ahead for the difference between tax planning, avoidance and evasion)

Once an arrangement is ruled 'impermissible' then the tax authorities can deny tax benefits. Most aggressive tax avoidance arrangements would be under the risk of being termed impermissible. The rule can apply on domestic as well as overseas transactions.

What were the key concerns?

GAAR is a very sweeping provision and can easily be applied to most tax-saving arrangements. Many experts feel that the provision would give unbridled powers to tax officers, allowing them to question any taxsaving deal.

Foreign institutional investors are worried that their investments routed through Mauritius could be denied tax benefits enjoyed by them under the Indo-Mauritius tax treaty.

It may become arbitrary and will make doing business in India difficult.

Also, unless external tax treaty overrides Gaar, it could raise concerns about the certainty of benefits conferred under the treaties and affect India's credibility as a reliable treaty partner.

Similarly, the flexibility of Indian multinationals to organise their businesses outside of India through overseas holding companies may get impaired due to this requirement under Gaar and, to that extent, make Indian MNCs less competitive than MNCs from other countries.

How did the Finance Minister amend it during the Budget session 2012?

Government has postponed GAAR to the next financial year 2013-14. This will give a breather to tax payers and also allow the government time to frame establish rules after consultations with stakeholders. It will not have retrospective effect. He has also clarified that the onus to prove that an arrangement is 'impermissible' will lie with the tax department as recommended by the Parliamentary Standing Committee . The GAAR panel, the final body that will decide on the applicability of the law, will include an independent member with legal background. A monetary threshold has been proposed. Taxpayers can approach the authority for advance rulings to give a ruling on the applicability of Gaar.

Why was Parthasarathy Shome Panel set up?

After the Finance Ministry released the draft guidelines on GAAR in June 2012, the Prime Minister constituted the expert panel headed by Dr. Shome in July 2012. The committee has been asked to review the draft guidelines and prepare its report on a GAAR implementation roadmap by September 30, 2012.

Advance ruling

Advance Ruling, means written opinion or authoritative decision by an Authority empowered to render it with regard to the tax consequences of a transaction. Under the law , the power of giving advance rulings has been entrusted to an independent adjudicatory body. headed by retired judge of the Supreme Court that is empowered to issue rulings, which are binding both on the Income-tax Department and the applicant. The procedure prescribed is simple, inexpensive, expeditious and authoritative.

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 gains), or financial transaction (as in the stock markets). This double liability is often mitigated by tax treaties between countries.

India has comprehensive Double Taxation Avoidance Agreements (DTAA) with more than 80 countries. This means if investment takes place in India by a company that is based in a country with which India has a DTAA, its capital gains etc will be taxed only in the country where the company is based and not in India. It encourages foreign investment; gives India access to forex etc. Under the Income Tax Act 1961 of India, Section 90 applies for taxpayers who have paid the tax to a country with which India has signed DTAA. The controversy arises from the abuse of the treaty whereby letter box companies without commercial substance invest in India only for tax benefits. A large number of foreign institutional investors who trade on the Indian stock markets operate from Mauritius and the second being Singapore. According to the tax treaty between India and Mauritius, capital gains arising from the sale of shares are taxable in the country of residence of the shareholder and not in the country of residence of the company whose shares have been sold. Therefore, a company resident in Mauritius selling shares of an Indian company will not pay tax in India. Since there is no capital gains tax in Mauritius, the gain will escape tax altogether.India thus becomes a tax haven. GAAR is meant to tackle such misuse, among other things.

Limitation of benefits and DTAAs

Indian negotiators are working on revising the India-Mauritius tax treaty to insert a "limitation of benefits" clause that will enable India to disallow tax exemptions claimed by third country firms using the Mauritius route to buy shell companies with underlying Indian assets.

Renewed urgency is felt as it is believed that Vodafone deal was done through tax haven Cayman Islands to take advantage of what it termed as "treaty shopping"-routing investment into India through countries with which India has a DTAA and even among these countries. from the country that gives best terms like Mauritius.

The Mauritius treaty is important for India as in the last decade foreign direct investment into India from the island nation totalled $55.2 billion, comprising about 42 per cent of the $133-billion foreign investment in the country.

The limitation of benefits clause is an "anti-abuse provision which disallows tax exemptions to shell companies set up merely to use provisions of the double taxation treaty to buy Indian assets but avoid tax payouts".

India has introduced such provisions in tax treaties with Singapore and the UAE. India renegotiated the treaty with Singapore to prevent third country residents from misusing the capital gains exemption rule by establishing a holding company in Singapore.

The Singapore tax treaty clearly says that genuine companies are only those which are listed on recognised stock exchanges there, or whose annual expenditure on operations is equal to or more than Singapore$200,000 in the 24 months immediately before the date the capital gains arise. Others will be treated as shell companies that were set up to avoid taxes.

The clauses added to the India-UAE treaty were broader and applied to all benefits under the double taxation avoidance agreement. It stated that tax benefits would not be given to a firm if "the main purpose or one of the main purposes of the creation of such an entity was to obtain the benefits" of the tax treaty.

Thus limitation of benefits and GAAR will ensure that substance is given importance and not form. Tax authorities will 'look throug' and not 'look at' the tax transaction.

Limitation of benefits clause for the tax treaties would be in addition to the general anti-avoidance rules (GAAR).

Vodafone verdict: The gist

A three-member bench of the Supreme Court pronounced a landmark verdict in the case of Vodafone in India's most debated tax dispute in January 2012. The dispute surrounds Vodafone's acquisition of Hutchison Essar Limited (HEL) in India in 2007 and its obligation to withhold tax on payments made to Hutchison's Cayman Island company (the seller). Under Indian tax laws, liability to withhold tax is that of the payer and default of such obligation makes the payer a defaulter and consequently liable for principal sum, interest and penalties.

Vodafone Netherlands (the buyer) acquired CGP, the Cayman Island company that owned the HEL, the former being under the control of Hutchison Group- for a consideration of $11 billion. CGP owned HEL of India. Vodafone 's case was that it was an offshore transaction between two foreign companies and there was thus no tax liability in India. The tax department argued that the acquisition via the Cayman entity was nothing but a tax avoidance scheme. In substance, the acquisition (of CGP) pertained to Indian assets represented in HEL.

The Supreme Court in its January 20 verdict upheld the arguments of Vodafone. It held the transaction as valid and non-taxable in India. It was not a case of tax avoidance but one of tax planning. The substance of the deal showed business purpose and not merely tax avoidance.

The apex court held the web companies that Hutchison set up as commercially justified. It held that IT department may invoke the "substance over form" principle or "piercing the corporate veil" test only after it is able to establish on the basis of the facts and circumstances surrounding the transaction that the relevant transaction is a sham and is structured to avoid tax.

(A **holding company** is a parent corporation that owns enough voting stock in another corporation to control its board of directors (and, therefore, controls its policies and management). Tata Sons, SAIL are some examples). The term usually refers to a company which does not produce goods or services itself; rather, its purpose is to own shares of other companies. It benefits by way of one company's fortunes can be improved by another- if one subsidiary goes sick, the holding company can bail it out with its own resources gained from other companies and the shareholders will not suffer; crossholdings for synergies are another benefit-subsidiaries working on common purpose like power companies and fuel companies under the same holding company umbrella.

Indirect transfer of Indian asset

Transferring a holding company or a chain of holding companies instead of transferring 'an underlying asset' is indirect transfer.

Such transfers are often required for business reasons and may not be solely for tax avoidance. Selling a holding company instead of the underlying property is common practice in many markets; but several jurisdictions have legislation to ensure that stamp duties are not avoided in the process. Similarly, many jurisdictions rightly seek to ensure that capital gains taxes are not avoided through offshore indirect transfers.

Indian Parliament in 2012 enacted retrospective amendments of the IT Act 1961 clarifying that the original legislative intent (since 1961) was to subject offshore indirect transfers to taxation in India and to compel acquirers to deduct and discharge tax obligations of non-resident sellers. The amendments are targeted at nullifying the Supreme Court (SC) verdict on taxation of Vodafone's acquisition of Hutchison Cellular, India's second-largest mobile telecom operator.
The SC has ruled that Vodafone was correct in accepting Hutch's negotiating position that no 'taxable event' will occur under Indian tax laws as no transaction was

contemplated in Indian securities. The amendments are seeking to make the Vodafone-Hutch transaction a taxable event and oblige Vodafone to discharge Hutch's tax liabilities.

The questions raised and answers given are the following:

a. Can the parliament in 2012 make clarifications on the laws made by Parliament in 1961. Yes they can as it is the institution that is doing it and not the members
b. Where is the need for the clarification? Supreme Court in the Vodafone verdict wanted the government to clarify
c. Is it meant to overcome the Vodafone ruling? No, retrospective amendment are common and are upheld by the courts often.
d. Can the judiciary strike it down? Yes.

Treaty shopping and round tripping

Treaty shopping is a practice featuring residents of a third country (Vodafone and Hutchison) taking advantage of a beneficial tax treaty between two countries (India and Mauritius) to lower their tax liability. Round tripping refers to the practice where, capital belonging to a country (India), which leaves the country (and invested in Mauritius) and then is reinvested in the form of FDI (back to India). Large number of Indian corporate are taking money out of India to invest in the Mauritius after registering a shell company there. This invested fund is taken back to India. The profit out of such investment can't be taxed in India as the fund is coming from Mauritius. In Mauritius, this income is not taxed or taxed at an insignificant rate.

These two practices are instances by corporate of utilizing tax havens to escape from taxation. Companies are adopting treaty shopping and round tripping practices as part of their tax planning. Supreme Court verdict in the Vodafone case in January 2012 t has given a legal validity to treaty shopping and round tripping.

Distinction between tax planning, tax avoidance and evasion

There are three phrases: tax planning, tax evasion, and tax avoidance. For example, if law says that if a company invests its profits in a tax-saving government bond, then it will not have to pay tax on those profits. Thus it can permit companies to avoid paying tax if they invest their profits in a particular financialinstrument. That is tax planning.

But if the legislative intent to tax capital gains, arising out of the transfer of assets in India is clear, and it is also clear that what has been transferred are really capital assets in India, then if a device of a holding company is adopted to transfer the assets in India, that is tax avoidance, which the McDowell judgment says must be frustrated by the courts. Avoidance is structuring a transaction in such a way as not paying tax is the primary motive. The legality is tested on the basis of `looking through' and not `looking at'. Substance is the issue not the form. Corporate veil needs to be pierced and tax collected.Wher e tax transaction is colourable, it attracts GAAR as it is construed as avoidance. For example, Minimum Alternative Tax(MAT) on companies that are not paying corporate tax.

Tax evasion means not declaring the transaction in the books at all. So, on tax evasion, there is no dispute that it is illegal. In the McDowell case, the Supreme Court said even tax avoidance by using artificial devices, such as holding companies, must be frustrated by the courts. But Azadi Bachao (2003)and the Vodafone(2012) judgments go against the mandate of the McDowell(1986) judgment and allow and legitimise tax avoidance devices.

Inflation
Concepts, Facts and Policy

Inflation means a persistent rise in the price of goods and services. Inflation reduces the purchasing power of money. It hurts the poor 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.

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 1 to 5 percent a year. Creeping inflation of 3 to 5 percent erodes the purchasing power of money when continued over many years, but it is "manageable." Furthermore, a low creeping inflation could be good for the economy as producers and traders make reasonable profits encouraging them to invest.

Trotting inflation is usually defined as a 5 to 10 percent annual rate of increase in the general level of prices that, if not controlled, might accelerate into a galloping inflation of 10 to 20 percent a year. If it aggravates, galloping inflation can worsen to "runaway" inflation which may change into a hyperinflation. Hyperinflation is inflation that is "out of control," a condition in which prices increase rapidly as a currency loses its value. No definition of hyperinflation is universally accepted. One simple definition requires 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.

Other related concepts are

- deflation when there is a general fall in the level of prices
- disinflation which 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 an attempt to raise prices to counteract deflationary pressures.

Measures of inflation

GDP deflator

GDP stands for gross domestic product, the total value of all final goods and services produced within that economy during a specified period.GDP deflator is a measure of the change in prices of all new, 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.

Cost of living index

The cost of living is the cost of maintaining a certain standard of living. It is defined with reference to a basket of goods and services. When their cost goes up, CoL is said to be dearer and the index will go up. 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

Producer price index (PPIs) measures the change in the prices received by a producer. The difference with the WPI is accounted for by logistics, profits and taxes, mainly. Producer price inflation measures the price pressure due to increase in the costs of raw materials. It may be absorbed by them or made up by increases in productivity or passed on to the consumers. It depends on the market conditions.

WPI

Wholesale price indices, which measure the change in price of a selection of goods at wholesale, prior to retail sales thus excluding sales taxes. These are very similar to the Producer Price Indexes.

CPI

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

Types of inflation based on causes

There are four major types of inflation

- 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, India in 2010 when the economy is said to have overheated and demand outstripped supply and prices rose. Since supplies will be augmented to adjust to demand, prices will come down. It may be refered to as 'growth inflation' too. 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. From 2010 March till the end of 2011, repo rates went up 13 times and thus RBI sought to control prices by controlling demand. Wage inflation, money supply growth etc create this type of inflation.

- Cost-push inflation: It is also refered to as "supply shock inflation," caused by reduced supplies due to increased prices of inputs, for example, crude prices globally have gone up causing supply constraints which means higher costs of production and so higher prices. Crude and food prices shot up in 2008 July,came down and again increased. Food prices are are shooting up again due to deficient monsoon and global shortages. Other examples are , higher cost of capital, increases in prices of imported raw materials. 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, and production of some goods controlled by some people. Food inflation currently being witnessed(2012) is 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
- Cartelization
- hoarding

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) will be worse off in real terms due to higher prices and equal income as before
- inflation discourages exports as domestic sales are attractive and BOP problems can be caused. Inflation may erode the external competitiveness of domestic products if it leads to higher production costs such as wage increases, higher interest rate and currency depreciation.
- 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 is also gets skewed in favour of unproductive assets like gold as inflation may be higher than interest rates and yield is negative.
- Inflation tax happens. When a government borrows and spends, the cash held by people erodes in value due to inflation
- It will redistribute income from those on fixed incomes, such as pensioners, and shifts it to those who draw an inflation-linked income and businesses.
- 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.

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. new products are launched at high prices, which quickly come down through competition. Therefore, there is encouragement for innovation and the problem is short lived. 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."

To control inflation

There are fiscal, monetary, supply-side and administrative measures to control inflation to ideal/optimal rates though zero rate of inflation is never preferred for the reasons cited elsewhere in the lesson.

- Fiscal measures include reduction in indirect taxes
- Dual pricing like in sugar.
- Monetary measures include rate and reserve requirements changes . Open market operations can stabilize prices under normal conditions Also, sterilization through Government bond transactions as in the case of MSBs
- Supply side factors include making goods available- import of edible oil in India.
- Administrative measures include implementation of dehoarding and anti-black-marketing measures. Wage and price controls can also be used

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 2004-05. Wholesale prices of all products in the basket with their respective weightages in that year add upto "100". If, in 04-05, 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 in 2005-06. 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. Different base years are used for different price indices due to convenience, data availability, logistics etc.

WPI

The Wholesale Price Index

Government launched a new series of wholesale price index (WPI) with 2004-05 as base from 2010. Earlier, 1993-94 was used as base year to calculate WPI. The new series of WPI has 676 items as against 435 items in the previous series. Consumer items widely used by the middle class like ice-cream, mineral water, flowers, microwave oven, washing machine, gold and silver are reflected in the new series of WPI. This would give better picture of the price variation.Readymade food, computer stationary, refrigerators, dish antenna, VCD, petroleum products and computers will also be part of the new series.

Under primary article group of the new WPI, there are 102 items against earlier 98, while fuel and power category remains static at 19. In the new series, there are 555 items of manufactured products compared to 318 items earlier.

241 new items are there in the basket of commodities making up the official wholesale price index in a bid to reflect changes in India's price line and consumption pattern better.

The new series is based on the recommendations of a working group that was set up under Planning Commission Member Abhijit Sen, which in its technical report submitted in May 2008 recommended the change of the base year to 2004-05. The new series has also altered the weight attached to each commodity group.

Manufactured items now have a higher weight of 64.972 as against 63.749 earlier. The weight for fuels has also increased to 14.910 against 14.226. But for primary articles, the weight is down at 20.118 against 22.025.

In a bid to reflect the actual consumption pattern, the new series drops as many as 200 items sach as typewriters, video cassette recorders, to make a room for items like computers, refrigerators, televisions and video disc players.

Government is also working on a two new indices to reflect the changes in the cost of services — one on financial services and the other on trade and transport.

The WPI, published weekly by the Economic Advisor in the Ministry of Commerce and Industry, with a two week lag, tracks the wholesale traded price of 676 items that include agricultural commodities (such as rice, tea, raw cotton, groundnut oil seed), industrial commodities (such as iron ore, bauxite, coking coal), intermediate products for industry (such as cotton yarn, polyester fiber, synthetic resins, iron & steel, sheet glass), products for consumers (atta, sugar, paper, electricity, ceiling fans) and energy items (petrol, kerosene, electricity for commercial use). The weight attached to each item in the index is meant to reflect the volume (by value) of wholesale trade in that item in the Indian market.

The wholesale price index (WPI) is an indicator designed to measure the changes in the price levels of commodities that flow into the wholesale trade. The index is a vital guide in economic analysis and policy formulation. WPI covers primary goods, power/fuel and manufactured goods.

The WPI is not intended to capture the effect of price rise on the consumer though it generally and broadly indicates it.

WPI is the only price index in India which is available on a weekly basis with the shortest possible time lag of two weeks.It 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.

To reflect the structural changes in the economy that have taken place over a decade, a large number of commodities have been added and a few with diminished importance have been dropped.

WPI is compiled on weekly basis with a time lag of two weeks. This provisional weekly index is made final after a period of 8 weeks .

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.

The advantage of the WPI is that it covers more goods; is available with relatively small time lag of fortnight; is convenient to compile. Disadvantages are that it does not include services like transport, health, education etc.

Limitations on WPI

The accuracy of WPI is unsatisfactory even after the introduction of the revised series in 2010. 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.

Government set up Abhijit Sen committee on revising the WPI and the revised series was introduced in 2010 to broadbase the basket and update the goods.

WPI: new reporting method

From 2009, government presented WPI inflation figures on a monthly basis instead of weekly system. Analysts say since weekly data on wholesale price index-based inflation do not adequately capture the movement of prices of manufactured goods, government has to often revise the figures later. Therefore, the government decided to have weekly release of inflation data on food and fuel prices and monthly data on WPI.Inflation of primary goods within the WPI is reported on a weekly basis.But from 2011, the WPI is reported every mont, including the food and primary article data

The earlier system was to release the wholesale price index every week and consumer price index, where food items have greater weightage, every month.

Comparative Statement of Commodities and price quotations

	No of Commodities		No of Price Quotations	
	1993-94	2004-05	1993-94	2004-05
All Commodities	435	676	1918	5482
Primary Articles	98	102	455	579
Fuel and Power	19	19	72	72
Manufactured Products	318	555	1391	4831

Weightage of the Sub Indices

	1993-94	2004-05
All Commodities	100%	100%
Primary Articles	22.025%	20.118%
Fuel and Power	14.226%	14.910%
Manufactured Products	63.749%	64.972%

CPI

There are three Consumer Price Indices in India . Each tracks the retail prices of goods and services for specific group of people, because the consumption patterns of different groups differ.

For Industrial Workers (CPI-IW), a basket of 370 commodities is tracked; for Urban Non-Manual Employees (CPI-UNME), 180 commodities; for Agricultural Labourers (CPI-AL), 60 commodities. The respective base years are 2001, 1984-85 and 1986-87. The first two indices have services in them. These baskets and the weightages to each item have been determined on the basis of surveys of consumption patterns. Information also differs from centre to centre around the country; the all-India figures declared are averages.

Mahatma Gandhi NaREGA wages are to be indexed to the CPI (AL) from the beginning of the year 2011.

CSO decided to discontinue CPI(UNME) from 2008.

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 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.

The coverage of CPI IW is broader than the other indices of CPI like the CPI for agricultural laborers (AL) and the CPI for urban non-manual employees (UNME).

In the organised sector, CPI-IW is used as a cost of living index.

CPI-AL and CPI-UNME are not considered as robust national inflation measures because they are designed for specific groups of population with the main purpose of measuring the impact of price rise on rural and urban poverty.

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. It is the responsibility of the Ministry of Statistics and Programme Implementation to compile and release the data on the CPI for Urban Non-Manual Employees.

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.

The national income deflator(GDP deflator) is a comprehensive measure statistically derived from national accounts data released by the Central Statistical Organization (CSO). Since it encompasses the entire spectrum of economic activities including services, the scope and coverage of national income deflator is wider than any other measure. At present, the GDP deflator is available only annually with a long lag of over one year and hence has very limited use for the conduct of policy.

Difference between wholesale prices and consumer prices

WPI measures price rise at the wholesale level. Wholesale means sale in large quantities and 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. The difference is due to a number of factors. A substantial portion of the differential 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. Therefore, give WPI an important place in government policy as it is more representative ; figues come quickly relatively; and has an all India character.

Divergence between WPI and CPI

Why do WPI and CPIs differ? They differ in terms of their weighting pattern. First, food has a larger weight in CPI ranging from 46 per cent in CPI-IW to 69 per cent in CPI-AL whereas it has a weight of only 27 per cent in WPI. The CPIs are, therefore, more sensitive to changes in prices of food items. Second, the fuel group has a much higher weight in the WPI (14.2 per cent) than the CPIs (5.5 to 8.4 per cent). As a result, movement in international crude prices has a greater bearing on WPI than on the CPIs. Third, services are not covered under WPI while they are, to different degrees, covered under CPIs. Consequently, service price inflation has a greater influence on CPIs.

New CPI series

The Central Statistics Office (CSO) of the Ministry of Statistics & Programme Implementation introduced the new series of Consumer Price Index(CPI) numbers for Rural, Urban and Combined (Rural +Urban) on base 2010 =100 taking all segments of rural and urban population for the States/UTs and all- India . Since n 2011 February, the new series is force. These indices are available for five major groups namely Food, beverages and tobacco; Fuel and light; Housing; Clothing, bedding and footwear, and Miscellaneous.

Present CPI numbers do not encompass all the segments of the population in the country and as such they do not reflect the true picture of the price behavior in the country. It is therefore necessary to compile a CPI which takes into account the consumption patterns of all segments of the population and includes services .

New series of CPI for urban areas

CPI (Urban) numbers are compiled at State/UT as well as at all- India level. Weighting diagrams (consumption patterns) of the CPI (Urban) have been derived from the results of the NSS 61st round of Consumer Expenditure Survey (2004-05). For regular price collection, 310 towns have been selected, which include all State/UT capitals. From each selected town, price data are collected in respect of items consumed by the population of the respective State/UT. In all, 1114 price schedules containing an average of 250 items are canvassed every month. House rent data are also collected from a fixed set of rented dwellings from the selected towns. Prices of items are collected by the field officials of the National Sample Survey Office (NSSO).

New series of CPI for rural areas

CPI (Rural) numbers are compiled at state/UT and all- India levels. Weighting diagrams of the CPI (Rural) have also been derived from the results of the NSS 61st round of Consumer Expenditure Survey (2004-05).

Considering the fact that the CPI (Rural) would provide the price changes for the entire rural population of the country, a total of 1181 villages have been selected at all India level. Regular prices are collected by the officials of the Department of Posts. One schedule containing an average of 225 items from each selected village is canvassed for collection of prices every month.

National CPI

CSO will also compile national CPI by merging CPI (Rural) and CPI (Urban) with appropriate weights, as derived from NSS 61st round of Consumer Expenditure Survey (2004-05) data.

Weighting diagrams

The share (weight) of the Food, beverages and tobacco group in the all India CPI (Rural) is 59.31% and it is 37.15% in the all India CPI (Urban). Fuel and light group has a weight of 10.42% in CPI (Rural) and 8.40% in CPI (Urban). Clothing, bedding and footwear group has weight of 5.36% in CPI (Rural) and the weightage of 3.91% in CPI (Urban). Housing group has not been given any weightage in the rural areas CPI as its share is around 1% and it has been distributed to other groups on pro rata basis. CPI (Urban) has a weightage of 22.53% in respect of Housing group. The Miscellaneous Group consisting of education, medical care, transport and communication etc has

24.91% weight in the all India CPI (Rural) and the corresponding weight in the all India CPI (Urban) is 28%.

Release of indices

Index numbers for both rural and urban areas and also combined for each month and released . It is proposed to release provisional indices for a period of one year. Indices are released with a time lag of one month.

Revision of indices

These new CPI numbers would be revised on the basis of the results of the next round of Consumer Expenditure Survey scheduled to be conducted during 2011-12 by the NSSO. Thereafter, revision will be undertaken every five years or so (whenever large scale Consumer Expenditure Survey data become available).

New series of CPI-- All India weights

Sub group/group	Rural	Urban	Combined (Rural+Urban)
Cereals and products	19.08	8.73	14.59
Pulses and products	3.25	1.87	2.65
Milk and milk products	8.59	6.61	7.73
Oils and fats	4.67	2.89	3.90
Egg, fish and meat	3.38	2.26	2.89
Vegetables	6.57	3.96	5.44
Fruits	1.90	1.88	1.89
Sugar etc	2.41	1.26	1.91
Condiments and spices	2.13	1.16	1.71
Non- alcoholic beverages	2.04	2.02	2.03
Prepared meals etc	2.57	3.17	2.83
Pan, tobacco and Intoxicants	2.73	1.35	2.13

Food, beverages and tobacco	**59.31**	**37.15**	**49.71**
Fuel and light	**10.42**	**8.40**	**9.49**
Clothing and bedding	4.60	3.34	4.05
Footwear	0.77	0.57	0.68
Clothing, bedding and footwear	**5.36**	**3.91**	**4.73**
Housing		**22.53**	**9.77**
Education	2.71	4.18	3.35
Medical care	6.72	4.34	5.69
Recreation and amusement	1.00	1.99	1.43
Transport and communication	5.83	9.84	7.57
Personal care and effects	3.05	2.74	2.92
Household requisites	4.48	3.92	4.30
Others	1.12	0.99	1.06
Miscellaneous	**24.91**	**28.00**	**26.31**
All Groups	**100.00**	**100.00**	**100.00**

The new series is broad based and covers the entire rural and urban population.In the new series compiled by Central Statistics Office, the consumption patterns have been derived from the results of the Consumer Expenditure Survey conducted by the National Sample Survey Office during 2004-05. Food group weights in all-India CPI (Rural), CPI (Urban) and CPI (Combined) are 59.31%, 37.15% and 49.71% respectively. Remaining weights are for non-food groups i.e. housing, fuel & light, clothing & footwear and miscellaneous group.

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.

Figures for inflation in the WPI are on the average much lower than those in the CPI indices. There could be two reasons for this difference in rates between the WPI and CPI: first. prices of the items in the CPI basket might have risen more sharply than items excluded from it — this would mean that prices of mass consumption goods have risen more sharply than inputs for production; secondly, the retail prices of commodities might have grown more sharply than the wholesale prices, indicating that middlemen have taken a bigger share.

Services and price index

While the WPI now does not include services, the two consumer price indices (CPI) meant for urban non-manual employees and industrial workers, do include 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 WPI or in the CPIs.

In India, the services sector accounts for about 57 per cent of the GDP.

In August 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 also underway in India, according to Dr Abhijit Sen, Member of Planning Commission. 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.

'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 usually 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 . These price changes are not within the control of monetary policy inasmuch as these are supply shocks. ~~The~~ The main argument here is that the central bank should effectively be responding to the movements in permanent component- manufacturing , of the price level rather than temporary deviations.

India's core wholesale price index rose an estimated 4.85 per cent in June 2012 from a year earlier, while the WPI rose 7.25%.When food and fuel price changes are added to core inflation, we get headline inflation.

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, although 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.

Prices impact on the macro economy in many ways – welfare of people, growth and stability of the economy in a globalised order.

Ideal level of Inflation

Ideal inflation rate is one that takes into consideration human,social and economic impact.It is the level of inflation beyond which the adverse consequences are strong. Chakravarty Committee(1985) had indicated 4 per cent as an acceptable level of inflation on a long-term basis However, such a level of inflation cannot be fixed at one level for all times. It depends on growth rate . It also depends on what the global levels are. RBI sees about 5.5% rate of inflation as 'comfortable'- neither does it hurt in human terms nor in growth terms.

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.

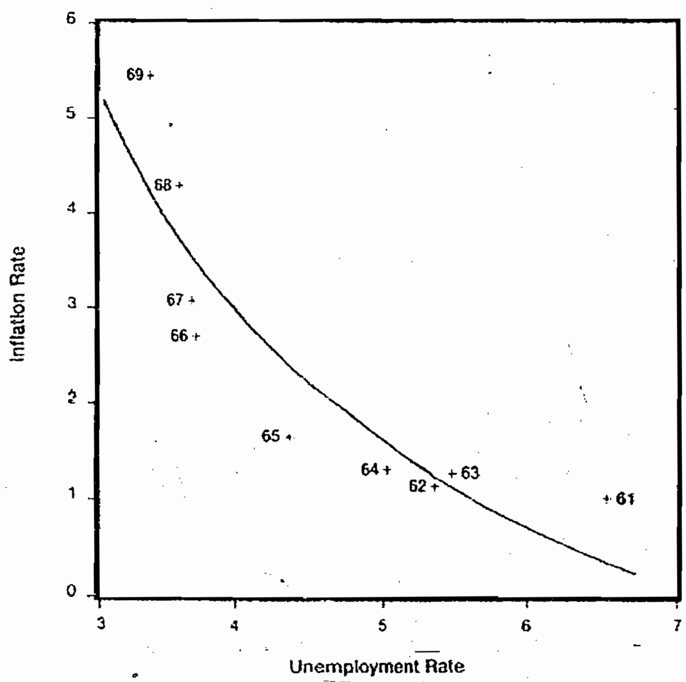
The Collection of Statistics Act, 2008, gives powers to the government to classify any statistics as "core statistics" and also determine the method to collect and disseminate the same.

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 .

This level of output corresponds to the Non-Accelerating Inflation Rate of Unemployment, NAIRU. 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 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

- 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.

The deflationary phase was short lived for a few weeks as the fiscal as well as monetary measures of the government started showing results and demand and growth returned.

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 and incomes rise, demands rises pushing up prices.

As prices rise, the central bank intervenes and raises rates to cool consumption and so prices fall relatively. Repo rates- 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 up in reponse to priceline in the country. The primary goal of the RBI is to moderate and stabilize prices.

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 a temporary pause to gain greater strength.

Fiscal drag operates in an overheated economy. That is the tax liability increases as wages rise. That leaves less purchasing power in the hands of the people and so demands drops automatically. It acts as an automatic stabilizer.

Inflation in India

Reasons for the current inflation

In spite of the steps of the government, prices are relentlessly on rise. WPI at 7.5% and CPI above 10% in mid-2012 have many reasons

- Growth
- The bad monsoons and the decline in production raised inflationary expectations
- Even as the buffer stocks accumulated to huge surplus, governance problems and the fiscal pressures of the states prevented them from being distributed
- Narega
- MSP increases
- Fuel price deregulation for petrol and increase in the prices of diesel and LPG
- Hoarding and cartelization as in the case of food items, cement
- Middle men

- Imported inflation due to rupee depreciation since late 2011

For food inflation, Dr.Subba Rao gave the following reasons in November 2011 and they continue to be relevant

1. Shift in dietary habits towards protein foods.
2. Pressure stemming from inclusive growth policies.
3. Large increases in MSPs of food grains.
4. Shocks from global food inflation.
5. Financialisation of commodities.

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 is 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 n the open market when prices are high.. This is in addition to the buffer stock held by FCI every year.

Issue price of grains supplied through PDS outlets are frozen.

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

Fiscal Measures

- Reduced import duties to zero for rice, wheat, onion, pulses, edible oils (crude) and to 7.5 per cent for refined and hydrogenated oils and vegetable oils.
- Permitted National Dairy Development Board (NDDB) to import 50,000 tonnes of skimmed milk powder and whole milk powder and 15,000 MT of butter, butter oil, and anhydrous milk fat at zero duty under tariff rate quota.
- Permitted the State Trading Corporation of India (STC)/Minerals and Metals Trading Corporation (MMTC)/Project Equipment Corporation (PEC) and National Agricultural Cooperative Marketing Federation of India (NAFED) to import duty-free white/refined sugar initially with a cap of 1 million tonnes. Later duty-free import was also allowed by other central / state government agencies and private trade without any cap on quantity.

Administrative Measures

- Removed levy obligation in respect of all imported raw sugar and white/refined sugar.

- Banned export of edible oils (except coconut oil and forest-based oil) and pulses (except Kabuli chana and organic pulses
- up to a maximum of 10,000 tonnes per annum).
- Imposed ban on export of non-basmati rice and wheat for short period of time.
- Permitted export of edible oils in branded consumer packs of up to 5 kg subject to a limit of 10,000 tonnes.
- Prohibited export of milk powders (including skimmed milk powder, whole milk powder, dairy whitener, and infant milk food), casein and casein products.
- Effected no change in tariff rate values of edible oils.
- Ban on export of onion was imposed for short period of time whenever required. Exports of onion were calibrated through the mechanism of minimum export prices (MEP) of onion.
- Maintained the central issue price (CIP) for rice (at ` 5.65 per kg for below poverty line [BPL] and ` 3 per kg for Antyodaya Anna Yopjana [AAY]) and wheat (at ` 4.15 per kg for BPL and ` 2 per kg for AAY) since 2002.
- Suspension of futures trading in rice, urad, and tur.
- Ten lakh tonnes of wheat and 10 lakh tonnes of rice allotted under the Open Market Sale Scheme (OMSS) and 15 lakh tonnes of wheat for bulk sale, including sale to small traders for the period October 2011to September 2012.
- An additional ad hoc allocation of 50 lakh tonnes of foodgrains made on 16 May 2011 to all states/UTs for BPL families at BPL issue price for distribution during the current year up to March, 2012.
- In addition, ad hoc allocation of 50 lakh tonnes of foodgrains made on 30 June 2011 to above poverty line (APL) families raising thereby monthly APL allocation up to 15 kg per family per month in 20 states and 35 kg per family per month in 4 north-eastern states, Sikkim, and 2 hilly states of Himachal Pradesh and Uttarakhand where it was less than that quantity for a period of ten months from June 2011 to March 2012.
- Extended the Scheme for distribution of subsidized imported edible oils through state governments/UTs with subsidy of ` 15 per kg for distribution to ration card holders at 1 litre per ration card per month.

Monetary Measures

Repo rates were raised and CRR also went up to make credit dearer.

Open inflation

When the government does not attempt to prevent a price rise, inflation is said to be open. Thus, inflation is open when prices rise without any interruption. In open inflation, the free market mechanism is permitted to fulfill its historic function of rationing the short supply of goods and distribute them according to consumer's ability to pay. Therefore, the essential characteristics of an open inflation lie in the operation of the price mechanism as the sole distributing agent.

Repressed inflation

When the government interrupts a price rise, there is a repressed or suppressed' inflation. Thus, it refers to those conditions in which price increases are prevented at the present time through an adoption of certain measures like price controls and rationing by the government, but they rise on the removal of such controls and rationing. The essential characteristic of repressed inflation , in contrast to open inflation, is that the former seeks to prevent distribution through price rise under free market mechanism and substitutes instead a distribution system based on controls.

Thus, the administration of controls is an important feature of suppressed Inflation . Repressed inflation is criticized as it breeds number of evils like black market and uneconomic diversion of productive resources from essential industries to non-essential or less essential goods industries since there is a free price movement in the latter and hence are more profitable to investors.

Inflation tax

Price rise means more money being paid by the consumers for what they buy. Thus, it is a type of tax.

Banking System in India

A commercial bank is a type of financial intermediary .. It is a financial intermediary because 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 commercial banking system in India consists of public sector banks; private sector banks and cooperative banks.

Currently, India has 88 scheduled commercial banks (SCBs) - 26 public sector banks (that is with the Government of India holding majority stake) that include SBI and its associates and the IDBIBank; there are private banks and foreign banks also. Public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively

Public Sector Banks

They are owned by the Government either totally or as a majority stake holder.

- State Bank of India and its five associate banks called the State Bank group
- 19 nationalised banks(earlier there were 7 associate banks but recently 2 were merged with SBI- SB of Saurashtra and Indore)
- Regional Rural Banks mainly sponsored by Public Sector Banks

Private Sector Banks include domestic and foreign banks

Co-operative Banks are another class of banks and are not considered as commercial banks as they have social objectives and profit is not the motive. (explained later)

Reserve Bank of India lays down the norms for banking operations and has the final supervising power.

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.

Bank Nationalization

In 1969 and again in 1980, Government nationalized private commercial banking units for channelizing banking capital into rural sectors; checking misuse of banking capital for speculative purposes; to shift from `class banking' to `mass banking'(social banking); and to make banking into an integral part of the planning process of socio-economic development in the country. Today, no other developing country can boast of a banking system comparable to India's in terms of geographic coverage, operational capabilities, range of services and technological prowess.

Commercial Banks

Today banks are broadly classified into two types - Scheduled Banks and Non-scheduled Banks

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 the RBI etc. The scheduled banks in India comprise of State Bank of India and its associates (8), the other nationalised banks (19), foreign banks, private sector banks,co-operative banks and regional rural banks. Today, there are about 300 scheduled banks in India having a total network of 79,000 branches among them.

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 vriteria 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.

In sum, all banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934 are Scheduled Banks. These banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks.

Scheduled Commercial Banks in India are categorised into five different groups according to their ownership and / or nature of operation. These bank groups are (i) State Bank of India and its Associates, (ii) Nationalised Banks, (iii) Private Sector Banks, (iv) Foreign Banks, and (v) Regional Rural Banks. In the bank group-wise classification, IDBI Bank Ltd. has been included in Nationalised Banks.

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 tem 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.

Prakash Bakshi Committee

In August 2012, Reserve Bank of India constituted a committee to suggest ways to strengthen the rural co-operative credit structure.The panel, headed by Nabard Chairman Prakash Bakshi, will review the existing short-term co-operative credit structure (STCCS), focussing on structural constraints in the rural credit delivery system. It will also explore ways to strengthen the rural co-operative credit architecture. The seven-member panel will make an in-depth analysis of the STCCS, and examine various alternatives with a view to reducing the cost of credit.The STCCS targets the credit requirement of the small and marginal farmers in the country.It will mainly assess the role played by State and district cooperative banks in fulfilling the requirement of agriculture credit.

Commercial banks and their weaknesses by 1991

The major factors that contributed to deteriorating bank performance upto the end of eighties were

- high SLR and CRR locking up funds
- low interest rates charged on government bonds
- directed and concessional lending for populist reasons
- administered interest rates and
- lack of competition.

The reforms to set the above problems right were

- Floor and cap on SLR and CRR removed in 2006
- interest rates were deregulated to make banks respond dynamically to the market conditions. Even SB 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

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.

Narasimham Committee

Banking sector reforms in India were conducted on the basis of Narasimham Committee reports I and II (1991 and 1998 respectively). 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
- 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 collect them for a commission .

Most of these reforms are implemented except priority sector lending which is welfare-based and relates to agriculture. SLR is 23% today and CRR is 4.75%. Bank rate is aligned with MSF.(2012)

Divestment in public sector banks led to their listing on the stock exchanges and their performance has improved.

NPAs

Non-performing assets are those accounts of borrowers who have defaulted in payment of interest or installment of the principal or both for 90 days atleast.

In 2003, NPAs stood at 9% and came down to 2.5% in 2008 but rose as economy slowed down since 2011.

Reflecting the stress in India Inc, net non-performing assets (NPAs) of banks at the aggregate level rose to Rs 60,100 crore at the end of March 2012.

One of the main reasons for this sharp jump in NPAs is the loans due to state electricity boards and also Air India. On the sectoral front, metals, textiles and infrastructure sectors were among the major ones to contribute to this slide.

The sharp rise in NPAs in the banking system, although was expected, has taken a toll on the stock prices of most of these banks .

PSU banks have seen their loans go bad at a faster rate than their private sector peers, the latter have been steadily improving their asset quality over the years.

RBI rules require that banks should set aside certain amount of money(provisioning) for the NPAs. Gross NPAs include the amount due along with the amount provisioned. Net NPAs include only the amount due.

NPAs are largely a fallout of banks' credit appraisal system, monitoring of end-usage of funds and recovery procedures. It also depends on the overall economic environment like the global recession since 2008, the business cycle and the legal environment for recovery of defaulted loans. Wilful default; priority sector problems among the poor etc are also responsible.

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 suffers etc.

NPAs are classified as sub-standard;doubtful and loss making assets for provisioning requirements .

The following are the RBI guidelines for NPAs classification and provisioning:
Sub Standard Assets – These are those accounts which have been classified as NPAs for a period less than or equal to 18 months.

Doubtful Assets –These are those accounts which have remained as NPAs for a period of 12 months.

Loss Assets – Such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value. But a loss asset has not been written off, wholly or partly.

What is being done

- provisioning
- CAR norms
- securitization law
- foreclosure norms
- one time settlement
- interest waiver
- writeoffs
- debt recovery tribunals

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.

SARFAESI Act 2002

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.

Asset Reconstruction Company

Normally banks and FIs themselves recover the loans. But in the case of bad debts(sticky loans) , it is outsourced to the ARCs who have built-in professional expertise in this task and who handle recovery as their core business. ARCs buy bad loans from banks and try to restructure them and collect them.Arcs were recommended by Narasimham committee II. ARCIL- the first asset reconstruction company was set up recently.

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.

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 sustain the risk exposures are readily available. Therefore, banks have 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 is a city in Switzerland. It is the headquarters of Bureau of International Settlement (BIS), which fosters co-operation among central banks with a common goal of financial stability and common standards of banking regulations. Every two months BIS hosts a meeting of the governor and senior officials of central banks of member countries. Currently there are 27 member nations in the committee. Basel guidelines refer to broad supervisory standards formulated by this group of central banks - called the Basel Committee on Banking Supervision (BCBS). The set of agreement by the BCBS, which mainly focuses on risks to banks and the financial system are called Basel accord. The purpose of the accord is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. India has accepted Basel accords for the banking system. In fact, on a few parameters the RBI has prescribed stringent norms as compared to the norms prescribed by BCBS.

In 1988, BCBS introduced capital measurement system called Basel capital accord, also called as Basel 1. It focused almost entirely on credit risk. It defined capital and structure of risk weights for banks. The minimum capital requirement was fixed at 8% of risk weighted assets (RWA). RWA means assets with different risk profiles. For example, an asset backed by collateral would carry lesser risks as compared to personal loans, which have no collateral. India adopted Basel 1 guidelines in 1999.

In June '04, Basel II guidelines were published by BCBS, which were considered to be the refined and reformed versions of Basel I accord. The guidelines were based on three parameters, which the committee calls it as pillars. - Capital Adequacy Requirements: Banks should maintain a minimum capital adequacy requirement of 8% of risk assets - Supervisory Review: According to this, banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks that a bank faces, viz. credit, market and operational risks - Market Discipline: This need increased disclosure requirements. Banks need to mandatorily disclose their CAR, risk exposure, etc to the central bank.

Basel III

In 2010, Basel III guidelines were released. These guidelines were introduced in response to the financial crisis of 2008. A need was felt to further strengthen the system as banks in the developed economies were under-capitalized, over-leveraged and had a greater reliance on short-term funding. Also the quantity and quality of capital under Basel II were deemed insufficient to contain any further risk.

More

CRAR at 9 percent of the risk weighted assets is prescribed by Basel norms. It is the capital that is required to be set aside for absorbing risks. It is not to be provisioned from deposits raised but has to be additionally provided from debt, equity, reserves etc.

Presently the Basel II norms are being complied with by Indian banks as follows:

Basel 2 norms are 8% of CRAR.RBI made it 9% for greater security.

Basel-II aims to strengthen Basel I.

Not only credit risk but also market risk and operational risk are covered.

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.

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 24 per cent of their net demand and term liabilities in cash, gold, government securities and other eligible securities to comply with SLR requirements(2008-09).

Such investments are risky because of the change in their prices. This volatility in the value of a bank's investment portfolio in known as the market risk, as it is driven by the market.

Operational risk

Several events that are neither due to default by third party nor because of the vagaries of the market. These events are called operational risks and can be attributed to internal systems, processes, people and external factors.

Thus, Basel II uses a **"three pillars"** concept

Pillar 1 Specifies includes more types of risk- credit risk ,market risk and operational risk.

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.

Capital -Tier1 And Tier 2

Capital adequacy norms divide the capital into two categories. Tier one capital is used to absorb losses while the Tier 2 capital is meant to be used at the time of winding up.

Tier I Capital: Actual contributed equity plus retained earnings.

Tier II Capital: Preferred shares plus 50% of subordinated debt(junior debt)

Subordinated debt figures between debt and equity – coming after the first in terms of eligibility for benefits like compensation.

Recapitalization is lending to the bank the resources needed to conform to the capital adequacy norms which stand at 8% today – minimum level.

One of the problems perceived in Basel 1 and 2 norms was that all sovereign debt, in general, was given a risk weight of zero, while all corporate debt was given similarly an equal weight irrespective of the difference in risk of the corporate concerned. The Eurozone sovereign debt crisis taught us lessons.

The risk weights led to some curious behaviour in lending. Banks started preferring to lend to governments, which required no capital addition, while even risk-free corporates, which had good rating, demanded additional capital provisioning under adequacy norms. Thus, one size fits all approach brought in distortions in lending.

Basel 3 norms: RBI Guidelines

The draft guideline norms announced by the RBI in mid-2012 will come into effect in a phased manner starting 1 January 2013 and have to be implemented fully by 31 March 2018. There isn't much change in the norms from the draft guidelines that were issued by RBI in December last year.

The key capital adequacy parameter has been stipulated at 9% higher than the international norm of 8%, and unchanged from what the regulator requires in India currently.

But banks will need to raise more money than under Basel II as several items are excluded under the new definition.

These guidelines mean that Indian banks would require a huge amount of capital in the next six years, about $30 billion to $40 billion. Some banks may find it difficult.

That would impose a heavy financial burden on the government, which will need to infuse capital in line with its holdings in the state-owned banks.

Under Basel III norms, a countercyclical capital buffer is prescribed: keep aside capital that can be used when the cycle turns, down and the loans may turn bad.

BIS

The Bank for International Settlements (BIS) is an international organization of central banks which fosters international monetary and financial cooperation and serves as a bank for central banks." It also provides banking services, but only to central banks, or to international organizations. Based in Basel, Switzerland, the BIS was established by the Hague agreements of 1930.

As an organization of central banks, the BIS seeks to make monetary policy more predictable and transparent among its 55 member central banks. The BIS' main role is in setting capital adequacy requirements to safeguard bank's operations.

Shadow banks

NBFCs are largely refered to as shadow banking system or the shadow financial system. They have become the major financial intermediaries. As seen in the note on NBFCs elsewhere, shadow institutions do not accept demand deposits and therefore are not subject to the same regulations. Familiar examples of shadow institutions included Bear Stearns and Lehman Brothers. Hedge funds, pension funds, mutual funds and investment banks are some examples.

Shadow institutions are not as effectively regulated as banks and so carry higher risk of failure.

Universal Banking in India

Universal banking in India was recommended by the second Narasimham Committee (1998) and the Khan Committee (1998) reports. It aims at widening and integration of financial activities.

Universal Banking is a multi-purpose and multi-functional financial supermarket.'Universal banking' refers to those banks that offer a wide range of financial services, beyond the commercial banking functions like Mutual Funds, Merchant Banking, Factoring, Credit Cards, Retail loans, Housing Finance, Auto loans. Investment banking. Insurance etc. This is most common in European countries.

Benefits to banks from universal banking are that , since they have competence in the related areas, they can reduce average costs and thereby improve spreads(difference between cost of borrowing and the return on lending) by diversification. Many financial services are inter-linked activities, e.g. insurance, stock broking and lending. A bank can use its instruments in one activity to exploit the other, e.g., in the case of project lending to the same firm which has purchased insurance from the bank.To the customers, 'one-stop-shopping' saves transaction costs.

However, one drawback is that universal banking leads to a loss in specialisation. There is also the problem of the bank indulging in too many risky activities. ICICI(Industrial Credit and Investment Corporation of India) merged with its subsidiary-ICICI Bank in a reverse merger(parent merging with the subsidiary, the ICICI Bank). Other banks are also emerging as universal banks which are popular in Europe.

The compulsions for the DFIs like ICICI, IDBI, IFCI etc to become UBs is the following:

Earlier in the sixties and seventies, the DFIs specialized in project finance for the industries with long term capital needs. But the industries of late are mobilizing the finances from external sources or from the stock market and so the DFI business suffered. The cheap Government funds that were available in the earlier pre-liberalization era also are not available today.Banks and DFIs are having to compete for the same clients. Banks have an advantage in that they have a deposit base but the DFIs do not have same.

Financial inclusion

Many people, particularly those living on low incomes, cannot access mainstream financial products such as bank accounts and low cost loans. This financial exclusion forces them to borrow from the moneylenders at high cost.Therefore, financial inclusion has been the goal of government's policy since late sixties.

Financial inclusion or taking banking services to the common man was the main driver of bank nationalization in 1969 and 1980 powered by three priority areas

- access to banking
- access to affordable credit, and
- access to free face-to-face money advice.

Thus, financial inclusion is the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. The Government of India's rationale for creating Regional Rural Banks (RRBs) in the years in 1975 following the nationalization of the country's banks was to ensure that banking services reached poor people.

The branches of commercial banks and the RRBs grew from 8,321 in 1969 to about 70,000.

Priority sector credit under which 40% of all bank advances should go to certain specified areas like agriculture is a form of directed credit that is aimed at financial inclusion.

Micro-finance(savings, insurance and lending in small quantities) and self-help groups are another innovation in financial inclusion.

Differential rate of interest; kisan credit cards;no-frills account (allowing opening of account with very little or no minimum balances)etc are examples of financial inclusion.

Scaling-up access to finance for India's rural poor, to meet their diverse financial needs (savings, credit, insurance, etc.) through flexible products at competitive prices is the goal of financial inclusion.

The total number of no-frill accounts opened over a two-year period (April 1, 2007 to May 30, 2009) stands at 25.1 million.

While it is beyond doubt that financial access of the people has significantly improved in the last three-and-a-half decades, and even more so in the last two years, the focus now should be on how to accelerate it as financial inclusion is important for economic growth, equity and poverty alleviation.

Unique identification number has some advantages for financial inclusion

KYC (know your customer) bottlenecks will be dramatically reduced. Millions of new customers will become bankable. Growth will get a boost. Risk management will undergo a paradigm shift. Credit histories will be available on tap. Profitability will improve and so will customer service. We could finally have a technology initiative to extend financial inclusion .

Bank consolidation

Merging public sector banks to form big and globally aspiring banks is bank consolidation. It is expected to bring about financial stability and was recommended by the Narasimham Committee-II (1997) on financial sector reform.

State Bank of Saurashtra's merger with SBI has been achieved and the remaining six are to be merged. Government says that bigger banks can take on competition; can raise more than smaller banks;

Rationalising the manpower and branch network after bank mergers is a challenge and the criticism also includes that the bigger banks will be so much more bureaucratized. Bigness also does not reduce chances of failure as seen in the west in the current meltdown.

India has more than 175 commercial banks, out of which 26 state-owned banks account for the majority of the banking sector's assets followed by private sector banks and foreign banks, which have a tiny share.

Financial stability

Financial stability is a situation where the financial system operates with no serious failures or undesirable impacts on development of the economy as a whole, while showing a high degree of resilience to shocks.

Financial stability may be disturbed both by processes inside the financial sector leading to the emergence of weak spots like excessive of leverage; dealing in doubtful products like collateralized debt options(CDS) etc. It can also be undermined through regulatory lapses and inadequate safeguards prescribed by law.

In India, the banking system was not impacted badly by the world financial crisis as Indian banks are well-regulated through proper supervision. They are also well capitalized through capital adequacy ratio according to the Bank of International Settlements(Basel, Switzerland).

Calibrated globalization also meant that we would open upon only on achieving the strength to compete successfully.

RBI and Financial Stability

Traditional role

Recent global financial crisis is largely attributed to the financial sector recklessness due to lack of quality regulation. The lesson to draw from the crisis is to provide for good regulation- need not be more regulation- by the Central bank so that there is financial stability. In India, RBI has performed the role by the following instruments

- Licensing of banks
- Deciding on who can set up a bank, expand etc
- SLR, CRR norms
- CAR rules
- Lender of last resort
- Laying down prudential norms
- Supervisory functions

RBI Governor heads the HLCC- High Level Coordination Committee of financial regulators of SEBI, PFRDA and IRDA.

RBI defines from time to time NPA norms; allows or limits or banks credit to certain sectors like real estate in order to make banking operations safe and stable. Interest rates are also changed through repo and reverse repo rates to caution the borrowers and consumers.

Post-Lehman

Maintaining and monitoring financial stability has always been a key objective of monetary policy. However, it was only from the middle of 2009(post-Lehman) that the government and the RBI sought to institutionalise the process, making financial stability "an integral driver of the policy framework."

RBI tracks the following parameters in its quest to maintain financial stability: excessive volatility in interest rates, exchange rates and asset prices; signs of excess leverage(borrowings) in the financial sector, companies and households; and the unregulated parts of the financial sector.

RBI set up a Financial Stability Unit in 2009 and started presenting periodical reports since March 2010. The first report found the banking system to be broadly healthy and well-capitalised, but noted that global economic shocks, inflation, the slow pace of fiscal consolidation and the unsettlingly large capital inflows posed significant risks to financial stability. According to the second FSR, many of the positive features are intact. Growth has rebounded strongly and the financial conditions are stable. Despite intermittent volatility in the foreign exchange and equity markets, the financial sector has been risk-free. New risk assessment measures are introduced by the RBI — such as the Financial Stress Indicator and the Banking Stability Index .

Risks to financial stability are : the widening current account deficit; volatile capital inflows and the persistently high inflation.

The asset quality of banks and their asset-liability mismatch need to be constantly monitored.

Recent developments in the microfinance institutional structure cause serious concern.

Given the increasing correlation between global economic growth and that in emerging markets, the possibility of certain exogenous risks materialising is strong.

Banking Stability Index

It has been devised by the RBI in 2009. This index is simple average of five sub indices chosen for banking stability map that RBI has constructed. Banking Stability Map has used five key risk dimensions like operational efficiency, asset-quality, liquidity and profitability. These are based on capital adequacy ratio, cost-to-income ratio, nonperforming loans to total loans ratio, liquid assets to total assets ratio and net profit to total assets ratio.

Toxicity Index etc : RBI

For the purpose of assessing the systemic importance of individual banks, the probability of a bank causing distress to another bank or being affected by the distress of another bank have been analysed through the construction of Toxicity index and vulnerability index for each bank.The probability of a distressed bank causing distress to another bank in India's financial system needs study so that financial stability can be protected and promoted. Vulnerability Index quantifies the vulnerability of a bank given distress in the other banks in the system.Another index, called the Cascade Effects, looks at the likelihood of a "domino effect" of banks in the financial system.

The Financial Stress Indicator captures the severity of stress on the financial markets.

Words

PLR

Prime Lending Rate (PLR) is the rate at which banks lend to the best customers. About 15% today.(2009)

Basis point

Changes in interest rates and other variables are expressed in terms of basis points to magnify and express the importance of changes. One basis point is 1% of 1%.

Weak Bank – Narasimham Committe – II

A 'Weak Bank' has been defined by the committee as follows: Where a total accumulated losses of the bank and net NPA amount exceed the net worth of the bank.

Narrow banking

For restoring weak banks to strength, restructuring is needed. Such restructuring is generally attempted by operating the bank(s) as narrow bank(s), among other things. Narrow banking would restrict banks to holding liquid and safe government bonds. It prevents bank run.

Bank run

A bank run is a type of financial crisis. It is a panic which occurs when a large number of customers of a bank fear it is insolvent and withdraw their deposits.

Subordinated debt

It is also known as junior debt. It is a finance term to describe debt that is unsecured or has a lesser priority than that of other debt claim on the same asset. This means that if the party that issued the debt defaults on it, people holding subordinated debt get paid after the holders of the "senior debt". A subordinated debt therefore carries more risk than a normal debt. Subordinated debt has a higher expected rate of return than senior debt due to the increased inherent risk.

Core banking

Core Banking is normally defined as the business conducted by a banking institution with its retail and small business customers. Many banks treat the retail customers as their core banking customers, and have a separate line of business to manage small businesses. Larger businesses are managed via the Corporate Banking division of the institution. Core banking basically is depositing and lending of money.

World bank recapitalization

Government of India has made an assessment that the public sector banking system would need as much as Rs.35,000 crore worth of Tier-1 capital by 2012, given projections of how much their business needs to expand. Past divestment of equity has significantly reduced the government's shareholding in many public sector banks. Hence, it is argued, if 51 per cent government ownership has to be maintained to secure the public sector character of these banks, this recapitalisation has to be in the form of new government equity capital. Since the government is strapped for funds for this purpose, it has decided to use this requirement as the basis for opting for a sector-specific $2 billion World Bank loan.

Banks stress tests

A **stress test** is an assessment or evaluation of a bank's balance sheet to determine if it is viable as a business or likely to go bankrupt when faced with certain recessionary and other stress situations- whether it has sufficient capital buffers to withstand the recession and financial crisis. European banks were recently subjected to such stress tests.

Financial sector reforms

Reforming the financial sector - banking, insurance,capital market, pensions- is crucial to make them generate resources; gain efficiencies; innovate new products and serve the economy and people well. It involves adoption of best practices in regulation and other areas like micro finance etc.The need is particularly felt in the wake of the global financial crisis brought about essentially by the financial sector that ruined the real economy related to production.

Some recent initiatives in this sector relate to introduction of private banks and foreign banks being given a level playing field with Government banks; deregulation of interest rates; reduction reserve requirements; pensions system being reformed ; base rate for banks; setting up of Financial Stability and Development Council; business correspondent model for financial inclusion.

There is a need however to improve the regulation of the NBFCs as they borrow from banks and lend which means if they are not properly regulated, the whole financial system is vulnerable.

Crr and slr have been freed from floor and cap to make banking more flexible.

Consolidation of banks is taking place so that benefits of scale can push Indian banks to global heights. State Bank of Saurashtra is merged with SBI and State Bank of Indore is also merged. Bank of Rajasthan has been acquired by ICICI Bank and merged with the latter.

However, in the insurance sector, reforms are still due. The Insurance Laws (Amendment) Bill provides for enhancement of share holdings by a foreign company from 26% to 49%. The Bill is not made into law as there ar differences among the political parties.

Pension Fund Regulatory and Development Authority (PFRDA) Bill that wants r FDI in this sector is also not approved.

The government was finding it difficult to manage its rising pension liability because of the defined-benefit system, under which the pension paid to employee was based on their last salary drawn.

In 2004, it shifted to a defined contribution system, which required employee to save for retirement from their earnings.

Towards this end, it set up a new pension system (NPS) for those joining government service after January 2004 and subsequently set up the Interim Pension Fund Regulatory and Development Authority to oversee the scheme that already managed the retirement savings of lakhs of state and central government employees.

The NPS was later extended to private individuals. The government now hopes to establish the NPS as the premier retirement savings scheme.

The pension bill seeks to give statutory or legal powers to the PFRDA, and set the framework for the regulation of pension fund schemes, including the ones being currently offered.

Debt market: The bond market in India remains limited in terms of nature of instruments, their maturity, investor participation and liquidity.Recent reforms include raising of the cap on investment by foreign institutional investors, or FIIs. Infrastructure debt fund etc.

Regulatory reforms- setting up of the FSDC is crucial for better supervision and clear demarcation of the jurisdiction.

The roadmap for financial sector reforms has been defined by the RH Patil, Percy Mistry & Raghuram Rajan reports.

How Indian banks survived the global crisis

Even though many banks failed and some survived on huge bailouts in the west due to the global financial crisis, Indian banking is almost unscathed for the following reasons

- Public sector banks- 27- dominate
- FDI is 74% in private banks but voting rights are only 10%
- We adopted capital account convertibility in a measured manner
- RBI has been conservative and regulated the banks well. Banks were not allowed to invest in risky instruments like credit default swaps(CDS)
- Basel norms, SLR and CRR levels were well maintained
- Prudential norms also saved the Indian banks from recklessness.

Financial Inclusion

Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth. Financial inclusion means delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The various financial services include credit, savings, insurance and payments and remittance facilities. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes.

NSSO data reveal that 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Further, despite the vast network of bank branches, only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). The poorer the group, the greater is the exclusion.

While financial inclusion can be substantially enhanced by improving the supply side or the delivery systems, it is also important to note that many regions, segments of the population and sub-sectors of the economy have a limited or weak demand for financial services. In order to improve their level of inclusion, demand side efforts need to be undertaken including improving human and physical resource endowments, enhancing productivity, mitigating risk and strengthening market linkages.

JLBs are proposed by the Rangarajan committee on financial inclusion 2008.JLB is like the SHG but is confined to farming operations mainly. A Joint Liability Group (JLG) is an informal group comprising preferably of 4 to10 individuals coming together for the purposes of availing bank loan either singly or through the group mechanism against mutual guarantee. The JLG members are expected to engage in similar type of economic activities like crop production.

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. The committee feels that legislation to regulate the microfinance sector is essential.

Important additional data for financial inclusion

- The first major breakthrough in financial inclusion came through when MYRADA, an NGO working in Karnataka developed the self-help group (SHG) methodology to link the unbanked rural population to the formal financial system through the local bank branches. Thanks to the efforts of the Reserve Bank of India (RBI), Nabard, state governments and numerous civil society organisations , about 8.6 crore households now have access to banking through SHGs. There are 61 lakh saving-linked SHGs with Rs 5,545.6 crore aggregate savings and 42 lakh credit-linked SHGs with loan outstanding of Rs 22,679.8 crore as on March 31, 2009.
- The business correspondent (BC) model advocated by the RBI is another pertinent example of potential frugal innovation in the financial inclusion space. The use of BCs enables banks to extend banking services to the hinterland without setting up a brickand-mortar branch, which is often an unviable proposition. Banks use various types of hand-held devices, (aptly nicknamed microATMs) to authenticate micro-transactions at the BC location and to integrate the same with bank's main database.
- Unique Identification Authority of India (UIDAI

RBI as a regulator (Can be constructed from above)

Basics of Base Rate

What is the base rate (BR)?
It is the minimum rate of interest that a bank is allowed to charge from its customers. Unless mandated by the government, RBI rule stipulates that no bank can offer loans at a rate lower than BR to any of its customers.

How is the base rate calculated?
A host of factors, like the cost of deposits, administrative costs, a bank's profitability in the previous financial year and a few other parameters, with stipulated weights, are considered while calculating a lender's BR. The cost of deposits has the highest

weight in calculating the new benchmark. Banks, however, have the leeway to take into account the cost of deposits of any tenure while calculating their BR. For example, SBI took costs of its 6-month deposits into account while calculating its BR, which it has fixed at 7.5%.

When did the base rate come into force?
It is effective from Thursday, July 1. However, all existing loans, including home loans and car loans, continue to be at the current rate. Only the new loans taken on or after July 1 and old loans being renewed after this date are be linked to BR.

How is it different from bank prime lending rate?
BR is a more objective reference number than the bank prime lending rate (BPLR) -- the current benchmark. BPLR is the rate at which a bank lends to lend to its most trustworthy, low-risk customer. However, often banks lend at rates below BPLR. For example. most home loan rates are at sub-BPLR levels. Some large corporates also get loans at rates substantially lower than BPLR. For all banks, BR will be much lower than their BPLR.

How often can a bank change its BR?
A bank can change its BR every quarter, and also during the quarter.

What does it mean for corporate borrowers?
Under the BPLR system, large corporates who enjoyed rates as low as 4-6% will be hit.

What are its benefits?

Makes the lending rates transparent. Monetary policy changes wil find genuine transmission. Cross subsidation of the corporate at the expense of MSMEs will stop and MSMEs wil get credit more affordably.

What are the exceptions?
Educational loans, export credit, credit to weaker sections can be given at sub-base rate.

Securities and Insurance Laws (Amendment) and Validation Act, 2010

United Linked Invest Plans(Ulips) are the insurance products in which payment is made partly for premium(insurance) and rest of it invested in the capital market like a Mutual Fund investment. It led to jurisdictional disputes between Sebi and Irda. Sebi says that a huge amount of Ulip is invested in stock market. Government promulgated an ordinance to set up a mechanism to regulate such jurisdictional disputes.

Financial sector is inter-related. Banks keep money that is invested in stock market. Insurance companies have stock market related products like Ulips.Pension funds are becoming popular in the stock market. These players can have mutual problems of jurisdiction as seen in the case of Ulips. Therefore, there is a need for a `super regulator'.

Parliament passed a Bill- Securities and Insurance Laws (Amendment) and Validation Bill, 2010 -that provides a mechanism, headed by the finance minister, to resolve disputes between financial regulators as an ad-hoc arrangement. It has representations from the four financial sector regulators and the Finance Ministry- Sebi, Irda, Rbi and Pfrda.

The Act states that the Reserve Bank Governor will be the vice-chairman of the joint committee. The joint body can entertain only jurisdictional issues . Even here, forst the involved parties should settle it between them

However, there were apprehensions expressed by RBI over its autonomy.

The government is still working on a permanent body to settle the inter-regulator disputes such as the SEBI-IRDA turf war.

The criticism is that there is already a Hligh level Coordination Committee with Rbi Governor heading it and there is no need for the current mechanism. It has lead to politicization.

Swabhimaan 2011

The government has launched 'Swabhimaan' – a programme to ensure banking facilities in habitation with a population in excess of 2,000, by March 2012. The programme will use various models and technologies, including branchless banking through business correspondents. The government has decided to pay banks Rs 140 for every no frills account they open as part of the financial inclusion plan.

The initiative would enable small and marginal farmers obtain credit at lower rates from banks and other financial institutions. This would insulate them from exploitation of the money lenders

The government has actually decided to give Rs 500 million to banks fo helping them open no frills accounts in the fiscal year 2011-2012.

Once banking access increases, it is hoped that it enables government subsidies and social security benefits to be directly credited to the accounts of the beneficiaries, enabling them to draw the money from the business correspondents in their village itself.

Given the size of the un-banked population in the country, the ongoing project can be considered a "significant beginning". Only a little more than a third of India's population has access to banking services at present. Among the bank-supported initiatives, self-help groups (SHGs) also have a role to play, the government's FI project is reliant more on Banking Correspondent(BCs) and technology to reduce the capital-intensity of expanding the banking cover.

There should at the same time be focus on financial literacy so as to take full benefit for the inclusion.This is particularly true in a context of rapid development of branchless banking, with newly banked people being exposed to non-bank intermediaries, therefore with no possibility to directly interact with experienced bankers.

Financial inclusion should not only be about reaching high numbers of unbanked or underserved groups. It should equally be about the provision of quality financial services and products. This means that access to safe, adapted, accessible, affordable and usable financial services and products should be offered.

The Insurance Regulatory and Development Authority's (IRDA) latest Annual Report indicates life insurance penetration at just 4.6 per cent and general insurance penetration at 0.6 per cent. Majority of the people do not have bank accounts, and even though RBI mandates have ensured the opening of 50 million no-frills accounts, hardly 11 per cent are active.

Innovations in financial products and technology-based delivery methods can expand the reach of financial services and create new opportunities to provide essential services to the poor. Financial products targeting the poor, such as money transfer services, microloans, microinsurance, or weather and catastrophic risk insurance, micropensions, can all have an important transformative effect. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present stage of development of our country.

One of the key features of the National Rural Livelihoods Mission (NRLM) is to work towards achieving universal financial inclusion, beyond basic banking services to all the poor households, SHGs and their federations. The key lies in linking access to financial services with livelihood options and leveraging the same to achieve poverty eradication. The end purpose of financial inclusion is and must be poverty alleviation.

Priority sector: Nair Committee recommendations

The RBI committee under the current Union Bank Chairman MV Nair has come out with their recommendations on lending to priority sector. It has reviewed the existing guidelines on lending to priority sector categories including agriculture, MSME and export.Its recommendations are

- Priority sector targets for public sector and private sector banks could be retained at the current level of 40% of the net credit to the sector.
- It has recommended severe changes should be made to exposure of foreign banks. Foreign banks' priority sector target should be increased from 32% to 40%.
- 5% of bank's credit to NBFCs could be classified priority sector.
- Lending to gold companies will not be classified as priority sector.
- Special treatment should be given to small and marginal farmers and housing loans below Rs 2 lakhs should be classified under priority sector.

RBI acted on these recommendations

The Reserve Bank of India (RBI) in July 2012 said that foreign banks having 20 or more branches in the country will be brought on par with domestic banks for priority sector targets in a phased manner over a maximum period of five years starting April 1, 2013.

Foreign banks with less than 20 branches will have no sub-targets within the overall priority sector lending target of 32 per cent. This is expected to allow them to lend as per their core competence to any priority sector category.

The RBI said that the revised guidelines aim at implementing the essence of recommendations of Nair Committee without dismantling the established and accepted structure of priority sector lending.

The overall target under priority sector lending is retained at 40 per cent as suggested by the Nair Committee. The targets under direct and indirect agriculture are retained at 13.5 per cent and 4.5 per cent, respectively while refocusing the direct agricultural lending to individuals, self help groups (SHGs) and joint liability groups (JLGs) directly by banks.

The RBI said that loans to micro and small service enterprises up to Rs.1 crore; all loans to micro and small manufacturing enterprises up to Rs.25 lakh and for housing in metropolitan centres above Rs.10 lakh and at other centres Rs.15 lakh would form part of priority sector lending as per the revised guidelines. Loans to food and agro processing units and individuals for educational purposes, including vocational courses up to Rs.10 lakh in India and Rs.20 lakh abroad would also be part of priority sector lending.

Loans for housing projects exclusively for economically weaker sections and low-income groups, provided the cost does not exceed Rs.5 lakh per dwelling unit, loans to distressed farmers indebted to non-institutional lenders, loans to state sponsored organisations for scheduled castes and scheduled tribes, loans to individuals for setting up of off-grid solar and other off-grid renewable energy solutions for households and loans to individuals other than farmers up to Rs.50,000 to prepay their debt to non- institutional lenders would also be part of priority sector lending.

Investments by banks in securitised assets, outright purchases of loans and assignments to be eligible for classification under priority sector provided the underlying assets qualify for priority sector treatment and the interest rate charged to the ultimate borrower by the originating entity does not exceed Base Rate of such bank plus 8 per cent per annum.

Savings bank rate deregulation

The Reserve Bank of India (RBI) in 2011 deregulated savings bank rates .

A savings deposit one where the depositor can earn interest like an FD and can withdraw from the account like a current account.The savings rate was fixed at 3.50% from 2003 to 2011 and waslater raised to 4%.

However, during the period, the RBI changed both repo and reverse repo rates many times but the same was not reflected in the interest rates that the normal household gets. There was a huge gap between savings and term deposit rates. Thus, the depositors in SB account suffered.

After deregulation, it is expected that savings rate would move in tandem with the RBI monetary policy, thus, making the policy more effective.

PUBLIC SECTOR

Evolution, Reforms and Performance

Public sector units in India are wholly or partly owned and controlled by the government. In a public sector enterprise, the majority of equity shares is owned by the government directly or indirectly through governmental institutions and the government has decision making control .Public sector enterprise normally has the following forms of organisational structure

- departmental undertakings
- statutory corporations
- companies registered under the Companies Act 1956
- boards
- cooperatives

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 which also receives their revenues(CFI). 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 , LIC 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 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..

Control Boards are set up to manage government projects- for example, the river valley projects. Bhakra Management Board.

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 .

Government company is one where the government owns 51% or more of the paid up capital, according to Section 617 of the Companies Act 1956.

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

- There are about 240 Central PSUs today (excluding insurance, finance and other companies) providing the country with infrastructure in steel, cement, transport, communication, power and so on.
- 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 ; did not have access to the best of technology ; had excess of manpower ; operated in areas not meant for profit making like FCI ; 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 post higher growth rates for 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 ; 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 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 ownership further in course of time
- 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
- mini –ratnas were taken up for similar reforms
- Maharatnas have been recognized since 2011
- professionalization of boards

As mentioned above, the reforms have paid off and the performance is improved.

PSEs 2012

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 248 CPSEs (excluding 7 Insurance Companies) with a total investment of Rs. 6,66,848 crore today(2012).

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 State Bank of India in the banking sector, Life Insurance Corporation in the insurance sector and 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).

Performance of CPSEs

The turnover of all 220 operating CPSEs stood at Rs. 14,73,319 crore as compared to Rs. 12,44,805 crore in the previous year. During the year 2010-11, the CPSEs earned foreign exchange equal to Rs. 97,004 crore as compared to Rs. 84,224crore in 2009-10. The foreign exchange outgo on imports and royalty, know-how, consultancy, interest and other expenditure, on the other hand, increased from Rs. 4,24,207crore in 2009-10 to Rs. 5,22,577 crore in 2010-11 showing an increase of 23.19%. The total employee strength in CPSEs was 14.44 lakh (excluding casual labours) in 2010-11 as compared to 14.90 lakh in 2009-10. The total strength of the employees in CPSEs has gone down by 45,981 persons due to superannuation, voluntary retirement etc. The salary and wages in all the CPSEs went up from Rs. 87,792 crore in 2009-10 to Rs. 96.210 crore in 2010-11, showing a growth of 9.58%.

Gross sales/turnover of CPSEs has been robust during 2010-11. The turnover of CPSEs (at the aggregate level) increased by 18.36 per cent in 2010-11 over 2009-10 against decline of 2.10 per cent in 2009-10 over 2008-09. There was, moreover, much variation from industry to industry. There was significant decline in turnover of CPSEs belonging to industries like medium & light engineering, transportation equipment and telecommunications services.

The profit of profit making CPSEs stood at Rs. 1,13,770 crore in 2010-11 compared to Rs. 1.08,434 crore in 2009-10. The loss of loss making CPSEs, on the other hand, was Rs. 21,693 crore in 2010-11 compared to Rs. 16,231 crore in 2009-10. At the aggregate level, the net profit of all CPSEs (aggregate net profit- aggregate net loss) stood at Rs. 92,077 crore in 2010-11 compared to Rs. 92,203 crore during 2009-10.

The best results were achieved by the 'mining' sector with 22.32 per cent growth in profit over the previous year. This was followed by 12.97 per cent growth in profits achieved by electricity sector. The 'services' sector suffered a loss of Rs. 7,639 crore during 2010-11, which was higher than the loss of Rs. 3,279 crore in 2009-10. This was mainly due to the loss suffered by Air India Ltd. in both these years. In the other industry groups, CPSEs belonging to transport services, telecommunication services and consumer goods were equally under stress, and their losses increased during 2010-11. Under the manufacturing sector, steel petroleum and textile showed a decline in profits. CPSEs belonging to medium and light engineering industries, suffered losses during the year in comparison to profit in the previous year. CPSEs in the chemicals & pharmaceuticals sectors, on the other hand, reduced their losses during 2010-11.

Oil & Natural Gas Corporation Ltd., NTPC Ltd., and Indian Oil Corporation Ltd have ranked first, second and third CPSEs respectively amongst the top ten profit making CPSEs. They are followed by NMDC Ltd., Bharat Heavy Electricals Ltd., Steel Authority of India Ltd., Coal India Ltd., GAIL(India) Ltd., Oil India Ltd. and Power Grid Corporation of India Ltd. All the top ten profit making companies are, more or less same in 2010-11 as in 2009-10 (with ranking slightly changed) except for Power Grid Corporation that has replaced the Power Finance Corporation.

Amongst the loss making companies, Air India Ltd., Bharat Sanchar Nigam Ltd. and Mahanagar Telephone Nigam Ltd. were the top three loss making enterprises during 2010-11. They are followed by Hindustan Photo Films Manufacturing Co. Ltd., Indian Drugs & Pharmaceuticals Ltd., Hindustan Cables Ltd., Fertilizer Corporation of India Ltd., Air India Charters Ltd., Hindustan Fertilizer Corporation Ltd. and ITI Ltd. The top ten loss making Companies covered nearly 92.55% of the total loss made by all the (62) CPSEs during the year. The top three CPSEs namely Air India Ltd., BSNL and MTNL alone have incurred a loss equal to 74% of the total loss of all CPSEs in 2010-11. Intense price war and cut-throat competition from new entrants, increase in salary & wages and increase in operating cost as well as increase in interest cost contributed to greater losses during the year. While the loss of Air India and MTNL have gone up by 24% and 54% respectively, the loss of BSNL increased by 145% in 2010-11 over 2009-10.

The share of 'gross value addition' in CPSEs (net value addition + depreciation) in Gross Domestic Product (at current market price) stood at 5.96 per cent in 2010-11 against a share of 6.44 per cent in 2009-10.

CPSEs contribute to the Central Exchequer by way of dividend payment, interest on government loans and payment of taxes and duties. There was, however, a significant increase in the total contribution of CPSEs to the central Exchequer during the year, which increased from Rs. 1,39,918 crore in 2009-10 to Rs. 1,56,124 crore in 2010-11. This was, furthermore, primarily due to increase in contribution towards 'customs duty' and 'excise duty' which increased from Rs. 6,896 crore and Rs. 52,627 crore in 2009-10 to Rs. 14,151crore and Rs. 62,713 crore respectively in 2010-11. There was a significant increase in contribution from corporate taxes as well, which went up from Rs. 38,134 crore in 2009-10 to Rs. 43,369 crore in 2010-11.

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.

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 is 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 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 prem ium). 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.

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 2012, Rs.1.3 lakh crores were raised totally since 1992. In 2010-11, government raised Rs.22,400 crores.(Given at the end)

Divestment Policy

Elements of the policy since 2009 are

- List all unlisted public sector enterprises and sell a minimum of 10 percent of equity to the public, the survey stated.
- It also called for completing the process of offloading 5-10 percent equity in previously identified profit making non-Navratna companies.

- According to the survey, the targeted revenue generation from divestment should be Rs.25,000 crore annually.
- Auction all loss making PSUs that cannot be revived, it added

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.

Details of the disinvestment proceeds till 2012are given at the end.

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
- Profit-making PSUs will not be privatized
- List the unlisted companies
- Making shares available to a wider section of the public
- Restructure and revive potentially viable PSUs;
- Close down PSUs which cannot be revived;
- 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.

Disinvestment 2012

For the fiscal year 2012-13, GOI set disinvestment target of Rs.30,000 crore.For the current fiscal, the Department of Disinvestment (DoD) has about 15 state-owned undertakings in the pipeline for equity stake sale. Among them are a slew of blue chip companies such as BHEL, SAIL, RINL, Oil India and HAL. This apart, two other sell-off modes made available by market regulator SEBI (Securities and Exchange Board of India) since January 2012: OFS (offer for sale) and IPP (Institutional Placement Programme) .

These two stake sell-off tools can be utilised by listed companies to meet the minimum public shareholding norm, as stipulated by SEBI by mid-2013.

As of now, there are over a dozen listed public sector undertakings which have to meet the minimum public holding norm of 10% set by SEBI and several public sector undertakings have initiated the exercise to raise the public shareholding ratio.

The finance ministry in 2009 had directed all listed firms to mandatorily enhance public shareholding to a minimum of 25% by 2013 and for the PSEs, it is 10%.

The new routes – IPP an OFS- signify faster, cheaper and safer methods of raising money for promoters.

Through the IPP route, listed firms can increase their public shareholding .IPPs can be used for both fresh issuance of capital and dilution of stakes by the promoters. This route can be used to offer shares only to qualified institutional buyers (QIBs) and at least 25% has to be reserved for mutual funds and insurance firms.

The second route—the offer for sale of shares through stock exchanges—is like selling shares on the exchanges through auction. The stock exchanges will offer a separate window for such share .Under this method, the issuer company has to offer at least 1% of its paid-up capital worth a minimum of Rs. 25 crore. Only the promoters will be allowed to offer shares for sale. The bidders will be required to pay 100% margin in cash upfront against every buy order.

Buyback and cross holdings

Cash rich companies buy back their own shares from the secondary market to help shareholders and share market. So far PSEs have not don buyback. But in 2012, GOI gave active consideration to the idea. Government in 2012 permitted public sector companies sitting on cash to buy back their own shares, a move that is expected to help the Centre raise more funds in the coming months. Public sector companies have the option of using their cash for investment and capex or buyback their own shares- in this case from the government, the promoter. The buyback route is useful for the government to meet its target for disinvestment.Under the buyback mode, the government can raise money by selling its equity in the company to the PSU itself.

To facilitate the disinvestment process, the Sebi Board in January 2012 had relaxed the norms for buyback of shares. It would help the companies to complete the process of selling shares within 1-1.5 months , as against the normal process which can take months.

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.

ETF

GOI is also considering exchange traded fund (ETF) route for selling shares of state-owned firms as part of steps to meet the disinvestment target.Divested shares can make up an ETF that can be listed on the exchange and can be traded upon by those who have the shares related to the ETF.

Board for Reconstruction of Public Sector Enterprises (BRPSE)

Government is committed to a strong and effective public sector; undertake measures for strengthening, modernizing, reviving, and restructuring of public sector enterprises; and in pursuit of the above, decided to establish a Board for Reconstruction of Public Sector Enterprises (BRPSE) to address the above mentioned tasks and advise the Government on strategies, measures and schemes related to them. The Board was set up in 2004

Following are the terms of reference to the Board:

- To advise the Government on ways and means for strengthening public sector enterprises in general and making them more autonomous and professional;
- To consider restructuring - financial, organizational and business (including diversification, joint ventures, seeking strategic partners, merger and acquisition) - of CPSEs and suggest ways and means for funding such schemes;
- To advise the Government on disinvestment/closure/sale, in full or part, in respect of chronically sick/loss making companies which cannot be revived. In respect of such unviable companies the Board would also advise the Government about sources of fund including sale of surplus
- assets of the enterprise for the payment of all legitimate dues and compensation to workers and other costs of closure;

- To monitor incipient sickness (incurring loss for two consecutive years) in CPSEs; and
- To make recommendations and advise the Government on such other matters as may be assigned to it from time to time.

All sick CPSEs will be referred to the Board for revival/ restructuring.

The recommendations of the Board are advisory in nature.

BRPSE which is an advisory body to advise the Government on the strategies, measures and schemes related to strengthening, modernizing, reviving and restructuring of public sector enterprises, comprises of a Chairman, three Non-official Members, three Official Members and three Permanent Invitees.Dr. Nitish Sengupta has been appointed as Chairman in the rank of Minister of State.

Navaratna and Miniratna 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. Many more CPSEs were made navaratnas since then. Totally, there are 16 (2012)

1. Bharat Electronics Limited
2. Bharat Heavy Electricals Limited
3. Bharat Petroleum Corporation Limited
4. GAIL (India) Limited
5. Hindustan Aeronautics Limited
6. Hindustan Petroleum Corporation Limited
7. Mahanagar Telephone Nigam Limited
8. National Aluminium Company Limited
9. National Mineral Development Corporation Limited
10. Neyveli Lignite Corporation Limited
11. Oil India Limited
12. Power Finance Corporation Limited
13. Power Grid Corporation of India Limited
14. Rashtriya Ispat Nigam Limited (Vizag Steel)
15. Rural Electrification Corporation Limited
16. Shipping Corporation of India Limited

The government is likely to accord the coveted status to Engineers India Limited, which is under consideration.

A new company Rashtriya Ispat Nigam Limited (RINL) in Visakhapatnam was formed in 1982. Visakhapatnam Steel Plant was separated from SAIL and RINL was made the corporate entity of Visakhapatnam Steel Plant in April 1982.

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 6 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 6 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.

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.

Category I

- Airport Authority of India
- Balmer Lawrie & Co. Limited
- Bharat Dynamics Limited
- BEML Limited
- Bharat Sanchar Nigam Limited
- Bridge & Roof Company (India) Limited
- Central Warehousing Corporation
- Central Coalfields Limited
- Chennai Petroleum Corporation Limited
- Cochin Shipyard Limited
- Container Corporation of India Limited
- Dredging Corporation of India Limited
- Engineers India Limited

- Ennore Ports Limited
- Garden Reach Shipbuilders & Engineers Limited
- Goa Shipyard Limited
- Hindustan Copper Limited
- Hindustan Latex Limited
- Hindustan Newsprint Limited
- Hindustan Paper Corporation Limited
- Housing and Urban Development Corporation
- India Tourism Development Corporation
- Indian Railway Catering and Tourism Corporation
- IRCON International
- Kudremukh Iron Ore Company Ltd.
- Mazagon Dock Limited
- Mahanadi Coalfields Limited
- MOIL Limited
- Mangalore Refinery and Petrochemicals Limited
- Mishra Dhatu Nigam
- Minerals and Metals Trading Corporation of India
- MSTC Limited
- National Fertilizers Limited
- National Seeds Corporation
- Neyveli Lignite Corporation
- NHPC Limited
- Northern Coalfields Limited
- Numaligarh Refinery Limited
- Rashtriya Chemicals & Fertilizers Limited
- RITES Limited
- Satluj Jal Vidyut Nigam
- Security Printing and Minting Corporation of India Limited
- South Eastern Coalfields Limited
- State Trading Corporation of India Limited
- Tehri Hydro Development Corporation Limited
- Telecommunications Consultants (India) Limited

- Western Coalfields Limited
- Water & Power Consultancy (India) Limited

Category II

- Bharat Pumps & Compressors Limited
- Broadcast Engineering Consultants (I) Limited
- Central Mine Planning & Design Institute Limited
- Educational Consultants (I) Limited
- Engineering Projects (I) Limited
- Ferro Scrap Nigam Limited
- HMT (International) Limited
- HSCC (India) Limited
- India Trade Promotion Organization
- Indian Medicines Pharmaceuticals Corporation Limited
- M E C O N Limited
- National Film Development Corporation Limited
- P E C Limited
- Rajasthan Electronics & Instruments Limited

Maharatnas

The category of PSEs was created in 2010.

Five companies have been granted the status, providing them greater financial and operational autonomy.
The five state-owned units which were accorded the status were
ONGC , NTPC , IOC , SAIL and CIL . BHEL and GAIL are the other two PSUs which have applied for the status.

To be eligible for the grant of the Maharatna status, the company should have an average turnover of over Rs 25,000 crore, average annual net worth of more than Rs 15,000 crore and average annual net profit of over Rs 5,000 crore during the last three years.

Besides, it should be a Navratna firm, should be listed on the Indian Stock Exchange with minimum prescribed public shareholding under the SEBI regulations and have global presence.

Once a company gets the Maharatna status, its board would not be required to take the government's permission for investments up to Rs 5,000 crore in a joint venture project or wholly-owned subsidiary.For the Navratna companies, the limit is Rs 1,000 crore.

The main objective of the Maharatna scheme is to empower mega-Central public sector enterprises to expand their operations and emerge as global giants.

Ad-hoc Group of Experts (AGE) Report

The Report on Empowerment of Central Public Sector Enterprises, prepared by a group of experts headed by Arjun Sengupta, recommended

- 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, mininavatnas, 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.

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

- BRPSE is set up as an advisory body
- National Investment Fund is set up
- more companies given navaratna and mini ratna status to improve their performance in the global competitive environment
- infusion of equity and debt capital in PSEs to turn them around and strengthen them

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

(Given above in detail)

Professionalisation of PSU Boards

Following are the steps taken

- 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

Problems and Prospects of 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-averse 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.

Non Commercial Activities

PSUs are expected to function on commercial consideration but are burdened with takeover of some sick/potentially sick unit.

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.

NIF

In 2005, it was decided that National Investment Fund would be set up. It was set up in 2007.

Objectives of NIF are

- The proceeds from disinvestment of CPSUs will be channelised into NIF, which is to be maintained outside the Consolidated Fund of India.
- NIF will be professionally managed to provide sustainable returns to the Government, without depleting the corpus. Selected Public Sector Mutual Funds will be entrusted with the management of the corpus of NIF.
- 75% of the annual income of NIF will be used to finance selected social sector schemes, which promote education, health and employment. The residual 25% of the annual income of the Fund will be used to meet the capital investment requirements of profitable and revivable CPSUs that yield adequate returns, in order to enlarge their capital base to finance expansion/diversification.

Use of Disinvestment Proceeds

The income from the Fund is to be used for the following broad investment objectives:

- 75% to finance selected social sector schemes, which promote education, health and employment
- 25% to meet the capital investment requirements of profitable and revivable CPSEs that yield adequate returns, in order to enlarge their capital base to finance expansion/diversification

However, in view of the difficult economic situation caused by the global slowdown of 2008-09 and a severe drought in 2009, GOI decided to give a one-time exemption to utilization of proceeds from disinvestment of CPSEs for a period of three years, till 2012 – i.e. disinvestment proceeds during this period would be available in full for meeting the capital expenditure requirements of selected social sector programmes decided by the Planning Commission/Department of Expenditure. It has been further extended to 2014.

Accordingly disinvestment proceeds are being routed through NIF to be used in full for funding capital expenditure under the following social sector programmes of the Government:-

- Mahatma Gandhi National Rural Employment Guarantee Scheme
- Indira Awas Yojana
- Rajiv Gandhi Gramin Vidyutikaran Yojana
- Jawaharlal Nehru National Urban Renewal Mission
- Accelerated Irrigation Benefits Programme
- Accelerated Power Development Reform Programme

NIF Chief Executive Officer (CEO), who is administratively attached to the Department of Disinvestment under the Finance Ministry, would formulate the investment strategy.

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.

Top 10 PSUs by market cap 2012 August

Company	Market Capitalisation (Rs.crore)
OIL & NATURAL GAS CORP.LTD.	2,44,515.91
COAL INDIA LTD.	2,26,946.97
NTPC LTD.	1,29,536.25
NMDC LTD.	74,298.78
MMTC LTD.	69,700.00
INDIAN OIL CORP.LTD.	65,603.28
POWER GRID CORP.OF INDIA LTD.	54,885.39
BHARAT HEAVY ELECTRICALS LTD.	52,794.73
GAIL (INDIA) LTD.	44,891.42
STEEL AUTHORITY OF INDIA LTD.	35,357.30

CPSEs listed on the BSE/NSE (2012)

1. OIL & NATURAL GAS CORP.LTD.
2. COAL INDIA LTD.
3. NTPC LTD.
4. MMTC LTD.
5. BHARAT HEAVY ELECTRICALS LTD.
6. NMDC LTD.
7. INDIAN OIL CORP.LTD.
8. STEEL AUTHORITY OF INDIA LTD.
9. GAIL (INDIA) LTD.
10. POWER GRID CORP.OF INDIA LTD.
11. POWER FINANCE CORP.LTD.
12. NHPC LTD.
13. OIL INDIA LTD.
14. HINDUSTAN COPPER LTD.
15. RURAL ELECTRIFICATION CORP.LTD.
16. NATIONAL ALUMINIUM CO.LTD.
17. BHARAT PETROLEUM CORP.LTD.
18. NEYVELI LIGNITE CORP.LTD.
19. CONTAINER CORP.OF INDIA LTD.
20. BHARAT ELECTRONICS LTD.
21. HINDUSTAN PETROLEUM CORP.LTD.
22. MANGALORE REFINERY & PETROCHEMICALS LTD.
23. ENGINEERS INDIA LTD.
24. SJVN LTD.
25. MOIL LTD.
26. RASHTRIYA CHEMICALS & FERTILIZERS LTD.
27. NATIONAL FERTILIZERS LTD.
28. SHIPPING CORP.OF INDIA LTD.,THE
29. HMT LTD.
30. BEML LTD.
31. CHENNAI PETROLEUM CORP.LTD.
32. FERTILIZERS & CHEMICALS TRAVANCORE LTD.
33. MAHANAGAR TELEPHONE NIGAM LTD.
34. STATE TRADING CORP.OF INDIA LTD.,THE
35. DREDGING CORP.OF INDIA LTD.
36. ITI LTD.
37. ANDREW YULE & CO.LTD.
38. BALMER LAWRIE & CO.LTD.
39. INDIA TOURISM DEVELOPMENT CORP.LTD.
40. MAHARASHTRA ELEKTROSMELT LTD.
41. HINDUSTAN PHOTO FILMS MFG.CO.LTD.
42. BALMER LAWRIE INVESTMENTS LTD.
43. HINDUSTAN ORGANIC CHEMICALS LTD.

44. MADRAS FERTILIZERS LTD.
45. IRCON INTERNATIONAL LTD.
46. SCOOTERS INDIA LTD.
47. BHARAT IMMUNOLOGICALS & BIOLOGICALS CORP.LTD.
48. HINDUSTAN FLUOROCARBONS LTD.
49. KIOCL LTD.
50. HINDUSTAN CABLES LTD.

Disinvestment through Public Offers-Highlights

- CPSEs constitute 20.4% and 20.9% of the total market capitalisation of companies listed at BSE and NSE respectively (as on 31 July 2012)
- The CPSE with the highest market capitalisation is Oil & Natural Gas Corp.Ltd. at Rs. 2,44,516 crore (BSE) and Rs. 2,44,730 crore (NSE) (as on 31 July 2012)
- VSNL was the first CPSE to be divested by way of a Public Offer in 1999-00
- ONGC Public Offer in 2003-04 has been the largest CPSE FPO, raising Rs. 10,542 crore
- Coal India Public Offer in 2010-11 has been the largest CPSE IPO, raising Rs. 15,199 crore
- The maximum number of applications received in a PSU IPO/FPO since 2003-04 was in CIL (15.96 lakhs)
- Total disinvestments proceeds from CPSE Public Offers in the Current Financial Year is Rs. 1144.55 crore (as on 14 August 2012)

Disinvestment 2010-2012

Year	Target	Actual					
2010-11	40,000.00	22,144.20	-	-	-	-	SJVN, EIL, COAL INDIA ; PGCIL ; MOIL SCI
2011-12	40,000.00	13,894.05	-	-	-	-	PFC, ONGC
2012-13	30,000.00	124.97	-	-	-	-	NBCC

Till 2012, Rs.1.13 lakh cores have been raised through disinvestment.

Money Market and Capital Market in India:Instruments and Details

Part-1

Money market covers sources of finance - lending and borrowing short term funds- funds with a maturity of less than one year. 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

Call/Notice money is money borrowed or lent for a very short period. If the period is more than one day and upto 14 days it is called 'Notice money' otherwise the amount is known as Call money'. No collateral security is required to cover these transactions. The call market enables the banks and institutions to even out their day to day deficits and surpluses of money.

Commercial banks, Co-operative Banks, mutual funds , primary dealers and others are allowed to borrow and lend in this market Interest rates in the call and notice money market are market determined.

Treasury Bills

Treasury bills are short-term money market instruments, which are issued by the RBI on behalf of the GOI. The GOI uses these funds to meet its short-term financial requirements of the government. T-Bills are sovereign zero risk instruments . They are available in primary and secondary market; issued at a discount to face value i.e., investors may buy the T-bill at discount to face value of Rs.100 and on maturity the face value of Rs.100 is received by the investor.

There are T-Bills of 14 days, 91 days, 182 days and 364 days maturity. Minimum investment required in case of T-Bills is Rs 25,000.

A considerable part of the government's borrowings takes place through T bills of various maturities. The usual investors in these instruments are banks, insurance companies and FIs.

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

After treasury bills, the next lowest risk category investment option is the certificate of deposit (CD) issued by scheduled commercial banks and FIs. Regional rural banks and Local area banks can not issue CDs.

Allowed since 1989, a CD is a negotiable promissory note, secure and short term (upto 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. CDs can be issued by scheduled commercial banks and select all-India Financial Institutions. 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 corporates 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).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
- CP can be issued for a minimum period of 7 days and a maximum up to one year.
- Minimum amount invested by single investor is Rs.five lakhs or multiple thereof.
- CPs are issued at a discount to face value.

Ready Forward Contracts (Repos)

See Chapter on Monetary Policy

Commercial Bills

Bills of exchange are negotiable instruments drawn by the seller (drawer) of the goods 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. If the bill is payable at a future date and the seller needs money immediately, he may approach his bank for discounting the bill.

Discount and Finance House of India (DFHI)

Set 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:

1. dealing in Treasury Bills
2. re-discounting short term commercial bills.
3. participating in the inert bank call money, notice money and term deposits and
4. Dealing in Commercial Paper and Certificate of deposits.
5. Government dated Securities

Money Market and Capital Market in India:Instruments and Details

Part-2

Capital Market

It refers to market for funds with a maturity of 1 year and above, refered to as term funds that includes 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 like ICICI, IDBI etc; mutual funds like UTI are the main participants in the market.The elements 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(please refer to the section on stock 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)

Government securities, or G-Secs as they are popularly known, are securities issued by the RBI on behalf of the Government of India to meet the latter's borrowing programme for financing fiscal deficit. 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-Secs have a maturity period ranging from one to 30 years and they carry a coupon rate (interest rate) which is paid semi-annually. They 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.

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 wholesale price index. Redemption is linked to the wholesale price index.

Capital Index Bond (CIB), 2002 was issued in 1997 where only principal repayments at the time of redemption were indexed to inflation. A new version of IIB has been designed with protection from inflation to both interest payments and principal repayments linking them to Wholesale Price Index (WPI) by the RBI and may be issued(2012).

2012 reforms in G-Secs

The existing limit for investment by Securities and Exchange Board of India (SEBI) registered foreign institutional investors (FIIs) in Government securities (G-Secs) has been enhanced by a further amount of $5 billion. This would take the overall limit for FII investment in G-Secsfrom $15 billion to $20 billion.Part of the debt may be for infrastructure.

RBI has decided to allow long term investors like Sovereign Wealth Funds (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks to be registered with SEBI, to also invest in G-Secs.

Lock in periods and residuary limits are also relaxed.

FII debt is rupee debt and so is welcome.

DFIs or Development Banks

Financial institutions assume a critical role in the provision of long term credit, especially in the absence of a well-developed long-term debt market. The financial institutions could be categorised into three broad heads, viz., all-India financial institutions (AIFIs), state-level institutions and other institutions. Of the three categories, AIFIs are the most dominant in terms of assets and range of operations.

The major AIFIs are the Industrial Development Bank of India (IDBI), IFCI Ltd., ICICI 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), Unit Trust of India (UTI), Life Insurance Corporation of

India (LIC), General Insurance Corporation of India (GIC) and its subsidiaries and 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 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.

Mutual Funds

Mutual funds raise money from public and invest them in stock market securities; bonds etc.Mutual funds were virtually synonymous with the Unit Trust of India(UTI) till two decades ago when India witnessed financial sector liberalization and many more public sector and private mutual funds came up. SEBI regulates mutual funds.

SEBI Reforms August 2012

Two important reforms are made to boost the MF sector:

- Firstly, if the mutual fund industry goes into areas other than the top 15 cities and enlists subscribers , there are some incentives
- Secondly, the retail (individual) investor has to pay the service tax and not the fund

Both are welcomed by the MF industry. The first one helps get more investors and thus helps markets and savings in the country while the latter makes the MFs expensive for the investor though it is good for the industry.

Hedge fund

Hedge fund is an MF though it is limited to few; non-transparent and is not regulated. The investment styles of the HFs are also criticised as they are not safe and aim at fast returns thus creating volatility in the markets. SEBI does not allow them.

Venture Capital

Venture capital is money provided by financial institutions who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture capital is an important source of equity for start-up companies.

Angel Investors

Individuals who invest in businesses looking for a higher return than possible from traditional investments. They invest their own money unlike a venture capitalist who invests public money. They became popular in recent years after the web-based enterprises came up in the 1990's.

QIPs

The QIP Scheme is open to investments made by "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) in any issue of equity shares/ fully convertible debentures/ partly convertible debentures or any securities which are convertible into or exchangeable with equity shares at a later date (Securities).

Since the beginning of 2009, Indian companies are raising billions of dollars from the QIP route.

NBFC

A company is treated as an NBFC if its financial assets are more than 50% of total assets and income from financial assets is more than 50% of the gross income

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, 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.

The Reserve Bank of India (RBI) in 2011 approved creation of a separate category of non-banking financial companies for the MFI sector and specified that such institutions need to have a minimum net owned fund of Rs 5 crore.

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)..

NBFC factor

The Reserve Bank of India (RBI) in mid-2012 introduced a new category called Non-Banking Financial Company-Factors. Under this new class, a company has to seek registration from the regulator with a minimum net owned fund (capital + reserve) of Rs 5 crore.Thus, RBI takes another step to tighten regulations for non-banking finance companies. 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. In India, it is still at a nascent stage. So far, there are around 10 'factors' including SBI Factors and Commercial Services, Canbank Factors, HSBC Factoring and others. Out of all factors, seven or eight companies are on standalone basis. 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.

RBI measure will help expand the factoring industry in India.Earlier in January, 2012; the Parliament had passed a bill on the Factoring Regulations Act, 2011 wherein similar proposal were mentioned. The RBI directives came in line with that.

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. In India, External Commercial Borrowings are being permitted by the Government for providing 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.

ECB access may be restricted when the there is a deluge of foreign inflows and the rupee is getting strong. It may be relaxed when the opposite happens as we have seen since 2009. 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 routse: Automatic Route and the Approval Route. The former does not require permit from the Regulator whereas the latter requires the same. 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. Subsequently, 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.

RBI in June 2012 decided to allow Indian companies to avail of ECBs for repayment of Rupee loan(s) availed of from the domestic banking system and / or for fresh Rupee capital expenditure, under the approval route, subject to them satisfying the following conditions:-

i. Only companies in the manufacturing and infrastructure sector will be eligible to avail of such ECBs;

ii. Such companies shall be a consistent foreign exchange earner during the past three financial years;and

iii. Such ECBs shall only be utilized for repayment of the unpaid Rupee loan(s) availed of for 'capital expenditure' incurred earlier.

The overall ceiling for such ECBs shall be USD 10 (ten) billion. The maximum permissible ECB that can be availed of by an individual company will be limited to 50 per cent of the average annual export earnings realised during the past three financial years.TheECBs will be allowed to companies based on the foreign exchange earnings and its ability to service the ECB.

Policy helps source loans cheap;domesric liquidity constraints are softened;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.

Private equity

In finance, private equity means equity in companies that is privately placed by the management to a finance firm. It generally has a lock in period during which they are not publicly traded on a stock exchange. Bulk private placement is done.Private equity firm also is given a place in the management of the company . Capital for private equity is raised primarily from institutional investors. The term private equity has different connotations in different countries.

Stock Market(Given as a separate chapter)

Apart from the above mentioned sources of capital for Indian companies from within the country, the International Finance Corporation(IFC) of the World Bank(WB) also provides funds for the private sector. (Given in the chapter on Bretton Woods institutions).

Credit Default Swap Q and A

RBI allowed CDSs

What is it?

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 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 that insurance, which is bought by those who fear default.

• What is the economic benefit of CDS?

It is a derivative instrument that transfers risk from investors to those willing to bear it for a fee. By insuring against risks of default, credit default swaps allow riskier companies to raise funds. Also, it improves investment and borrowing opportunities by redistributing risk. Therefore, overall it helps increase credit flow and boost liquidity.

• What are the key concerns?

The third party insurer issuing credit default swaps must have the capital to pay-up in case of debt default. Therefore, the issuers of CDS must be well capitalized and have stringent regulations on their exposure or else in case of a default they will not be able to honour their commitment.

• What role did credit default swaps play in the financial meltdown?

Speculators started buying CDS on even the bonds they did not hold, hoping to make good gains in the case of a default. This kind of CDS is known as naked CDS wherein the buyer doesn't hold the underlying debt. In many cases; such investors were holding CDSs worth much more than underlying debt, betting on the defaults in the US subprime market. And when those defaults did happen, CDSs compounded the problem as the underwriters did not have the capital to honour their commitment.

• How is RBI safeguarding against CDS ills?

CDSs will be subject to strict capital requirements, ensuring that the business is within prudent limits. Second, naked CDS will not allowed in India. Third, insurance can not be higher than the value of the underlying debt. These steps are expected to control speculation on default of bonds, restricting them to their proper use.

Corporate debt

Corporate debt is necessary for their investment, acqusitions etc.

The following are some of the different types of corporate debt securities issued:
Non-Convertible Debentures
Partly-Convertible Debentures

/Fully-Convertible Debentures (convertible in to Equity Shares)
Bonds

FCCBs(See elsewhere in this Chapter)

Bonds are issued to domestic and foreign investors. They are traded on the stock market.

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.

For a variety of reasons, the following relaxations have been affected in 2012 June:

- Limits in G secs raised.
- QFIs allowed to invest with a larger portfolio that includes certain tpes of MFs and corporate debt(read ahead)

RBI has decided to allow long term investors like Sovereign Wealth Funds (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks to be registered with SEBI, to also invest in corporate debt.

Further, Qualified Foreign Investors (QFIs) can now invest in those mutual fund (MF) schemes that hold at least 25 per cent of their assets (either in debt or in equity or both) in infrastructure sector under the current $3 billion sub-limit for investment in mutual funds related to infrastructure.

The terms and conditions for the scheme for FII investment in Infrastructure Debt Funds (IDFs) have been further rationalised in terms of lock-in period and residual maturity.

The liberalisation measures for capital account transactions, besides increasing foreign fund inflows into the country are also likely to check slide of rupee against the US dollar.

It must be noted that even before June 2012, corporate debt investment by FIIs were allowed upto 40 billion dollars. There is a sub limit for infrastructure sector.

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, say 5 years. At the end of five years, the bank could sell the loans to the institution and get it off its books. This ensures that the project gets long-term funding though various participants. Banks otherwise can not lend for infrastructure as their deposits are for a short period and the loans are for a long period- asset liability mismatch.

Infrastructure Debt Funds (IDFs)

The Finance Minister had in his budget speech for the year 2011-2012 announced the setting up of Infrastructure Debt Funds (IDFs), to facilitate the flow of long-term debt into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust based IDF would normally be a Mutual Fund (MF) while a company based IDF would normally be a NBFC. IDF- NBFC would raise resources through issue of either Rupee or Dollar denominated bonds of minimum 5 year maturity. The investors would be primarily domestic and off-shore institutional investors, especially insurance and pension funds which would have long term resources. IDF-MF would be regulated by SEBI while IDF-NBFC would be regulated by the Reserve Bank.

Reliance Mutual Fund, SBI Mutual Fund along with IDBI Mutual Fund, Axis Mutual Fund and L&T Mutual Fund have applied to SEBI. By August 2012, only IDFC has obtained SEBI's approval to start its infrastructure debt fund.

IDF can relieve pressure on banks and can mobilise more savings.

It is also important as in the current 12th Five Year Plan (2012-17), Planning Commission has projected an investment of $1 trillion for infrastructure development.

Stock Market in India

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 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 issuance and sale of shares. In common parlance, however, 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 and does the work of arranging the transfer of stock from a seller to a buyer.

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). Since then we have come a long way. With over 25m shareholders today, India has the third largest investor base in the world after the USA and Japan. 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 are 24 stock exchanges in the country, 21 of them being regional ones with allocated areas. Three others are set up in the reforms era, viz.; National Stock Exchange (NSE), the Over the Counter Exchange of India Limited (OTCEI) and Inter-connected Stock Exchange of India Limited (ISE). Important Stock Exchanges in India are Bombay Stock Exchange, popularly known as BSE and National Stock Exchange located in Bombay. MCX-SX will also begin equity trading in 2014. MCX-SX a joint venture between Financial Technologies India (FTIL) and Multi Commodity Stock Exchange (MCX), n 2012 got the approval of market regulator Securities and Exchange Board of India (SEBI) to operate a full-fledged stock exchange.

Stock Exchanges in India

1. Ludhiana	2. New Delhi	3. Jaipur	4. Meerut
5. Ahmedabad	6. Rajkot	7. Indore	8. Vadodara
9. Bombay	10. Pune	11. Hyderabad	12. Mangalore
13.Bangalore	14. Ernakulam	15. Coimbatore	16. Madras
17. Patna	18. Kanpur	19. Bhubaneshwar	20. Calcutta
21. Guwahati			

BSE

The Bombay Stock Exchange, or BSE) is the oldest stock exchange in Asia located at Dalal Street in Mumbai, India. Established in the year 1875, it is the largest securities exchange in India with more than 6,000 listed Indian companies. BSE is also the fifth largest exchange in the world with market capitalization of US $1.1 trillion(2012).About 5000 companies are listed on the BSE.

Overall performance of BSE is measured using the BSE SENSEX or the BSE 30 index. This index is composed of 30 BSE stocks. These stocks are selected from specified group shares on the basis of market cap, liquidity, depth, trading frequency and industry representation. BSE 30 was introduced in 1986. Apart from BSE 30, there are various other indices used in the BSE:. Some of these include BSE 100, BSE 200, BSE 500, BSE PSU, BSE MIDCAP, BSE SMLCAP etc.

One of the unique features inside 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. BSE contributes phenomenally to the overall economic development and capital markets in India.

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.

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, 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.

National Stock Exchange of India

The National Stock Exchange of India (NSE), is one of the largest and most advanced stock exchanges in India. In the year 1991 Pherwani Committee recommended to establish National Stock Exchange (NSE) in India. In 1992 the Government of India authorized IDBI for establishing this exchange. The National Stock Exchange of India was promoted by leading Financial Institutions and was incorporated in 1992. In 1993, it was recognized as a stock exchange .NSE commenced operations in 1994. It is located in Mumbai, the financial capital of India.

Following financial institutions were the promoters of National Stock Exchange :

- Industrial Development Bank of India(IDBI).
- Industrial Finance Corporation of India(IFCI).
- Industrial credit and Investment corporation of India(ICICI).
- Life Insurance Corporation of India(LIC).

- General Insurance Corporation of India(GIC).
- SBI Capital Markets Limited.
- Stock Holding Corporation of India Limited.
- Infrastructure Leasing and Financial services Limited.

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 21 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

The Inter-Connected Stock Exchange of India Limited (ISE)

The Inter-Connected Stock Exchange of India Limited (ISE) is being promoted by regional stock exchanges to set up a new national level stock exchange. The ISE would provide a national market in addition to the trading facility at the regional stock exchanges.

Indonext

BSE, Federation of Indian Stock Exchanges and regional stock exchanges have promoted IndoNext. The regional stock exchanges that are part of Indonext include Madras Stock Exchange, Bangalore Stock Exchange, Interconnected Stock Exchanges of India, Ludhiana Stock Exchange and Vadodara Stock Exchange. IndoNext is envisaged to bring liquidity and attention to stocks that are listed on RSEs.

Over the Counter Exchange of India(OTCEI)

The OTC Exchange of India (OTCEI) incorporated under the provisions of the Companies Act 1956, is a public limited company. It allows listing of small and medium sized companies. OTCEI is promoted by the Unit Trust of India, Industrial Development Bank of India, the Industrial Finance Corporation of India and others and is a recognised stock exchange .

Global rankings of BSE and NSE

The Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) are among top five bourses across the emerging economies of the world in terms of market capitalisation.Listing out a total of 14 stock exchanges across emerging countries, Sebi said the BSE stood at fourth position and the NSE at fifth among these bourses in terms of cumulative market capitalisation of all The BSE stood at the fourth position with a market cap of $1,101.87 billion as on June 30, 2012.The NSE stood at fifth spot with market valuation at $1,079.39 billion at June-end.

BSE SME and NSE Emerge

Leading bourses 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 kick-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 will provide 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 constraints faced by SMEs, said RK Mathur, micro, small and medium enterprises (MSMEs) Secretary, while launching the BSE platform.

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.

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 scrips. 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

Sebi makes new rules 2009

The Securities and Exchange Board of India (SEBI) approved the "anchor investor" concept under which an investor can subscribe to up to 30 percent of the quota for institutional investors in an initial public offering.Under the new rules, an anchor investor would pay 25 percent of the total investment at the time of applying for the initial public offering, and the balance within two days of the closure of the issue.Such anchor investors would have to adhere to a lock-in period of one month from the date of the share allotment.

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

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 Folllow 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 derivates.

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.

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 corporation's repurchase of stock it has issued. 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.

Rolling Settlement

Rolling Settlements is a mechanism of settling trades. In Rolling Settlements, trades done on a single day are settled separately from the trades of another day on the basis of Trade day + 2 days(T+2). Such netting of trades is done only for the day. As such, in Rolling Settlement, settlement is carried out on a daily basis. Since trades done on a given day can not be bunched with those of another day. Thus, speculation is drastically reduced.

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, Forward Markets Commission allows futures trading in over 120 commodities. There are two types of commodity exchanges in the country: national level and regional. There are five national exchanges:

- National Commodity & Derivatives Exchange Limited (NCDEX)
- Multi Commodity Exchange of India Limited (MCX)
- National Multi-Commodity Exchange of India Limited (NMCEIL)
- ACE Derivatives and Commodity Exchange
- Indian Commodity Exchange (ICEX)

The unique features of national level commodity exchanges are:

- They are demutualized,
- They provide online platforms or screen based trading
- They allow trading in a number of commodities and are hence multi-commodity exchanges.

They are national level exchanges which facilitate trading from anywhere in the country.

In the NCDEX the following contracts are traded

Agricultural Products

- NCDEX Barley
- NCDEX Cashew
- NCDEX Castor Seed
- NCDEX Chana
- NCDEX Chili
- NCDEX Aribica Coffee
- NCDEX Robusta Cherry AB Coffee
- NCDEX Cotton Seed Oilcake
- NCDEX Medium Staple Cotton
- NCDEX Mentha Oil
- NCDEX Mulberry Green Cocoons
- NCDEX Mulberry Raw Silk
- NCDEX Rapeseed - Mustard Seed
- NCDEX Pepper
- NCDEX Potato
- NCDEX Raw Jute

- NCDEX Crude Palm Oil
- NCDEX Expeller Mustard Oil
- NCDEX Groundnut (in shell)
- NCDEX Groundnut Expeller Oil
- NCDEX Guar Gum
- NCDEX Guar Seeds
- NCDEX Gur
- NCDEX Indian Parboiled Rice
- NCDEX Pusa Basmati Rice
- NCDEX Indian Raw Rice
- NCDEX Indian Traditional Basmati Rice
- NCDEX Indian 28.5 mm Cotton
- NCDEX Indian 31 mm Cotton
- NCDEX Jeera
- NCDEX Jute Sacking Bags
- NCDEX Massor Grain Bold
- NCDEX Rapeseed - Mustard Seed Oilcake
- NCDEX RBD Palmolein
- NCDEX Refined Soy Oil
- NCDEX Rubber
- NCDEX Sesame Seeds
- NCDEX Shankar Kapas
- NCDEX Soybean
- NCDEX Sugar
- NCDEX Tur
- NCDEX Turmeric
- NCDEX Urad Desi
- NCDEX V-797 Kapas
- NCDEX Wheat
- NCDEX Yellow Peas
- NCDEX Yellow Red Maize
- NCDEX Yellow Soybean Meal

Precious Metals

- NCDEX Gold
- NCDEX Gold (100 g)
- NCDEX Silver
- NCDEX Silver (5 kg)

Base Metals

- NCDEX Electrolytic Copper Cathode
- NCDEX Aluminium Ingot
- NCDEX Nickel Cathode
- NCDEX Zinc Ingot

Ferrous Metals

- NCDEX Mild Steel Ingots
- NCDEX Sponge Iron

Energy Products

- NCDEX Brent Crude Oil
- NCDEX Furnace Oil
- NCDEX Light Sweet Crude Oil

Polymers

- NCDEX Linear Low-Density Polyethylene
- NCDEX Polypropylene
- NCDEX Polyvinyl Chloride

Carbon Credits

- NCDEX Carbon Credits

FMC

Forward Markets Commission (FMC) headquartered at Mumbai is a regulatory authority, which is overseen by the Ministry of Consumer Affairs and Public Distribution, Govt. of India. It is a statutory body set up in 1953 under the Forward Contracts (Regulation) Act, 1952. The Commission consists of 2-4 members.

It monitors and disciplines the working of the exchanges. It recognizes an exchange or can withdraw such recognition. It collects and whenever the Commission thinks it necessary, publishes information regarding the trading conditions in respect of goods.

It makes inspection of the accounts and other documents of any recognized association or registered association or any member of such association whenever it considerers it necessary.

Forward Contracts (Regulation) Amendment Bill, 2010 was introduced in the Parliament. It seeks to make FMC into a Sebi-like regulator that is independent.

- Forward Markets Commission is at present is a part of the department of consumer affairs. FMC will be given more teeth to regulate exchanges and all market participants.

In addition, the bill proposes to increase the monetary penalty for contravention of the legal provisions to up to Rs 25 lakh from a meagre Rs 1,000 at present.

New products will also be traded.

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.

An open fund issues and redeems shares on demand, whenever investors put money into the fund or take it out.

Closed-ended fund

It is a collective investment scheme issued by a fund. Only a fixed number of shares 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.

The total value of all the securities in the fund divided by the number of shares in the fund is called the net asset value.

FIIs

Foreign institutional investors are organisations which 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.

Foreign individuals are not allowed to participate on their own but go through FIIs.

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.

FIIs called hot money invested in Indian equities and debt about $30 billion in 2010.The number of registered FIIs is 1,660 and that of registered sub-accounts is above the 5,000 mark. 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.

There are more than 1700 FIIs registered in India(2012). The FII's total investments in domestic markets amount to $ 122 billion in debt and equity , since India allowed them to invest here in 1992.In the calendar year 2012 upto July, about 11b dollars of FII came into India.

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.

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 can invest in corporate debt, equities and mutual funds.

The move comes against the backdrop of significant foreign capital outflows from the domestic equity market in recent times, which has resulted in rupee depreciation.

Its aim is to widen the class of investors, attract more foreign funds and reduce market volatility and deepen the Indian capital market.

With regard to foreign portfolio investments, till 2012, only FIIs/sub-accounts and NRIs are allowed to directly invest in the Indian equity market.

The RBI would grant general permission to QFIs for investment under the Portfolio Investment Scheme (PIS) route, similar to FIIs.

The individual and aggregate investment limit for QFIs shall be 5 per cent and 10 per cent, respectively, of the paid-up capital of an Indian company. These limits shall be over and above the FII and NRI investment ceilings prescribed under the PIS route for foreign investment in India, it added.

In mid-2012, government set a separate $1-billion corporate bond investment limit for QFIs. The finance ministry also expanded the list of countries from which such investments will be permitted. A separate sub-limit of $1 billion has been created for QFI investment in corporate bonds and mutual fund debt schemes. The foreign investment limit in corporate debt, which consequently increased by $1 billion to $21 billion will boost debt inflows.

In July 2012, Sebi allowed QFIs to invest in those debt mutual fund schemes that hold atleast 25% of their assets (either in debt or equity or both) in the infrastructure sector.

The scheme was earlier open to only residents of countries that are members of Financial Action Task Force, or FATF, a global body to check money laundering and terror funding.

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.

IOSCO

The **International Organization of Securities Commissions** (IOSCO) is an association of 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.

Investment First

Who are qualified foreign investors (QFIs)?

A resident of a country that is a member of the Financial Action Task Force (FATF) or member of a group which, in turn, is member of this global body against money laundering and terror funding. Resident of a country signatory to International Organization of Securities Commissions (IOSCO) or has signed a bilateral agreement with Sebi.

Where can they invest?

QFIs are now allowed to invest in all the three important segments of capital market – mutual funds, equities and corporate debt

Why has this been done?

India's current account deficit is said to have widened to over 3.6% of GDP

The capital flows needed to fill this current account gap have been muted

With weak appetite for risky assets very low, the government is trying to spur debt flow

to

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 into the select club, 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) as and when they are allowed.

Participatory notes

Participatory notes are instruments used for making investments in the stock markets. In India, foreign institutional investors (FIIs) 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 upto over about 1750(2011).

The SEBI action aims at ensuring that the quality of flows into stock markets and Indian forex market is clean.

Rajiv Gandhi Equity Savings Scheme

It was presented in as a part of the Union Budget 2012-13 for the new investors in stocks with an annual income of less than Rs.10 lakh. He gets 50 percent tax deduction on investments upto Rs 50,000. Money will be locked for three years. Details are still being worked out.

Hedge fund

A hedge fund is an investment fund open to only a limited range of investors. They are mostly unregulated. The term- hedge funds , is used to distinguish them from regulated investment funds such as mutual funds and pension funds, and insurance companies. Hedge funds are not allowed into India as they do not disclose data required by the Sebi.

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.

Bull

Bull is an investor who believes that the market will go up- optimistic

Bear Market

A sustained period of falling stock prices usually preceding or accompanied by a period of poor economic performance known as a recession.

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.

Small investor

Market regulator SEBI set the investment limit for retail investors in an initial share sale offer to Rs 2 lakh. This will cut the numerous applications investors sometimes make in the name of relatives to get more shares.

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.

Primary Dealers

The Reserve Bank of India introduced a system of Primary Dealers (PDs) in government securities market in 1995 with the objective to strengthen the infrastructure in the government securities market in order to make it vibrant, liquid and broad-based. The following can be the PD: subsidiaries of scheduled commercial banks and all India financial institutions and engaged predominantly in securities business and in particular the government securities market; or companies incorporated under the Companies Act, 1956 and engaged predominantly in securities business and in particular the government securities market.;The company should have net owned funds of Rs.50 crore.

Market depth

It is a dimension of market liquidity and it refers to the ability of a market to handle large trade volumes without a significant impact on prices.

Liquidity is the ease to find a trading partner for a given order.

Market breadth means the following: The fraction of the overall market that is participating in the market's up or down move. The greater the breadth, the more the companies that are participating.

Trading volumes means the number of shares traded.

Negotiated Dealing System

Negotiated Dealing System (NDS) is an electronic platform for facilitating dealing in Government Securities and Money Market Instruments.

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.

P/E ratio

Also known as the P/E multiple, this is the latest closing price divided by earnings per share EPS). P/E is perhaps the single most widely used factor in assessing whether a stock is overvalued or cheap. A company's P/E should be looked at against those of similar companies, and against that of the stock market as a whole, since different industries and even different company are characterized by markedly different P/Es. In general, fast-growing technology companies have high P/Es, since the stock price is taking account of anticipated growth as well as current earnings. A high P/E is often a reflection of high expectations for a stock.

EPS

The portion of a company's profit allocated to each outstanding share of common stock. The amount is computed by dividing net earnings by the number of outstanding shares of common stock. For example, a corporation that earned Rs10 million last year and has 10 million shares outstanding would report earnings per share of Rs.1.

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

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
- Japanese Nikkei 225
- Indian Sensex and Nifty
- 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

Ethical investing

A notable specialised index type is those for ethical investing indexes that include only those companies satisfying ecological or social criteria, e.g. those of Dow Jones Sustainability Index.

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 because it is not possible to earn such high reurns on any investment.The system is destined to collapse because the earnings, if any, are less than the payments. 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. 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 itss 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.

IDR

Indian Depository Receipts are issued by a non-Indian company to Indian investors for its listing on Indian stock exchanges. It is like ADR.

Bimal Jalan Committee

SEBI, in January 2010, had appointed a committee under Dr. Bimal Jalan (former Governor of the Reserve Bank of India) to study and recommend changes on the ownership and governance of the Market Infrastructure Institutions ("MIIs") like stock exchanges, depositaries and clearing corporations. The committee, on November 22, 2010, has submitted its report. The report makes some particularly strong recommendations including not allowing such entities to get listed on stock exchanges.

The Report examines the nature of these institutions and emphasizes on the systemic importance of these MIIs for the economy. The report views these MIIs as producers of public good for society, which are essentially the price signals produced by a transparent and efficient market mechanism'.

The Report says that it is not possible to sever the regulatory role of the MIIs from their more obvious role of serving as providers of infrastructure of the market and goes on to describe the characteristics and functions of these MIIs emphasizing the following characteristics of such institutions:-

1. In general, MIIs are in the nature of public utilities.
2. All of them are vested with regulatory responsibilities, in varying degrees.
3. They have systemic importance to the economy.

In the above background, the Report highlights the conflict in the'regulatory role' of these MIIs with their 'economic interests'.

The Committee suggests the raising of entry level barriers for the new exchanges. Only financial institutions and banks with a net worth of Rs.1,000 crore could become anchor investors. There will be a cap on the profits that the MFI shareholders can enjoy and on the remuneration of top executives of the exchange. Trading and clearing members will be ineligible to serve on the boards and the number of public interest directors should be at least equal to those representing the shareholders. No stock exchange will be allowed to list, a recommendation that should put an end to a long-standing controversy over conflict of interest. Stock exchanges and other MIIs will have to fulfil the disclosures and corporate governance requirements of the listing agreement applicable to public companies. Clearly, the Jalan Committee has taken note of the fact that stock exchanges will continue to have regulatory functions. The bar has to be kept high to admit only genuine players.

Shariah index

Asia's oldest stock exchange, the Bombay Stock Exchange (BSE), launched its Shariah index in December 2010. The index, structured in partnership with Taqwaa Advisory Shariah Investment Solutions 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. But no stock will have more than an 8% weightage. The stock screening has been done by Taqwaa Advisory (Tasis) scholar board, and the index construction, by BSE.

The new index will attract investments from Arab and European countries, where Shariah funds are already popular.

Shariah, the religious law of the followers of Islâm, 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.

The index will be rebalanced every quarter though stocks that do not comply (at some point of time) with Shariah statutes will be excluded immediately. National Stock Exchange S&P CNX Shariah Index and Dow Jones Islamic India Index are other Shariah benchmarks that are tracked by investors. Shariah-based equity investments do not allow investors to invest in heavily indebted.

Brics cooperation among exchanges

In 2011 October 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, BM&FBOVESPA from Brazil, Open Joint Stock Company MICEX-RTS from Russia, BSE Limited from India, Hong Kong Exchanges and Clearing Limited (HKEx) as the initial China representative, and JSE Limited from South Africa, announced the formation of the alliance on 12 October 2011 at a World Federation of Exchanges" conference in Johannesburg, South Africa. 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.

The move was endorsed in the March 2012 Delhi summit of Brics.

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.

SGX Nifty

SGX Nifty is Indian Nifty traded in Singapore Stock Exchange. It moves with respect to Indian Nifty. SGX Nifty is open at 8.00 am Indian standard time (IST) on all working days and mostly it becomes initial direction to the Indian Market.

Dollex

(In the class)

Indian Economy

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 is a way of listing receipts and payments in international transactions of a country. 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.

Balance of Payments in the 1990s

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.The consequent rise in India's import bill depleted 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.

Confidence building measures were taken up after a new government was formed in June 1991. The rupee was devalued. The rupee was partially freed in 1992, wherein 40 per cent of the foreign exchange earnings were to be surrendered at the official exchange rate and the remaining 60 per cent could be converted at market determined exchange rates.

The response to the crisis also spurred a host of reforms in the Indian economy which had a significant bearing on the balance of payments. The rupee was devalued substantially, foreign portfolio investments were welcomed and Indian companies were allowed to raise capital from the international markets. Convertibility of the rupee was gradually brought in from 1992-1993 budget onwards.India's foreign trade expanded as tariff and non-tariff barriers to trade dropped.

The partial convertibility that was introduced in 1992 was extended to full convertibility and rates were unified on trade account in 1993 and an effective current account convertibility in 1994. In 1994, 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.

Surge in Capital Flows

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, debt instruments 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 infrastructure and other projects. The dramatic change in the environment led to a surge in capital flows. Foreign investments into India shot up dramatically. The RBI by August 2012 has $290b forex reserves including gold and SDRs .

FOREIGN EXCHANGE RESERVES (in million U.S. dollars)

	Aug. 10 2012	Aug. 3 2012	Aug. 12 2011
Foreign currency assets	256.920	256,954	283,667
Gold	25,715	25,715	25,349
SDRs	4,348	4,350	4,614
Reserve Tranche Position	2,187	2,134	2,975
Total	289,170	289.152	316,605

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.The receipts under the miscellaneous category in the invisible account, which include software exports rose substantially. Software exports continue to show exceptional growth rates.

Remittances

India es expected to receive about $70 b in remittances .Remittances to India have been on the rise over the past few years as it became one of the preferred destinations for global flows of capital.

The Gulf region accounted for an average of 27% of the total remittance inflows into India, with major source countries being the UAE and Saudi Arabia.

According to Reserve Bank of India figures North America continued to be one of the most important source of remittances to India.

Indian diaspora- about 25m- which is one of the most prosperous in the world is sending money home.Controls are lifted and so there are greater inflows.Rupee exchange rate is also attractive.The government has progressively reduced the red tape. Interest rates are high. RBI increased the amount that can be remitted home.

Convertibility Of Rupee

Covertibility refers to the freedom of the holder of domestic currency to freely convert it into any other foreign currency. 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) etc. Convertibility for investment and borrowing abroad comes under capital account convertibility.

Since the beginning of economic reforms in 1991, one of the most consistent aspects of economic policy of the country was with regard to deregulating the external sector dynamics and the valuation of the rupee. As detailed above, from 1992, initially partially and later fully convertibility was ushered in as it moves the economy closer to the global dynamics.

Convertibility has three dimensions:

- Freedom to convert
- Convert at market rate and
- Removal of restrictions for conversion 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) and Indians being allowed greater freedom to take their money abroad.

The rupee's external value was regulated by the Reserve Bank of India till 1992. Unlike in the developed countries 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. However, since 1991, reforms emphasized on external sector security through forex earnings- by exports and FDI and FII. In the 1992-93 Union Budget , the freeing of the rupee began gradually culminating in the 1994-95 Union budget granting current account convertibility. The reform, however, was slowed down after the currency crisis of East Asia in 1997 but resumed momentum since 2000. The fact that India has current account convertibility means that it has acceded to Art.VIII of the IMF with accompanying benefits.

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, 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 is gradually being introduced in India since the reforms began. We have virtual capital account convertibility for foreigners and NRIs for investing in India and taking out profits relating to FDI, portfolio investment and bank deposits in India. For Indian residents and corporates, fairly conservative 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)
- 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 presented differently are:

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 Corus, 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 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. 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 that were made earlier in 2007 are

- 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 $2,00000 per year in foreign markets

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.

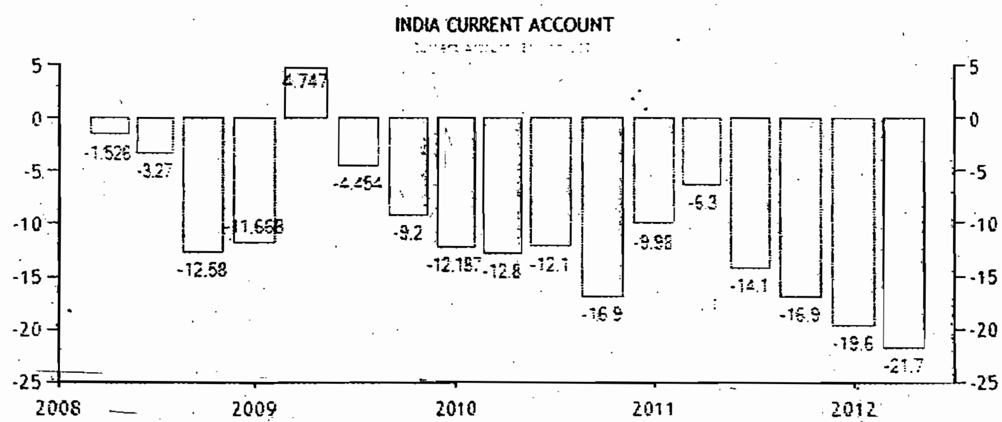
Capital account liberalization in recent months (2012) is given elsewhere in the Chapter.

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). A current account surplus increases a country's net foreign assets by the corresponding amount, and a current account deficit does the reverse. 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.

CAD 2012



The Indian rupee has dropped nearly 23% from its August 2011 peak against the dollar. This sharp depreciation is mainly because of India's large current account

8

deficit (about 4%* of GDP in 2011-12) that capital flows have not been sufficient to cover. A look at the concept of CAD and how it is pressuring the rupee:

FAQ on CAD from ET
(adapted and updated)

WHAT IS CURRENT ACCOUNT DEFICIT?
A country's current account consists of its visible (exports and imports of goods) and invisible trade — income and expenditure from export and import of services such as banking and insurance, and profits earned on investments and remittances by workers.

WHAT IS INDIA'S CURRENT ACCOUNT SITUATION?
India runs a large trade deficit; that is, its imports exceed exports. Some of this trade deficit is covered by the surplus on the invisibles side -- largely IT exports and remittances by Indian workers overseas --leaving India with a net deficit on the current account. This deficit widened to 4.2% of GDP in 2011-12 from 2.7% in the year before.

WHAT ARE THE IMPLICATIONS OF A LARGE CURRENT ACCOUNT GAP?
Deficit on the current account means a net outflow of foreign exchange. In India's case, this means a dollar outgo. Such a deficit could exhaust a country's forex reserves if inflows to make up the deficit do not materialize. 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 it has no more forex left to buy foreign goods and services; worse, it has no forex to meet it debtservicing obligations. This is why a current account deficit in excess of 2.5% of GDP is seen as worrisome in case of India.

WHAT SHOULD THE GOVT DO?
India's large current account deficit has been fuelled by heavy gold and crude oil imports.Also, coal imports. The rupee depreciation has served as an automatic check on gold imports by making the yellow metal expensive. Government increased the customs duty on gold imports in the 2012-13 budget.

To act against CAD, India will need to push 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.

What has been done to remedy the CAD?

Government raised customs duty on gold.

Petrol has been deregulated and the prices of other petroleum goods are raised

RBI took a slew of measures on ECB, FII , QFI, EEFC and NRI deposit routes.

RBI also cracked down on speculators by disallowing them to renew their forward currency contracts during the period that rupee was sliding.

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 suit certain national goals like export promotion etc. Management of the currency valuation is within a band called the target zone . 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. India follows the system.

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 when 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. Its movements are determined by the hard currency. It is essentially meant for imparting stability and credibility to the domestic currency 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.(Yuan revaluation story in Current Affairs). It is called dirty peg and is a managed peg

5. Crawling peg means, the Government accepts that the currency will crawl up or down gradually by a certain annual rate.

Why did the rupee slide to historic lows below 57

Since 2011 December, rupee tested new lows against the dollar for which the external and internal reason are responsible

- Eurozone crisis
- Flight to safety
- Dollar is relatively strong as the US economy came out of recession and growth resurfaced
- Risk aversion for the foreign investor
- Domestic policy and investment climate was not encouraging
- GAAR/retro laws
- CAD widening

Is the rupee likely to recover?

It may not reverse to the earlier levels. The new normal seems to be around Rs.55 for dollar for the following reasons:

- Exports falling
- Current account deficit could rise
- Dependence on foreign flows
- Fiscal deficit
- Growth slows

What is the Real Value Of the Rupee ?

Since 1991 when dollar fetched 16 rupees , rupee has depreciated to Rs. 56 per dollar by August 2012. 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

1. Demand and supply
2. Capital flows
3. Performance of economy and its prospects
4. Forex reserves with the RBI
5. Interest rates
6. Short term debt and the Current Account Deficit(CAD) or CAS

7. 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

The prevailing official exchange rate is called the nominal effective exchange rate (NEER) The potential for adjustment –upward or downward –according to factors mentioned above brings in 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.

How much reserves are enough/ necessary ?

Today RBI has $290b of reserves.It is acquired by the RBI for the following reasons

- To check the appreciation of rupee
- 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

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.

Why accumulate forex?

India's foreign exchange reserves comprise foreign currency assets of the RBI, gold held by the RBI and special drawing rights. Foreign exchange reserves increased rapidly during the last decade, standing today at $290b.(Reasons are listed above).But there are problems with huge forex reserves as to

- Cost of acquisition is high
- Sterilization costs are high
- 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.

Sterilisation mechanism and MSBs

(Covered elsewhere)

Rupee Devaluation/depreciation and Export Performance and Promotion

It is argued that when rupee depreciates due to market forces of supply and demand or is devalued by the Central bank, exports go up as in price terms Indian goods and services will be cheaper especially in relation to similar goods and services from competitive countries. In fact, since the beginning of reforms 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 and better goods can be exported. Devaluation becomes necessary if competing countries for any reason suffer depreciation or resort to it deliberately. For example, China undervaluing its Yuan.

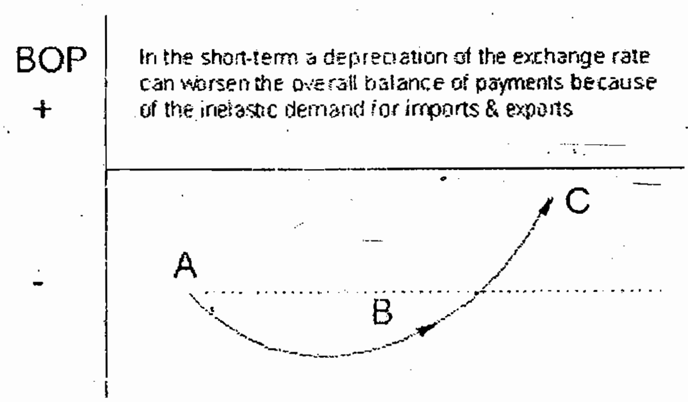
The export strategy of the Government banks partly on appropriate exchange rate policy. The forex reserves that the RBI holds are partly explained by the need for RBI intervention in the forex market to see that the rupee does not appreciate too much and thus help exports.

There is a point beyond which export promotion based on rupee depreciation can not be hoped for as quality, reliability, packaging and so on matter. Price-elasticity of our exports is also to be considered before depreciation is advocated. Further, competitive devaluation will harm the economy .

Also, import elasticity of Indian exports- about 50% exports like engineering goods, gems and jewellery etc is high and thus depreciation hurts them.

Thus, all the necessary factors need to be balanced before the rupee movements are managed.

The J Curve effect



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. When exports become price-competitive and imports are reduced due to high cost, the BOP turns positive.

2012 Depreciation

Fall in rupee is likely to bring opportunities for the domestic economy by boosting exports and substitution of import in the near future though with a time lag.

Opportunities though will be more visible over the next 18-24 months as companies generally hedge and it takes time for supply chains to reconfigure..

According to one estimate, around $60 billion of exports can be increased due to weak rupee, while $60 billion of import can be substituted.

Indian rupee is now hovering around $55 level which is likely to make exports from the country competitive with substitution of imports due to expensive imports.

Opportunities for substitution exist because domestic manufcturers will make the goods whose imports are expensive.It can be either by allowing for immediate substitution or, in a smaller way, by accelerating the set-up of new capacity.

Categories like diesel gensets, textile-related machinery, household appliances, furniture, tyres, penicillin/cephalosporin intermediate manufacturers and sectors aligned to the growing of pulses and oilseeds are potential beneficiaries of import substitution.

Similarly, sectors like auto and auto components, agriculture, bulk drug exporters, jewellery and service exports will be benefitted from the weak rupee.

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 brought in FIIs; huge FII inflows into financial asset markets and an increasing reliance on low cost foreign loans (ECB) add to the supply 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 and borrowers in foreign currency are delighted with the rupee's appreciation to the dollar as most imports and external borrowings are denominated in dollars.

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 rupee's appreciation is one of the reasons for the current low inflation rate.

The effect on exporters too is not all negative. With increasing global integration an ever-increasing proportion of exports consists 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.

Forex reserves and infrastructure

Sovereign wealth fund(discussed in the class).

Bretton Woods Institutions & Others

The United Nations Monetary and Financial Conference, commonly known as Bretton Woods conference, was held in Bretton Woods, New Hampshire , USA 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.

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 188 members(2012). It is headquartered in Washington and its Managing Director is Christine Lagarde. It started functioning in 1947.

Upon joining, each member of the IMF is assigned a quota, 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
- Access to financing: The amount of financing a member can obtain from the IMF

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.

India's current quota in the IMF is SDR (Special Drawing Rights) 5821.50 million, giving it a shareholding of 2.44 %. Based on voting share, India (together with its constituency countries viz. Bangladesh, Bhutan and Sri Lanka) is ranked 17th in the list of 24 constituencies.

The IMF reviews members' quotas once in five years and the last such review took place in December, 2010. India has already consented to its quota increase under the 2010 review and after the 2010 quota review comes into effect, our quota share will increase from the current 2.44% to 2.75%, making India the eight largest quota holding country at the IMF up from its previous position of being the 11th largest. In absolute terms, India's quota will increase to SDR 13,114.4 million from SDR 5,821.5 million (an increase of approximately US$ 11.5 billion or INR 56,000 crore).

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 avoid competitive exchange rate revaluation
- To help members in times of balance of payments crisis.

What the IMF Does

In order to achieve the above objectives, the following functions are performed:

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 involves the monitoring of economic and financial developments, and the provision of policy advice, aimed especially at crisis-prevention.

The IMF also lends to countries with balance of payments difficulties, to provide temporary financing and to support policies aimed at correcting the underlying problems; loans to low-income countries are also aimed especially at poverty reduction.

Third, the IMF 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

Surveillance is the process of appraisal of the exchange rate policies of member countries. In the absence of surveillance, the financial volatility in the world today can become worse.

Special Drawing Rights (SDRs)

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 four key international currencies- dollar, euro,yen and pound. SDRs can be exchanged for national currencies.

SDR is neither a currency, nor a claim on the IMF. Rather, 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.

The value of the SDR is set dynamically against a basket of currencies consisting of the euro, Japanese yen, pound sterling, and U.S. dollar. 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. China wants Yuan included.

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.

General Arrangements to Borrow(GAB)

The GAB , established in 1962 ,enables the IMF to borrow specified amounts of currencies from 11 industrial countries at market-related rates of interest. It is used to lend to countries for stablilising their external account.

New Arrangements to Borrow(NAB)

IMF set up NAB in 1998.

The NAB is a set of credit arrangements between the IMF and 39 member countries (2011). Commitments from individual participants are based predominantly on relative economic strength, as measured by IMF quotas. It has a corpus of US $ 580 billion which is equivalent to SDRs 367 billion (2012). The increase is rendered necessary to bail out the sick Eurozone economies like Greece and Portugal.

India and NAB

India funded bailouts in financially-stricken Europe, marking a dramatic role reversal from 20 years ago when it went knocking on the doors of the International Monetary Fund (IMF) to avert a balance of payments crisis.

The government took parliamentary approval to provide over Rs 9,003 crore (over $2 billion) in loans to the multilateral agency's New Arrangements to Borrow (NAB), a fund whose corpus was raised to $580 billion when the debt crisis in Europe showed no signs of abating.

Over the past two years, amid increased stress in the global economy, the IMF has been pressed into service on several occasions and has financed bailouts in European countries facing a crisis due to high levels of debt.

The 10-fold rise in the NAB corpus was the result of the new global financing order created by G20, a group of the world's most powerful economies, in the post-financial crisis era. Along with the jump in corpus, membership to the elite club of NAB contributors was also expanded to include 13 emerging economies, which included India.

The NAB is the facility of first and principal recourse in circumstances in which the IMF needs to supplement its quota resources.

India participates in the Financial Transactions Plan of the International Monetary Fund since 2002.FTP is the mechanism through which the Fund finances its lending and repayment operations to its members.

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 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.

IMF Facilities

Over the years, the IMF has 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) and the Exogenous Shocks Facility (ESF). 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 with very strong policies and policy frameworks, and the Extended Fund Facility (which is useful primarily for low-income members).

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.

Extended Fund Facility (EFF) is to help countries address longer-term balance of payments problems requiring fundamental economic reforms. Arrangements under the EFF are thus longer than SBAs.

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 the global financial crisis

As the world economy has become engulfed in the worst crisis since the Great Depression before the second world war, the IMF has 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.

Stepping up crisis lending, including a sharp increase in concessional lending to the world's poorest nations.

Providing analysis and targeted advice.

Becoming more flexible. The IMF has overhauled its general lending framework to make it better suited to country needs.

Creating a financial safety net. The IMF created a broad financial safety net to limit the spread of the crisis.

Drawing lessons from the crisis. The IMF is contributing to the ongoing effort to draw lessons from the crisis for policy, regulation, and reform of the global financial architecture.

The financial crisis of 2008 called the fund into action, as it brokered rescue packages for countries like Pakistan, Iceland, Hungary and Ukraine that were swamped by the collapse.

But since the spring of 2010 the I.M.F. has focused largely on Europe after the outbreak of the sovereign debt crisis that has threatened the euro.

It was drawn into the crisis when France and Germany were unable to agree on a purely European solution to Greece's short-term debt needs. The fund pledged to provide up to 15 billion euros as part of a 45 billion euro aid package. But as the crisis deepened for Greece and threatened to spread to Spain and Portugal, the fund promised to put up a share of a package that could total 120 billion euros, or $160 billion, over three years.

Christine Lagarde made herself into a blunt voice of dissent, criticizing Europe's handling of the debt crisis for an over-emphasis on austerity. She warned repeatedly that the bailout fund created by the European Union was inadequate to stop the spread of the crisis to larger countries like Spain and Italy, and called for measures to restore growth.

In April 2012, the I.M.F. announced that it had raised at least $430 billion in extra lending capacity to be used if the euro zone crisis worsens or global financial conditions deteriorate.

In June, Ms. Lagarde made her most forceful intervention in the European crisis, as the fund called for the euro area to move swiftly toward a fiscal union including issuance of joint euro zone debt and said the viability of the currency was being questioned.

The fund also said it would like euro zone bailout funds to be lent directly to struggling banks – rather than through national governments – and appealed to the European Central Bank to take more aggressive measures to quell volatile financial markets, such as increasing the money supply or resuming the purchase of the bonds of stressed sovereigns such as Spain.

IMF and Brics

In the wake of the ongoing Eurozone crisis, the IMF has proposed a new bilateral borrowing programme to augment its resources for crisis prevention and resolution and to meet the potential financing needs of all IMF members. 37 members representing three-fifths of the total quota of the IMF, have pledged contributions to enhance the IMF's resources by US $ 456 billion. At the Los Cabos Summit of the G20 held on June 19th, 2012, BRICS countries have announced their contributions, including US$ 10 billion by each of India, Brazil and Russia and US $ 43 billion by China.

The IMF has committed that these new resources will be drawn only if they are needed as a second line of defense after resources already available from quota and existing borrowing arrangements are substantially used. If drawn, they would be repaid with interest. It has been clarified that quota resources would remain the basic source of fund financing and that the role of borrowing is to temporarily supplement the quota resources.

IMF and Conditionalities

There has been a controversy about the IMF loans that the debtor countries are suggested economic reforms that are socially and in human terms damaging in return.. The conditionalities as they are called are justified by the IMF on grounds that they are the genuine reforms necessary for economic health to be restored. IMF further believes that if the recipient country follows the reforms it will be in a position to repay the loan. Debtor countries however hold that the reforms suggested are anti-poor and anti-development- like cutting subsidies; scrapping priority sector lending; opening up the country at a fast pace etc.

Some of the conditionalities are
/reduce fiscal deficit
/follow privatisation
/deregulate the rupee in external transactions
/downsize the government
/enact flexible labour sector reforms
/reduce subsidies etc.

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.

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 poor be curtailed
- The private international flows are huge and in comparison, the IMF resource base is small and so is rendered ineffective
- 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 has 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, and in 1991 it. borrowed SDR 1.4 billion under the Compensatory Financing Facility.

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.(See India and NAB above)

The Importance of IMF in the post-Lehman period

The IMF saw its international standing strengthened with the global financial crisis of 2008.The global financial crisis, which originated in the U.S. housing market, sparked a growing discussion among policy makers and academics that the world should no longer rely on a single, dominant currency, such as the dollar.Nobel Prize-winning economist Joseph Stiglitz even called for a new global reserve system based on the SDR's.

With the financial crisis intensifying and private capital drying up for credit, more and more countries are coming to the IMF for funds. Recently IMF bailed out Greece.

G20 has agreed that the IMF should triple its borrowing, to ensure that it has enough money to offer loans.

The money is pledged by other IMF countries.

The IMF wants to use this money to offer a new kind of loan that would be preventive. Rather than waiting for countries to get into financial difficulties, it would offer them a line of credit to help them defend their currencies in advance. – NAB- an additional $250bn. This would be done by creating more of its own currency. the SDR or special drawing right.

The IMF is also set to have a bigger role in preventing future crises, by developing an early warning system for financial problems, and taking a larger role in looking at the problems of the financial sector as a whole, in conjunction with a new global regulator, the Financial Stability Board.

But the biggest changes in the IMF involve giving greater voice to the developing countries.(Read ahead).

Another reform:It has already been agreed that in future, the convention that the World Bank and IMF must be headed by an American and a European respectively will be abandoned.

The changes to the resources and the role of the IMF are historic and perhaps the most important development in international monetary system that reflects changing realities.

But it is a move towards a more balanced global system of international finance.

Quotas, GAB and NAB

While quota subscriptions of member countries are the IMF's main source of financing, the Fund 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).

The G20 and the IMF

G20 in 2010 south Korea arrived at an agreement to reform the IMF: quota expansion to shift the structure of quota holding in favour of some emerging market economies such as China, India and Brazil. This in turn would marginally alter the voting structure in the IMF that is heavily biased in favour of the developed countries in general and the United States in particular.

Quotas are supposed to reflect a country's position and influence in the world economy, determined by a formula based on GDP, openness, economic variability and international reserves. 85 per cent of votes are required for major decisions to be taken by the IMF Board. US has a 16.7 per cent vote share and wields a veto.

G20 decision means more than 6 percent of voting shares at the Fund will shift to emerging economies like India and China which will become the third-most important member of the 188-strong IMF. India with 2.75% voting share will rank 8^{th}, Russia 9th and Brazil 10th. Together, the BRICs will control 14.18 percent of IMF quotas, and emerging markets as a whole will have a 42.29 percent share.

The Gyeongju agreement of Finance Ministers and Central Bank Governors held in South Korea in 2010 declared that the reforms would make the IMF "more effective, credible and legitimate".

The doubling of quotas increases the resources the IMF can leverage and enhances the legitimacy of the IMF.

The IMF reforms, which have been debated for years, would go into effect in 2012 and see overrepresented countries, primarily Western industrialized ones, lose influence

SDRs as an alternative to the US dollar as global reserve currency

The international monetary system needs fundamental reform. Dollar as a global reserve currency is neither viable nor desirable to the same degree as before. It has led to problems like the huge current account deficit and fiscal deficit of the USA. Global imbalances- counties like China make and export goods and have current account surpluses and USA import them and depend on them and thus have 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 current account deficits. These deficits generate excessive indebtedness, both external and internal. So if the US were to shrink its deficit too quickly, a deficiency of supply of the global reserve currency could result.

Responses to global financial instability creates the other problem, where developing countries have accumulated large reserves as "self-insurance" against a future balance of payments crisis. These protect them during crises, but also add to global imbalances.

In the late 1960s a more limited global currency was created: the SDRs, issued by the IMF when enough member countries agree. The largest such issue – equivalent to $250bn, and suggested by the G20 in April 2009 – was a response to the dramatic collapse in international private lending after the global financial crisis. It helped soften the negative impact of the crisis on growth.

Some experts argue that the global role of SDRs should be increased as it would avoid the need for countries like India and China to build reserves of dollars. US deficits can also be resolved. Global stability enhances as dollar worries recede.However, SDRs can only supplement the dolar 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.

World Bank Group and World Bank

The World Bank Group (WBG) is a family of five international organizations that gives loans, generally to poor countries. 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). It is responsible for the preparation of the World Development Report. Commencing operations in 1946, it began operations for post-war reconstruction. Its current role is different as it focus is to lend to and develop the poor countries and help fight poverty in all its facets.

The Group's headquarters are in Washington. It is an international organization owned by member governments; although it makes profits, these profits are used to support continued efforts in poverty escalation.

Technically the World Bank is part of the United Nations system, but its governance structure is different: each institution in the 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. The President of the World Bank is conventionally an American and currently is Jim Yong Kim whose ancestry is from South Korea. There are 188 countries in the WB today.

A country has to first join IMF before it can be a member of the WB.

Its five agencies are:

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

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

The World Bank's (i.e.. the IBRD and IDA's) activities are focused on developing countries, in fields such as human development (e.g. education, health), agriculture and rural development (e.g. irrigation, rural services), environmental protection (e.g. pollution reduction, establishing and enforcing regulations), infrastructure (e.g. roads, urban regeneration, electricity), 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.

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.

Whereas the latter incorporates these two in addition to three more:[3]

- 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 provides grants and credits with repayment periods of 35 to 40 years.

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. IDA 15 (IDA 15th Replenishment) projects over the three-year period ending June , 2011.

IDA15 replenishment provided US$ 41.6 billion. IDA15 supports low-income countries by increasing its activities in combating climate change, facilitating regional integration and cooperation, boosting infrastructure investment and providing greater support to post-conflict countries, notably in Africa.A total of 45 countries made pledges to IDA's 15th replenishment

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.

IDA 16

Donors agreed to contribute nearly $50 billion over three years(2011-14) to the World Bank fund dedicated to the globe's poorest countries.

It supports health, education, food security and building programmes through grants and long-term, interest-free loans to the world's 79 least-developed countries. The fund is replenished every three years at a donors conference. This year it marked a record for giving, with 51 countries agreeing to contribute.

IDA has 172 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.

Established in 1956, 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 been a member of IFC since 1956. As of June 2012, India held 81,342 shares of IFC, representing 3.43% of IFC's subscribed share capital and 81,592 votes, representing 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. As of May 31, 2012, IFC's portfolio of committed investments in India was approximately US$4 billion.In IFC's Fiscal Year 2012, total commitments in India reached US$960 million in 45 projects, distributed across infrastructure, manufacturing, financial markets, agribusiness and renewable energy. The above figures include commitments for IFC's own account and mobilized financing.IFC is scaling up its presence and activities in the Low Income States and NE States (LIS) in India. A new office in Kolkata was set up to focus on the LIS; approximately US$400-500 million has been invested in the LIS over the past three fiscal years. Further. IFC Advisory Services is working in the LIS in 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 to 30-40% of IFC's portfolio in India in the last few years and currently accounts for about US$1.3 billion of current committed portfolio.

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 was founded in 1988 and is headquartered in Washington.

MIGA promotes foreign direct investment into developing countries by insuring investors against political risk, advising governments on attracting investment etc.

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 was established in 1966 . ICSID has an Administrative Council, chaired by the World Bank's President, and a Secretariat. It provides facilities for the conciliation and arbitration of investment disputes between member countries and individual investors.

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 MDGs. IBRD funds are semi - concessional and of a longer maturity and therefore, cheaper than commercial external borrowings. GOI utilizes IBRD loans primarily for infrastructure projects.

Since 1949 when India took the first assistance from World Bank, the Bank's cumulative commitment to India stands at US$ 91.91 billion {US$ 48.28 billion under IBRD and US$43.63 billion under IDA (up to July, 2012)}.

The support would be for transformative projects, including the Kosi flood recovery project in Bihar state and cleaning up the River Ganga. As part of the overall lending, the Bank also has earmarked USD $3 billion to support the country's domestic response to the global financial crisis.

This includes a USD $2-billion package for the federal government to provide capital to some of the public sector banks so that they could maintain their credit expansion and prevent a shortfall of capital from affecting the economy in the wake of the global economic crisis.

India's enhanced voice

In the recent Capital Increase in IBRD (2010), India has been allocated additional shares. As a result India will become the 7th largest shareholder in IBRD with voting power of 2.91%. Before this revision, India's voting power was 2.77% with 11th position among shareholders. As a constituency (comprising of four countries - India, Bangladesh, Sri Lanka and Bhutan), India's voting power will increase to 3.26% from the present 3.14%. India along with developing countries like China, Brazil, Indonesia, Mexico and Turkey, with greater voting power, would now have more say in the affairs of the World Bank and how its funds are disbursed.China has overtaken Germany, France and the UK to become the third largest shareholder in the Bank with 4.42% voting rights. There is an overall shift of 3% voting share in favour of developing countries, bringing their total vote share to 47%. The change will give emerging nations more say in how the bank is run and how its funds are disbursed.

These changes "are transformative in nature and will reposition the World Bank Group in the international financial architecture".They will strengthen the role the World Bank Group in being an effective multilateral instrument for eradicating poverty. achieving the MDGs (millennium development goals), supporting international efforts to manage global public goods, and most importantly, keeping it relevant in a dynamic world.

Membership of the financial institution gives certain voting rights, which are the same for all countries. But additional votes are granted depending on a country's financial contribution to the organisation.

IMF and WB

The International Monetary Fund and the World Bank at a Glance

International Monetary Fund	World Bank
• oversees the international monetary system • promotes exchange stability and orderly exchange relations among its member countries • assists all members--both industrial and developing countries--that find themselves in temporary balance of payments difficulties by providing short- to medium-term credits • supplements the currency reserves of its members through the allocation of SDRs (special drawing rights) • draws its financial resources principally from the quota subscriptions of its member countries • has at its disposal fully paid-in quotas now totaling SDR 145 billion (about $215 billion)	• seeks to promote the economic development of the world's poorer countries • assists developing countries through long-term financing of development projects and programs • provides to the poorest developing countries whose per capita GNP is less than $865 a year special financial assistance through the International Development Association (IDA) • encourages private enterprises in developing countries through its affiliate, the International Finance Corporation (IFC) • acquires most of its financial resources by borrowing on the international bond market • has an authorized capital of $184 billion, of which members pay in about 10 percent

Financial action task force

In 2010, India has become a member of the Financial Action Task Force (FATF), an inter-governmental body responsible for setting global standards for anti-money-laundering and combating financing of terrorism.

The membership of FATF comes nearly four years after the country became an observer (in 2006) to this elite global body. India is now the thirty-fourth country member of FATF. There are 36 countries in it.

FATF membership is very important for India in its quest to become a major player in international finance, an official release said.

It will help India build the capacity to fight terrorism and trace terrorist money and help to successfully investigate and prosecute money laundering and terrorist financing offences.

India will benefit in securing a more transparent and stable financial system by ensuring that financial institutions are not vulnerable to infiltration or abuse by organised crime groups.

The FATF process will also help in co-ordination of international efforts in anti-money laundering and combating the financing of terrorism, the release added.

The FATF Secretariat is housed at the headquarters of the OECD in Paris.Its President is Mr.Corral.

Asian Clearing Union

The Asian Clearing Union (ACU) was established with its head quarters at Tehran, Iran in 1974 at the initiative of the United Nations Economic and Social Commission for Asia and Pacific (ESCAP), for promoting regional co-operation. The main objectives of a clearing union are to facilitate payments among member countries for eligible transactions on a multilateral basis, thereby economizing on the use of foreign exchange reserves and transfer costs, as well as promoting trade among the participating countries.

The Central Banks and the Monetary Authorities of Iran, India, Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka, Myanmar and Maldives are currently the members of the ACU.

The Asian Monetary Units (AMUs) is the common unit of account of ACU and is denominated as 'ACU Dollar' and 'ACU Euro', which is equivalent in value to one

US Dollar and one Euro, respectively. All instruments of payment under ACU have to be denominated in AMUs.

Reserve Bank receives and pays US Dollars / Euros.

All permitted current account transactions including export / import transactions among ACU member countries are eligible to be settled through the ACU.

India- Iran oil payments

In 2010, Reserve Bank of India has barred Indian companies from using the Asian Clearing Union (ACU) to process current account transactions for oil and gas . India used to make $12 billion worth of oil imports annually from the Islamic Republic. In 2009, Iran asked Indian companies such as ONGC to use the ACU to avoid being targeted by U.S. extra-territorial sanctions. But since the U.S. Treasury, which enforces those sanctions, is unable to monitor ACU transactions, Washington had been pressuring Delhi to shut down this route. ACU transactions are made by the central banks and the individual companies and their identities are not known. Thus, USA can not punish them for dealing with Iran.

Trade in each other's currency (rupee and Rial) is not feasible as India's imports are many times more than exports.

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 region 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.

India borrows from the ADB within the overall external debt management policy pursued by the Government which focuses on raising funds on concessional terms from less expensive sources with longer maturities. We started borrowing from ADB (Ordinary Capital only) in 1986. India is eligible to draw partly from the Asian Development Fund (ADF) which provides concessional funding. India has 6.37% of shares.

Financial Stability Board

The Financial Stability Board (FSB), successor to the Financial Stability Forum, was established in 2009 following the G-20 London summit, and includes all G-20 major economies, including India.

The FSB has been established to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. It comprises senior representatives of national financial authorities (central banks, regulatory and supervisory authorities and ministries of finance), international financial institutions etc. G20 gave the FSB more power in surveillance role.

FSB is based in Basel, Switzerland.

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 inaugural meeting of the G-20 took place in Berlin in 1999, hosted by German and Canadian finance ministers.

Mandate

The G-20 is the premier forum for our international economic development that 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.

Origins

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.

Membership

The G-20 is made up of the finance ministers and central bank governors of 19 countries:

- 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

The European Union, who is represented by the rotating Council presidency and the European Central Bank, is the 20th member of the G-20. 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. The G-20 thus brings together important industrial and emerging-market countries from all regions of the world. 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.

Achievements

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 since the first one in Washington in 2008 till the 7th summit in Los Cabos in Mexico. The next one will be held in Russia in 2013.

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:

First, the scope of financial regulation has been largely broadened, and prudential regulation and supervision have been strengthened. There was also great progress in policy coordination. Finally, global governance has dramatically improved to better take into consideration the role and the needs of emerging of developing countries, especially through the ambitious reforms of the governance of the IMF and the World Bank.

Chair

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 2011 the G-20 chair is France.

Meetings and activities

It is normal practice for the G-20 finance ministers and central bank governors to meet once a year.

Interaction with other international organizations

The G-20 cooperates closely with various other major international organizations and fora- World Bank and IMF. The G-20 also works with, and encourages, other international groups and organizations, such as the Financial Stability Board and the Basel Committee on Banking Supervision.

How does the G-20 differ from the 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.

Due to the financial and economic crisis of 2008, the west lost its economic muscle and parallelly emerging countries are playing a bigger role in the global economy. Therefore. G20 is gradually replacing G8 as the most coveted platform for global economic management.

Miscellany

Every G-20 member has one 'voice' with which it can take an active part in G-20 activity. To this extent the influence a country can exert is shaped decisively by its commitment.

There are no formal criteria for G-20 membership and the composition of the group has remained unchanged since it was established. In view of the objectives of the G-20, it was considered important that countries and regions of systemic significance for the international financial system be included. Aspects such as geographical balance and population representation also played a major part.

The G-20 Finance Ministers are mandated to take forward work in the following areas;

- Framework for Strong, Sustainable, and Balanced Growth
- Strengthening the International Financial Regulatory System
- Modernizing our Global Institutions to Reflect Today's Global Economy
- Reforming the Mandate, Mission, and Governance of the IMF
- Reforming the Mission, Mandate, and Governance of Our Development Banks
- Energy Security and Climate Change
- Strengthening Support for the Most Vulnerable
- Putting Quality Jobs at the Heart of the Recovery
- An Open Global Economy

Summits

Date	Host country	Host city
1st November 2008	United States	Washington, D.C.
2nd April 2009	United Kingdom	London
3rd September 2009	United States	Pittsburgh
4th June 2010	Canada	Toronto
5th November 2010	South Korea	Seoul
6th November 2011	France	Cannes
7th 2012	Mexico	TBD

OECD

The Organisation for Economic Co-operation and Development (OECD) is an international economic organisation of 34 countries founded in 1961 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.

The OECD originated in 1948. Later, its membership was extended to non-European states. The OECD's headquarters are in Paris.

ECB

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

International financial stability architecture for the 21st century

The institutions involved are:

- IMF
- WB and ADB provide economic assistance so that the long term economic underpinings of global economy are strengthened.
- G-20 and G20 Summit since 2008
- 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.

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

- we need to restructure global finance, based on an expanded system of capital adequacy standards, financial reporting, system-wide risk management etc. FSB and BIS can have a larger role in this matter.

- 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, and accountability for their success. Specifically, the bank should have one overarching assignment: helping the poorest countries achieve the millennium development goals to reduce poverty, hunger and disease.
- global trade agenda should be reoriented A trade agreement worthy of the effort would do two main things. Importantly, it would help the poorest countries to be more productive ;global trade would 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. A tax on the carbon content of fossil fuels, levied by all countries, would do the job.
- G20 summit should be the policy guidance platform.

WTO and GATT

The General Agreement on Tariffs and Trade (GATT) is an agreement that was arrived at in 1947 by 23 countries to establish an 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 GATT was headquartered in Geneva, Switzerland. Eight rounds of such negotiations were held under GATT:

- Havana Round (1947) with 23 countries brought into being the . GATT.
- Annecy(France) Round (1949)(France)
- Torquay Round(England) (1950)(England)
- Geneva Fourth Round (1956)
- Dillon Round (1960-1961) was held in Geneva and were named after Under Secretary of State, Douglas Dillon, who first proposed the talks
- Kennedy Round (1962-1967) was also held in Geneva but was named after the US President John F Kennedy, in his memory.
- Tokyo Round (1973-1979)
- 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.

As can be seen from the above, the Uruguay round lasted the longest 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; 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. It 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 156 members. Pascal Lamy, former European Commissioner for Trade, is the current Director-General of the World Trade Organization.

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.

The process of taking the decision by the DSB is known as 'reverse consensus' or 'consensus against': the process requires that the ruling of the Panel should be adopted "unless" there is a consensus of the members against adoption.

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 `losing 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.

WTO members and observers.

There are 156 members in the WTO. 28 countries enjoy observer status at the WTO. 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 (as "Hong Kong, China" since 1997) became a GATT contracting party, and the Republic of China (Taiwan) acceded to the WTO in 2002 as "Separate Customs Territory of Taiwan, Penghu,Kinmen and Matsu" (Chinese Taipei) despite its disputed status. Iran is the biggest economy outside the WTO.

Chronology

- 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 – Thi rd 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 (the longest in GATT history).
- 2002 - Taiwan joined under the name "Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu".
- 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
- 2007 - Potsdam G-4 talks failed
- 2008- Mini-ministerial in 2008 failed
- Seventh Ministerial 2011 in Geneva

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)

One of the most contentious issues that the Uruguay Round addressed was agriculture. When the Marrakesh Treaty was signed in 1994, AoA was resisted by the developing countries. They were won over with some concessional features and flexibilities. Its three pillars are

- domestic support
- export subsidies
- market access

Domestic support

It 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 subsidies relate to research and development and infrastructure like universities, roads in rural areas etc. Since they do not distort trade, there is no limit on them.
- Amber Box includes those domestic subsidies that impact on market prices. For example, food subsides. Therefore, they need to be limited at an agreed level. Devẽloped countries are allowed less than developing countries in percentage terms.
- Blue Box contains subsidies that are direct payments to the farmers to limit their production as agriculture needs to play a multifunctional role that includes environmental stability. Leaving land fallow etc.

Subsidies given by USA and Europe make agricultural goods so cheap that their markets are virtually inaccessible to exports from developing countries. The earlier gains expected by the developing countries from an 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.

Export subsidies

"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 of the developing countries are not priced out..

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

AoA can be expected to, in the long run, benefit the developing countries that have cost advantages in production. However, any such benefits are conditional on the developed countries reducing their subsidies.

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 trade marks, 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 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. TRIPs 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 of 20 years from the filing date. 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 process that may lead to the product, whereas process patents provide protection in respect of the technology and the 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 have 10 years to adopt the TRIPS agreement standards while the advanced countries adopted them by 1995 itself.

TRIPS agreement is an integrated package . 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.

Geographical Indications

There are world famous goods that owe their origin 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.

GI is granted to a community or group or an institution that represents the interests of the product. It is generally not granted to an individual. It is given to a product for a specific period of time (10 years in India).The product can be an agricultural, natural or manufactured one. The manufactured goods should be produced or processed or prepared in that territory. It should have a special quality or reputation or other characteristics

If these products and processes are given geographical indication registration, commercial proceeds can accrue to the holder of the GI. GIs prevent spurious goods from entering the market It helps maintain quality . There is greater accountability, too. It boosts exports

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.

As per the Geographical Indications Act, 1999 "*Any association of persons or producers or any organization or authority established by or under any law for the time being in force representing the interest of the producers of the concerned goods*" may file an application for registration of a GI. This is in keeping with the overall objective of the G.I. Act, which is to protect the identity of a particular good that has properties which are attributable to a particular region or which are manufactured in a particular region.

The year 2007-08 recorded a surge in the registration of Geographical Indications (GIs). During the year, 31 GIs were registered. This is more than the total number of GIs registered during all the previous years since the registration process commenced in India. The total number of GI products registered in the country now stands at 61.

The GIs registered during 2007-08, inter alia, include Muga Silk from Assam, Madhubani Paintings from Bihar, Aleppy Coir, Navara and Palakkadan Mutta Rice varieties, Malabar Pepper and Aleppy Green Cardamom from Kerala, Salem and Arani Silks and Kovai Cora Cotton from Tamil Nadu, Allahabad Surkha from Uttar Pradesh, Nakshi Kantha from West Bengal, Silver Filigree from Andhra Pradesh, and Ilkal Sarees and Monsooned Malabar Coffees from Karnataka and Kerala.

Earlier registered GIs include Darjeeling Tea from West Bengal, Chanderi Fabric from Madhya Pradesh, Solapur Chaddar from Maharashtra, Kotpad Handlooms from Orissa, Kota Doria from Rajasthan, Mysore Silk from Karnataka, Kullu Shawl and Kangra Tea from Himachal Pradesh and Pochampalli Ikat from Andhra Pradesh.

During 2007-08, the Geographical Indications Registry received 37 applications which include Bagh Prints of Dhar from Madhya Pradesh, Banaras Brocades and Sarees and Lucknow Chikan Craft from Uttar Pradesh, Kutch Embroidery from Gujarat, Naga Mircha from Nagaland, Fazli Mango from West Bengal, Pipli Applique Work from Orissa, Goan Cashew Feni from Goa, Assam Tea from Assam, and Nilgiri Tea from Tamil Nadu. These and other applications are under various stages of processing.

Registration details of G.I Applications 2003-2008

S. No	Product	State	Geographical Indications
1	Tea	West Bengal	Darjeeling Tea (word & logo)
2	Handicrafts	Kerala	Aranmula Kannadi
3	Textiles	Andhra Pradesh	Pochampalli Ikat
4	Textiles	Tamil Nadu	Salem Fabric
5	Textiles	Madhya Pradesh	Chanderi Fabric
6	Textiles	Maharashtra	Solapur Chaddar
7	Textiles	Maharashtra	Solapur Terry Towel
8	Textiles	Orrissa	Kotpad Handloom fabric
9	Textiles	Karnataka	Mysore Silk
10	Textiles	Rajasthan	Kota Doria
11	Incense Sticks	Karnataka	Mysore Agarbathi
12	Textiles	Tamil Nadu	Kancheepuram Silk
13	Textiles, Carpets	Tamil Nadu	Bhavani Jamakkalam
14	Textiles	Himachal Pradesh	Kullu Shawl
15	Handicrafts	Karnataka	Bidriware
16	Textiles	Tamil Nadu	Madurai Sungudi
17	Textiles	Orissa	Orissa Ikat
18	Handicrafts	Karnataka	Channapatna Toys & Dolls
19	Handicrafts	Karnataka	Mysore Rosewood Inlay
20	Tea	Himachal Pradesh	Kangra Tea
21	Wet Grinder	Tamil Nadu	Coimbatore Wet Grinder
22	Textiles	Andhra Pradesh	Srikalahasthi Kalamkari
23	Essential Oil	Karnataka	Mysore Sandalwood Oil
24	Soap	Karnataka	Mysore Sandal soap
25	Embroidery (Textiles)	Karnataka	Kasuti Embroidery

26	Paintings	Karnataka	Mysore Traditional Paintings
27	Horticulture Product	Karnataka	Coorg Orange
28	Horticulture Product	Karnataka	Mysore Betel leaf
29	Horticulture Product	Karnataka	Nanjanagud Banana
30	Paintings	Bihar	Madhubani Paintings
31	Handicrafts	Andhra Pradesh	Kondapalli Bommallu
32	Paintings	Tamil Nadu	Thanjavur Paintings
33	Handicrafts	Andhra Pradesh	Silver Filigree of Karimnagar
34	Coir Products	Kerala	Alleppey Coir
35	Textiles	Assam	Muga Silk
36	Handicrafts	Tamil Nadu	Temple Jewellery of Nagercoil
37	Horticulture	Karnataka	Mysore Jasmine
38	Horticulture	Karnataka	Udupi Jasmine
39	Horticulture	Karnataka	Hadagali Jasmine
40	Agricultural Products	Kerala	Navara Rice
41	Agricultural Products	Kerala	Palakkadan Matta Rice
42	Handicrafts	Tamil Nadu	Thanjavur Art Plate
43	Textiles	Karnataka	Ilkal Sarees
44	Handicrafts	Bihar	Applique - Khatwa Patch Work of Bihar
45	Handicrafts	Bihar	Sujini Embroidery Work of Bihar
46	Handicrafts	Bihar	Sikki Grass Work of Bihar
47	Agricultural Products	Kerala	Malabar Pepper
48	Guava	Uttar Pradesh	Allahabad Surkha
49	Textiles	New Delhi	Nakshi Kantha
50	Handicrafts	Karnataka	Ganjifa cards of Mysore (Karnataka)
51	Textiles	Karnataka	Navalgund Durries
52	Handicrafts	Karnataka	Karnataka Bronze Ware
53	Textiles	Karnataka	Molakalmuru Sarees
54	Coffee	Karnataka	Monsooned Malabar Arabica Coffee
55	Coffee	Karnataka	Monsooned Malabar Robusta Coffee

56	Agricultural Products	Kerala	Spices - Alleppey Green Cardamom
57	Agricultural Products	Karnataka	Coorg Green Cardamom
58	E. I. Leather	Tamil Nadu	E. I. Leather
59	Textiles and Textile Goods	Tamil Nadu	Salem Silk
60	Textiles and Textile Goods	Tamil Nadu	Kovai Cora Cotton
61	Textiles and Textile Goods	Tamil Nadu	Arani Silk

Patents (Amendment) Act 2005

Indian Parliament passed the Patents (Amendment) Bill 2005. It introduced product patent regime for food, chemicals and pharmaceuticals. India was required to introduce product patent protection in these sectors from 1.1.2005 in accordance with the obligation under the TRIPS Agreement of the WTO.

Highlights of the Act

- Product patent protection to drugs, foods and chemicals
- availability of Pre-grant and Post-grant challenge
- discovery of a new form of a known substance does not qualify for a patent; nor mere discovery of any new property or new use for a known substance
- Introduction of a provision for enabling grant of compulsory license and parallel imports to meet public health crises

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; also, TRIPS is a part of the larger

WTO package.

There is a fear that prices of medicines will spiral due to product patents as it can lead to monopoly pricing. Some experts say the fear is unfounded because 97 per cent of all drugs manufactured in India are off-patent and will remain unaffected.

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 fees. (Generic medicines are unbranded drugs . They can be produced for drugs for which either there is a process patent or the product patent expired. Once product patents are introduced for drugs, generic manufacturers can not continue in India except when they pay a fee if the patent holder agrees)

Another criticism is that it acts as a roadblock to cheap drugs.Indian generic companies brought down the prices of antiretroviral therapy for HIV/AIDS from $12,000 to $140 a year. Two-thirds of the world' s population will be systematically deprived of life-saving drugs when the Indian law comes into effect. Countries in Africa are dependent on Indian generic products and the WHO [World Health Organisation] expressed apprehensions about the Act.

The other criticism is that patents being given for 20 years will stunt technological development in India.

However, supporters argue that that product patents provide an opportunity for greater investment in R and D and exploitation of global markets. Prices also may not rise much as there is bound to be competition and also government regulation. DPCO-Drug Price Control Order of the Government ensures that essential drugs are sold cheap.Another reassurance about whether TRIPS can cripple public health concerns relates to compulsory licensing and parallel imports.

The **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, genericmedicines 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 October 2011
by Australia, Canada, Japan, Morocco, New Zealand, Singapore, South Korea, and

the United States.[5] In 2012, Mexico, the European Union and 22 countries which are member states of the European Union signed as well.[6] No signatory has ratified (formally approved) the agreement, which would come into force after ratification by six countries. After entry into force, the treaty would only apply in those countries that ratified it.

Supporters have described the agreement as a response to "the increase in global trade of counterfeit goods and pirated copyright protected works". Trades Unions representing workers in the music, film and TV industries [7] and large intellectual property-based organizations such as the Motion Picture Association of America and Pharmaceutical Research and Manufacturers of America were active in the treaty's development.

Opponents say the convention adversely affects fundamental rights including freedom of expression and privacy. ACTA has also been criticised by Doctors Without Borders for endangering access to medicines in developing countries.[8] The secret nature of negotiations has excluded civil society groups, developing countries and the general public from the agreement's negotiation process and it has been described as policy laundering by critics including the Electronic Frontier Foundation and the Entertainment Consumers Association.

The signature of the EU and many of its member states resulted in the resignation in protest of the European Parliament's appointed chief investigator, rapporteur Kader Arif, as well as widespread protests across Europe. In 2012 the newly-appointed rapporteur, British MEP David Martin, recommended against the treaty, stating: "The intended benefits of this international agreement are far outweighed by the potential threats to civil liberties". On 4 July 2012, the European Parliament rejected the agreement in plenary session, with 478 voting against the treaty, 39 in favour and 165 MEPs abstaining.[9]

European Union (EU) Parliament Rejects ACTA

In a huge boost to makers of generic medicines, the European Union (EU) parliament in July 2012 rejected ACTA.

The Anti-Counterfeiting Trade Agreement, or ACTA, sought to empower EU and other customs authorities to seize in-transit legitimate generic medicines from countries like India if their innovators- the original patent holder whose patent has expired and the drugs are eligible for generic production- enjoyed patent protection in the EU countries.

On mere allegations, including those brought by competitors, generic manufacturers allegedly infringing a trademark or patent could have faced a destruction of goods or criminal proceedings under ACTA.

In 2008 and 2009, more than 18 in-transit consignments of generics from India — manufactured by companies like Aurobindo, Cipla, Dr Reddy's and Ind-Swift Laboratories — were seized in Paris and the Netherlands on the ground of being 'counterfeit' since their innovators enjoyed patents in France and the Netherlands.The seized drugs, meant for treating AIDS, blood pressure, Alzheimer's and other diseases, were bound for markets like Columbia, Brazil, Peru and Nigeria.

Pharma industry officials welcomed the move.

The treaty clauses could still come in the way of the industry in the US and other countries that have signed it.The US, Australia, Canada and Japan signed the ACTA in 2011(given above), while 22 members of the EU signed it in January 2012.

It must be stressed that the generics conform to the WTO-TRIPS standards. But the companies whose patents have expired want to continue to enjoy monopoly rights over the products and are responsible for the ACTA through pressure on the governments. ACTA violates WTO norms.

The Anti-Counterfeiting Trade Agreement (ACTA) is a secret IP treaty being negotiated by the US, Japan, the European Commission and others outside of the normal international trade bodies the World Trade Organisation (WTO) and the World Intellectual Property Organisation (WIPO).

India argued that in going further than TRIPS, ACTA undermined not only the WTO and its agreements, but the very basis of some elements in developing nations' economies.

"Such higher levels of protection are likely to disturb the balance of rights and obligations in the Agreement ... and have the potential to constrain TRIPS and the public health clauses in it.

The TRIPS Agreement has achieved a very careful balance of the interests of the right holders on the one hand, and societal interests, including development-oriented concerns on the other."

Acta could impede legitimate competition. Harm interests of poor people. Hurt the developing countries. They are a violation of the WTO regime and its social commitment.It is unilateral.

Public Health Concerns : TRIPS Agreement and Safeguards

Safeguards in the TRIPS Agreement include provisions that allow "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 allows a government to temporarily override a patent. Government may issue a compulsory license to a company to produce generics when faced with a public health problem. 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. (Generic drugs are unbranded drugs with the same chemical ingredients of a the branded drug)

Tamiflu

Oseltamavir (Tamiflu) generic makers from India see greater demand for their cheaper versions of the anti-flu drug, as the swine flu spread across the continents.

Recently, the Indian Patent Office denied Gilead Science Inc. patent rights for its anti-influenza drug oseltamivir phosphate marketed as Tamiflu, in India.

India's generic firm Cipla Ltd had earlier opposed extending patent rights to Gilead's Tamiflu as did not have inventive step – a pre-requisite for products to gain patents in India.

The Mumbai-based Cipla filed a pre grant opposition suit with the Indian Patent Office against the applicant Gilead alleging that Tamiflu did not have the inventive step or non-obviousness.

Cipla had received marketing approval from the drug controller-general of India in 2006.

Patent laws allow governments to authorise supply from generic companies, subject to remuneration to patent owners to address public health problems, including emergencies.

The US government has already declared the swine flu outbreak a public health emergency.

Cipla's version of oseltamivir is priced at about Rs 1,000 per strip of ten 75 mg tablets. It is less than half the current Tamiflu market price of $60.

Now Cipla claims that it can legally sell oseltamivir to India and 49 other developing countries.

Glivec

Supreme Court will hear final arguments from September 11, 2012 in a key patent dispute between Swiss drugmaker Novartis and India's patent office, a case that involves legality of patent law in India and the concerns of cancer patients and cheap generic medicines in general. India's global position as a supplier of cut-price generic medicines is also at stake.

Novartis appealed to the Supreme Court after its cancer medicine Glivec was refused a patent on the grounds the drug is not a new molecule but an amended version of a known compound. Novartis has challenged this clause of Indian Patents Act.

The case has further built tensions between the Big Pharma and India, following a decision by the patent office in March 2012 to strip Germany's Bayer AG of its exclusive right to sell another costly cancer drug, Nexavar.

Nexavar

The government has allowed Indian drugmaker, Natco Pharma, to make and sell a patented cancer drug at a fraction of the price charged by Germany's Bayer AG, setting a precedent for more such efforts by Indian firms and heightening the global pharmaceutical industry's anxiety over the use of the controversial compulsory licensing provision.

Patent controller of India, PH Kurian, in March 2012 granted the country's first compulsory licence to Hyderabad-based Natco Pharma, permitting it to manufacture and market a generic version of Nexavar, a medicine used for treating liver and kidney cancer, in India for just 3% of the patented drug's price in return for paying 6% royalty on sales to Bayer.

The order may encourage other Indian drugmakers to file for compulsory licences, setting the stage for a spate of regulatory disputes between Indian and foreign drug companies over pricing and patent issues.

The following graphic has been taken from Economic Times:

A Blockbuster Deal

Compulsory licensing

A provision that gives the government rights to allow a generic drugmaker to make and sell a low-cost version of a patented drug in India under certain conditions, without the consent of the patent holder, by paying royalty

Today's order

Allows Natco Pharma to make and sell generic version of Bayer AG's patented kidney and liver cancer medicine Nexavar in India at Rs 8,880 for 120 tablets by paying 6% royalty to Bayer AG. Nexavar costs Rs 2.84 lakh for the same dosage

Implication More Indian firms may apply for similar applications. Innovator companies may lower prices of their patented drugs. Long-drawn legal battles expected

Nexavar Sales

	2009	2010
Global	\$843 m	\$934 m
India	₹16 cr	Not Known

The compulsory licensing provision arms the government with the power to ensure that medicines are available to patients at affordable rates and has so far been used in Brazil, Thailand and South Africa.

It gives the government the right to allow a generic drugmaker 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.

One important positive consequence of the order may be that MNCs may adopt multiple/dual pricing- selling drugs cheap relatively in developing countries.

In his order, the patent controller said Natco's application met three key conditions for granting compulsory licences. First, the German firm was able to supply its drugs to only 2% of the country's patient population and did not meet the 'reasonable public criteria' requirement. That is, it did not make sufficient efforts to make the drug available to public. Second, its price was not "reasonably affordable", and third, it was imported and not manufactured in the country.

Health experts and NGOs have welcomed the order saying it would deter innovator companies from selling their drugs at exorbitant prices.

Initially, Natco had sought voluntary licence for Nexavar from Bayer. The German company rejected Natco's proposal, saying it needed to reinvest its earnings from such patented products for future R&D.

Subsequently, the Hyderabad based drugmaker applied for a compulsory licence. The Hyderabad-based firm will have to make the kidney and liver cancer drug at its own manufacturing plant and send quarterly updates about sales to Bayer and the patent office. Natco has also committed to donate free supplies of the medicines to 600 needy patients each year.

The licence granted to Natco was under Section 84 of the Indian Patent Act, which is in compliance with the TRIPS agreement of the World Trade Organization.

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 patents. That is , they can protect inventions either on the basis of patents or any other indigenous system (sui generis).

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 was adopted in 1995 and details are being worked out since then .. GATS rules 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 includes direct foreign investment in services. Liberalisation means national treatment to foreign investor; ending public monopolies, as well as deregulation whenever a regulation is considered restrictive for foreign investors and service providers.

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 partners covering sectors with export interest. These requests ask for full market access and national treatment commitments. National treatment requires that foreign investor should be offered the same terms as the local one.

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.

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. 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.
The criticism is that since the developing countries believed that they received a raw deal under the Marrakesh Treaty in matters related to agriculture, patents and so on, 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.Two Ministerial Meets at Cancun(Mexico) in 2003 and Hong Kong in 2005 took place without a result. The mini-ministerial in Geneva in 2008 also broke down due to deep differences between the developing countries and the advanced countries.The informal meet in New Delhi of trade ministers in September 2009 is to develop common ground so that the Doha round can be wrapped up by 2010. 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.

Developing countries' demands and concerns

In the Cancun Ministerial Meet 2003 , developing countries like India, Brazil, South Africa and China formed the Group of 20 countries- G20 . They want the US to slash its agricultural export and domestic subsidies and the EU to reduce tariffs on agricultural goods so that international market is relatively free of distortion and allows fair competition.

This is the 'offensive' interest of the south countries. On the 'defensive' side, countries like India want acceptance of two provisions: special products and special safeguard mechanisms.

Developed countries demands

The rich countries(North) want the developing countries to open up the domestic markets for the manufactured goods- called Non-Agricultural Goods Market Access(NAMA) which the poor countries are resisting partly because it hurts the domestic industry at this stage and partly to use it as a bargaining lever for reforms expected of the rich countries in agriculture. Agriculture is associated with food security, livelihood security and holds key to self-reliance in these countries.

Rich countries also want liberalization of the services sector in the fields of education, legal advice and insurance.

US and EU consider access to rapidly developing economies as vital to their own growth. The negotiations are not yielding results as the poor countries are not responding to the demands on NAMA positively till their concerns on agricultural subsidy and tariff cut were met. Both the Cancun and Hong Kong Ministerial Meets broke down on this issue.

MFN

The principle of the MFN treatment means that the tariff policy that one country receives in an organization should be extended to all others. Some members may form a preferential trading block within the larger body but all others should atleast receive normal treatment. Contrary to the popular view, the MFN does not mean giving special treatment to imports from another country. It only means normal trading relation- neither positive nor negative discrimination. MFN treatment is not limited to tariffs. It extends on all matters like quotas and other rules related foreign trade.

The members of the World Trade Organization, which also include all developed nations, accord MFN status to each other.

What are the benefits

- It provides level playing field among countries which is the essence of multilateralism
- A country can import from the most efficient source. This may not be the case if tariffs differ by country.
- Poorer countries will have normal trading relations with the rich countries which may not be the case otherwise

- Same tariffs being given to all countries will lead to customs rule simplification
- Domestic companies can not lobby for protectionist measures as the government is committed to MFN tariffs with all countries.

WTO allows departures from the MFN principle.

- imports from poor countries are allowed at lower/zero tariffs(Generalised System of Preferences (GSP)
- 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.

Regional Trading Arrangement (RTA) and Multilateralism under WTO

Conceptually, PTA/FTAs should be understood in the context of economic integration among countries- usually in a geographical region.

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.

Customs union is one where the FTA members have a common tariff policy towards non members.

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 an monetary and economic union.

As mentioned above, RTAs are allowed under the WTO. Some countries grant themselves concessions in regional and extra-regional trade that other members of the WTO are denied and given only MFN. Benefits are many

- 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.

Regionalism and Multilateralism

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
- 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

- 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-4 -- the United States, the European Union, Brazil and India. It has developing and the developed world.

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. It stands for drastic reduction in agricultural subsidies by industrialized nations and opposed liberalization like Singapore issues and NAMA. The G-20 accounts for 60% of the world population, 70% of its farmers and 26% of world's agricultural exports

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.

WTO Words

- ACP countries - About 70 African, Caribbean and Pacific (developing) countries that have preferential access to the EU market.
- AMS – Aggregate Measurement of Support shows the extent of support-provided by governments to the agricultural sector, including direct payments to farmers and intervention in the market, e.g. through setting minimum prices. There are limits set on AMS under the AOA of WTO.
- Agreement on Agriculture - the first multilateral framework for the long-term reform of agricultural trade, through the creation of specific rules and commitments for international and domestic agricultural activities, e.g. tariffs, export subsidies and domestic support.
- Amber box - trade and production-distorting policies. They are subject to reduction commitments (AMS).
- Anti-dumping duties – special import duties imposed when a firm, following an enquiry, is assessed as having sold a product in the importing market at a price below the one it charges in the home market or below the cost of production or at less than fair value; and it damages the producers in the importing country
- Blue box – Trade-distorting direct payments to farmers combined with production-limiting programmes, e.g. programmes requiring land to be "set-aside" from production. Blue box support is not subject to reduction commitments in the Uruguay Round. .
- Cairns Group – A group formed in 1986, comprising 17 WTO members dedicated to the fundamental reform of the agricultural trading system. The Chair is Australia. Other members are New Zealand, Argentina, All but three – New Zealand, Australia and Canada – are developing countries.
- Common Agricultural Policy (CAP) - the EU's internal agricultural policy, intended to provide stable agricultural markets and incomes for European farmers and food for European consumers through a system of domestic support, market access protection and export subsidies.
- Countervailing duties - special duties imposed on imports to offset the actual or potential injurious effects (i.e. price undercutting) of subsidies to producers or exporters in the country of export.
- Dumping - exporting goods at a price lower than the price a company normally charges on the domestic market. Governments in the importing

country may levy anti-dumping duties, designed to offset the actual or potential injurious effects of dumping practices.

- Export Subsidies – government payments or other financial contributions provided to domestic producers or exporters if they export their goods and services (i.e. contingent on export performance).
- Government procurement – purchases by central and local governments.
- LDCs – Least Developed Countries, group defined by the United Nations on the basis of certain economic indicators. Includes 49 countries .
- Market Access - a negotiated commitment to guarantee a certain level of access in specified sectors.
- Most-Favoured Nation (MFN) – A core principle of the multilateral trading system which requires that normal trade be conducted among all members.
- Multilateral – among many parties, e.g. the WTO is a multilateral organisation involving 148 economies.
- National treatment - In services trade, a WTO member agrees in certain "committed" sectors to treat a foreign supplier no less favourably than a domestic supplier.
- Natural persons - People, as distinct from juridical persons such as companies and organisations. 'Movement of natural persons' concerns the ease of travel through and ability to live and work in other countries.
- Non-discrimination – a core principle of the multilateral trading system under the WTO. It includes most favoured nation (MFN) treatment and national treatment.
- Non-tariff barriers – government measures others than tariffs that restrict trade flows. Examples include quantitative restrictions, import licensing, standards and conformance regulations.
- Plurilateral – among several parties, e.g. the FTAA
- Round – the process of multilateral trade negotiations. Each of the eight sets of negotiations prior to the Doha Development Agenda (DDA) has been called a Round, e.g. the Uruguay Round, the Tokyo Round.
- Rules of origin – the production and content criteria defining where a good comes from. For example, among the FTA countries, any country can import from non-member countries but has to add a minimum value of about 30% or so before it can be traded within the FTA region.
- Safeguard action - temporary measures to allow countries to adjust to heightened competition from foreign suppliers, even where the competition is not a result of dumped or subsidised product.

- S&D – the "special and differential treatment", i.e. flexibility, given to developing countries in implementing WTO commitments, allowing longer phase-in times and addressing concerns such as food security and rural development.
- SPS – Sanitary and Phytosanitary agreement within the WTO dealing with trade affecting human, animal and plant health and life.
- Tariff escalation - tariff rates that increase with each additional level of processing, thus penalising value-added products, as is often the case with our wood exports.
- Tariff peaks – tariffs on particular products that are significantly higher that the typical tariff that the country in question levies on the full range of imports.
- Tariff rate quotas - allow a certain volume of product access at a lower tariff level. A higher tariff is charged on products imported outside the tariff quota.
- Three pillars - Market access, export competition and domestic support are the three pillars of the Agreement on Agriculture.

G33 and SP and SSM

G-33 is an alliance of developing countries on Special Products (SP) and Special Safeguard Mechanism (SSM) in the ongoing agriculture negotiations in the World Trade Organisation (WTO).

The WTO Framework Agreement of 2004 – also known as the July Framework – which laid down the parameters for further negotiations in the Doha Round, contained two major elements of interest to developing countries in the area of agricultural market access

It provided that developing countries would be eligible to designate an appropriate number of products as Special Products, based on their food and livelihood security or rural development needs; and

It also provided for the use of a Special Safeguard Mechanism against surge in imports so as to safeguard domestic producers of agricultural products in developing 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 (i.e., restrict importation 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 supposed to be 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.

Special Products and Special Safeguard Mechanisms

Special Products (SP) and Special Safeguard Mechanisms (SSM) are key concerns of developing nations involved in WTO negotiations. 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. Even with the available headroom between bound and applied tariff rates, 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.

The Hong Kong Ministerial text allows developing countries the right to impose SSMs based on both price and volume triggers. This means that developing countries will have the option of temporarily imposing higher tariff rates on the import of an agricultural product if there is either a surge in its import volume or a sharp dip in its import price. However, the exact mechanisms of the implementation of SSMs have not been spelt out.

To conclude, Special Products and Special Safeguards Mechanisms together can provide a reasonable level of protection to the agriculture sector of developing countries.

Safeguard Duty

When imports of a particular product, as a result of tariff concessions or other WTO obligations undertaken by the importing country, increase unexpectedly to a point that they cause or threaten to cause serious injury to domestic producers of like or directly competitive products, a safeguard which is a form of temporary relief is used. Safeguards give domestic producers a period of grace to become more competitive vis-à-vis imports.

If this happens, the government of the importing country may suspend the concession or obligation, but will be expected to provide compensation by offering some other concession. Otherwise, the affected WTO member(s) can retaliate by withdrawing equivalent concessions. Safeguards usually take the form of increased duties to higher than bound rate or standard rates or quantitative restrictions on imports.

Safeguard duty in India

The Central Government after conducting an enquiry is satisfied that any article is imported into the country in such increased quantities and under such conditions so as to cause or threatening to cause serious injury to domestic industry, then it may by notification impose a safeguard duty on that article.

Faced with complaints from domestic manufacturers of a surge in import of caustic soda, a chemical used as a base for making products such as paper, textiles, soap and detergents, India has initiated investigations for imposing a safeguard duty on it.

The investigation has been initiated by the directorate general of safeguards (DGS following a complaint. The imports have come mostly from China, Qatar, Thailand and Saudi Arabia.

Special safeguard mechanism and safe guard duty: differences

Safeguards are contingency restrictions on imports taken temporarily to deal with special circumstances such as a sudden surge in imports or depressed prices. The special safeguards provisions for agriculture differ from normal safeguards. In agriculture, unlike with normal safeguards:

- higher safeguards duties can be triggered automatically when import volumes rise above a certain level, or if prices fall below a certain level; and
- it is not necessary to demonstrate that serious injury is being caused to the domestic producer.

Special and differential treatment

The principle of special and differential treatment for addressing the concerns of developing countries is incorporated through a number of provisions in the area of market access including, proportionately lower tariff reductions and longer implementation periods, working out a tariff reduction formula after taking into account the different tariff structures of developed and developing countries as well as the new instruments of SP and SSM.

The Ministers are expected to discuss suggestions on SP and SSM in the WTO so that the sensitivities of various members of G-33 could be factored in the first approximation expected in July and also later in the Ministerial Declaration in Hong Kong.

What has India gained from the WTO?

- MFN status in the 153 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)
- Definitive schedule for trade liberalization with special protection so as to calibrate alignment with global economy
- Opportunity to throw up MNCs in the pharma sector
- Opportunity to step up agri exports as Indian agricultural reforms yield results and USA and EU reduce their subsidies

The adverse effect is in the from of uncertainties in the age of globalization; drug prices of some products going up due to product patents; farmers feeling the pressure of open trade etc.

WTO: Boon or bane

WTO liberalises International trade and steps up the total output which in turn promotes standards of living for all participants sooner or later. However, the exact impact differs from country to country- the rich benefiting sooner and more substantially than the poor , in general.

There are many benefits to India from its membership of the WTO

- The globalization process that WTO ensures is the course chosen by India as a part of the economic reforms launched in 1991.
- It is a multilateral trade body with 153 members and so can set the pace for globalization to benefit all
- Most Favoured Nation(MFN) treatment is given to all members within the body by one another. MFN essentially means normal trade among member countries.
- The one country one vote system of decision making makes WTO a democratic body where rich do not command greater voting weightage
- Dispute settlement process is rule based and transparent
- India has advantage in the services sector and will benefit from its opening up
- Lower tariffs, introduced gradually and the right pace, will make Indian economy competitive
- Reduction of subsidies on agriculture by the developed countries will help India tap its agricultural potential to capture global markets

The opponents argue the following

- While globalization is welcome, its pace must be set by the sovereign government
- The agreement on TRIPS works against affordable medicines
- Multinational corporations influence the agreements and their working in WTO to their advantage
- Farmers may lose their livelihood as agriculture is compulsorily thrown open to imports at lower import duties
- Rich countries are not following their treaty obligations and reduce agricultural subsidies and tariffs
- The dispute settlement process gives the impression of being fair and transparent but works against poor countries as there is no way of enforcing the verdict of the dispute settlement body.

TBT and SPS

The Agreement on Technical Barriers to Trade --- commonly referred to as the TBT Agreement --- 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 (first the ban and then its revision to new mandatory safety standards).

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 four issues have been controversial. Poor countries do not allow them to be brought into the agendas they feel that they might damage their economic interests. In Cancun Ministerial, trade facilitation is admitted by consensus as it has only procedural implications.

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.

Nama

The Non-Agricultural Market Access (NAMA) negotiations cover all those products that are not covered by the Agreement on Agriculture or the negotiations on services. In practiee, NAMA products include manufacturing products.

The NAMA negotiations have been considered important by the WTO because NAMA products account for almost 90% of the world's merchandise exports.

After the Doha Declaration was adopted in 2001, negotiations on NAMA formally began in 2002 In the beginning, negotiations on non-agricultural products were to be concluded by 1 January 2005.

However, this deadline was missed and the negotiations are still under way.

The deadlock on NAMA negotiations centres around how much tariff cut should be made; what formula should be sued; and whether north and south countries should be treated alike.However, here too the developed and developing countries are divided

Swiss formula and India

Tariff cut formulae are either linear or non-linear. In a linear formula, tariffs are reduced by the same percentage, irrespective of how high the initial tariff is. As opposed to a linear formula, in a non-linear formula, tariff cuts are directly or inversely proportional to the initial tariff rate.

Swiss formula is a non-linear formula. In the Swiss formula, tariff cuts are proportionally higher for tariffs which are initially higher. For instance, a country which has an initial tariff of 30% on a product will have to undertake proportionally higher cuts than a country which has an initial tariff of 20% on the same product.

India's average tariffs are much higher than those existing in the developed countries. If a linear formula for tariff reduction was used, then its reduction burden would have been proportional to that of developed countries. However, using a Swiss formula could lead to India taking on a greater reduction commitment than its developed counterparts with lower initial tariffs.

Nama 11 is a coalition of strong developing countries (including Argentina, Brazil, Egypt, Venezuela and the Philippines). They are fighting to get a fair deal from the north countries. India is a member.

H1B Visa Fee Hike and WTO-Compatibility

The new law- Border Security Act - earmarks funds from the visa fee hike to pay for the US government's plans to boost security along its border with Mexico to crack down on illegal immigration and drug smuggling.

The visa fee hike "is WTO incompatible and India is considering challenging the US legislation before the World Trade Organisation.

The 600-million-dollar measure, will nearly double visa fees for some Indian information technology workers entering the United States.

The National Association of Software and Services Companies (NASSCOM), which represents India's top software exporters, has said the measure will increase annual US visa costs for the sector by 200-250 million dollars.

The US legislation affects those skilled workers brought in by companies whose employees are more than 50 per cent foreign, a move that largely affects India's IT and outsourcing industries.

US high-tech firms such as Microsoft, which bring skilled immigrants into the United States on the same visas, will not be hit because the vast majority of their workforce is American.

More than half of the world's top 500 companies outsource work to India, which has become the world's back office where Western firms have set up call centres and number-crunching and software development outlets to cut costs.

But the industry also flies employees to the US each year to work at their clients' locations as on-site technicians and engineers.

Under the law, fees for non-immigrant 'H1B' and 'L' visas go up by 2,000 dollars for firms with more than a 50 per cent non-American workforce. The fee now is 2,500 dollars.

Anti-outsourcing sentiment in the United States has been stoked by high unemployment.

Banana Wars

The European Union has agreed a deal with Latin American countries and the US to end the long-running "banana wars" trade dispute in late 2009.

The term "banana wars" refers to a series of trade disputes between the European Union, the United States and several Latin American countries concerning access to Europe's banana market.

The disputes surround EU tariffs on banana imports.

There is no duty imposed on bananas imported from former European colonies in Africa, the Caribbean and the Pacific (known as the ACP countries).

However, the EU charges duties on bananas imported from other countries.

This includes bananas from some of the world's largest banana producers in Latin America, who argue that the tariffs are unfair and breach free trade rules.

The US has a vested interest in the issue, as the largest banana producers in Latin America are operated by US companies including Dole and Del Monte.

Latin American banana producers have been complaining about the unfairness of the EU tariffs ever since they were introduced.

In 1996, Ecuador, Guatemala, Honduras and Mexico, together with the US, formally complained to the World Trade Organization (WTO) about the tariffs.

Since then the WTO has repeatedly ruled that the EU tariffs are unfair.

"The Geneva Agreement on trade on bananas", brokered without the WTO, will see the EU gradually reduce the tariffs it charges Latin American banana importers.

US Cotton Subsidies

American subsidies to the cotton growers makes US cotton so cheap that it hurts other countries producing cotton. It distorts international trade. Brazil dragged the USA to WTO on this score and had an important victory in 2009 August. Brazil was allowed to slap sanctions on US goods and drugs upto $300million annually.

Protectionism

Protectionism is the economic policy of restricting trade and economic relations between countries , through methods such as tariffs on imported goods, restrictive quotas, and a variety of other restrictive government regulations designed to discourage imports, and prevent foreign participation in local markets and companies. This policy is closely aligned with anti-globalization, and contrasts with free trade, where government barriers to trade are kept to a minimum. Protectionism refers to policies or doctrines which "protect" businesses and workers within a country by restricting or regulating trade with foreign nations.

Historically, protectionism was associated with import substitution. Contemporary economists agree that protectionism is harmful in that its costs outweigh the benefits, and that it impedes economic growth. Recent examples of protectionism in first world countries are typically motivated by the desire to protect the livelihoods of individuals in politically important domestic industries. US stimulus package encourages `buy American ' philosophy.

Whereas formerly blue-collar jobs were being lost to foreign competition, in recent years there has been a renewed discussion of protectionism due to offshore outsourcing and the loss of white-collar jobs. However, most economists agree that the benefits from free trade in the form of consumer surplus and increased efficiency outweigh the losses of jobs.

- Instruments of protectionism

A variety of policies can be used to achieve protectionist goals. These include:

- Tariffs: Typically, tariffs (or taxes) are imposed on imported goods. Tariff rates usually vary according to the type of goods imported. Import tariffs will increase the cost to importers, and increase the price of imported goods in the local markets, thus lowering the quantity of goods imported. Tariffs may also be imposed on exports.
- Import quotas: To reduce the quantity and thus protect the domestic producers. The economic effects of an import quota is similar to that of a tariff more or less.
- Administrative Barriers: Countries are sometimes accused of using their various administrative rules (eg. regarding food safety, environmental standards etc.) as a way to introduce barriers to imports.
- Anti-dumping legislation Supporters of anti-dumping laws argue that they prevent "dumping" of cheaper foreign goods that would cause local firms to close down. However, in practice, anti-dumping laws are usually used to impose trade tariffs on foreign exporters.
- Direct Subsidies: Government subsidies (in the form of lump-sum payments or cheap loans) are sometimes given to local firms that cannot compete well against foreign imports. These subsidies aim to "protect" local jobs, and to help local firms adjust to the world markets.
- Export Subsidies: Export subsidies are often used by governments to increase exports. Export subsidies are the opposite of export tariffs, exporters are paid a percentage of the value of their exports. Export subsidies increase the amount of trade and help the local producers.
- Exchange Rate manipulation: A government may intervene in the foreign exchange market to lower the value of its currency by selling its currency in the foreign exchange market. Doing so will raise the cost of imports and lower the cost of exports, leading to an improvement in its trade balance. However, such a policy is only effective in the short run, as it will most likely lead to inflation in the country, which will in turn raise the cost of exports, and reduce the relative price of imports.

Other initiatives besides tariffs have also been cited as protectionist. For example, some commentators, such as Jagdish Bhagwati, see developed countries efforts in imposing their own labor or environmental standards as protectionism. Also, the imposition of restrictive certification procedures on imports are seen in this light.

Further, others point out that free trade agreements often have protectionist provisions such as intellectual property, copyright, and patent restrictions that benefit large corporations.

There are three types of protectionism:

- help protect infant industries as India followed them in the pre-reform period. It allows domestic industries to grow and become strong before they are opened up for competition
- protectionism for public interest and social good like SP and SSM mechanisms under WTO
- the third variety is when the economy is in crisis and politically it becomes necessary to close the economy for imports to save jobs. For example, may countries in the global recession (2008-09). These are temporary measures lasting till the crisis lasts.

Arguments against Protectionism

Protectionism is frequently criticized as harming the people it is meant to help. Free trade helps all including third world economies and workers. This is because "the growth of manufacturing has a ripple effect throughout the international economy" and creates competition among producers, lifting wages and living conditions. Protectionist proposals stunt economy and make it uncompetitive and so harm jobs and increase prices and lose out on innovation.

Current world trends

World Trade Organization. since its inception in 1995 has been striving for free trade. G20 meeting in London in April 2009 promised to continue the Doha Round and warned against protectionism as the restoration of international economic growth demands that protectionism be scrupulously avoided.

Some recent measures that have raised complaints of protectionism

China - Frequent target of complaints that it blocks access to its markets or gives unfair help to exporters, including by keeping its yuan currency weak. China rejected a $2.4 billion bid by Coca-Cola for China's top juice maker, Huiyuan Juice blocking what would have been the largest-ever takeover of a Chinese company by a foreign rival.- Increased rebates under the duty drawback system for exporters.

EU - Imposed anti-dumping duties on Chinese screws, fasteners, candles and steel wire products.- Reinstated export subsidies on dairy produce.- Imposed steep anti-dumping and anti-subsidy duties on imports of biodiesel from the United States.

India - Initiated anti-dumping investigations on some imported steel products affecting 19 countries. It also banned imports of Chinese toys for six months, saying it was in the interest of public safety. Increased rebates under the duty drawback system for exporters.

Japan - Introduced special safeguard measures on imports of certain foods

Russia - Raised duties on imports of used cars to prop up its struggling domestic industry.

USA - A $787 billion U.S. stimulus packagewas criticised for its "Buy American" clause that says firms must use U.S. steel and other U.S.-made goods. Multibillion dollar lifeline to two Detroit carmakers

Bhagavati and protectionsim

As indicated above, Dr Jagdish N. Bhagwati says there are two kinds of protectionism

- one, that is violative of WTO rules (such as the 'buy American' provision in the US economic stimulus package) and
- two, the exercise of options allowed under the WTO rules, such as bringing in a safeguard duty or raising tariffs from existing levels but still below bound levels.

While the first form of protectionism is bad , there is nothing wrong with the second kind, which is only an exercise of permitted options.

Prof.Bhagavati feels that measures such as 'buy American' will not work essentially because the well-globalised American companies themselves will provide sufficient counterweight to such measures.

The Tragedy of the Commons

It is an influential article written by Garrett Hardin in 1968. The article describes a dilemma in which multiple individuals acting independently in their own self-interest can ultimately destroy a shared limited resource even when it is clear that it is not in anyone's long term interest for this to happen.

Beggar thy neighbour

It is a policy and means that one nation develops at the expense of others. Beggar thy neighbour, or beggar-my-neighbour policy is an attempt to remedy the economic problems in one country by means which tend to worsen the problems of other countries. The term was originally devised to characterize policies of trying to cure domestic depression and unemployment by shifting effective demand away from imports onto domestically produced goods, either through tariffs and quotas on imports, or by competitive devaluation.

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 as "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: Administration of quota restrictions

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

Eighth Ministerial

The 8th Ministerial Conference of the World Trade Organization was held in Geneva in December 2011, amid challenging times for the trade body. Russia has been welcomed into the fold after nearly two decades of negotiations. But there has been no major progress on stalled trade talks.

The ministerial was held in circumstances where the world trade sharank after 2008 and does not have bright prospects of growth in the near future due to Eurozone crisis; increading resort to protectionism due to recessionary conditions of national economies and the resultant popular discontent expectations about jobs; proliferation of RTAs etc.

Delegates also knew that little or no progress would be made on the Doha Development Round due to the anger of the developing countries on certain issues and the determination of the developed countries like the US and EU not to accept any reforms in their domestic economies and not yield any concessions.

Supporters argue that WTO made progress- Russia's accession - and the continued battle against protectionism. But with Doha itself is stalled.

General Agreement on Trade and Tariffs in 1947 had 13 countries and WTO in 2012 has 156. That is also progress. Expanded agenda is also progress. Without the WTO, the world economy would be much worse and protectionism would be on the rise.

India's position

- expressed concern at the current impasse in the Doha negotiations
- stressed that this remains the Doha Development Round and so issues key to LDCs should be a priority, including implementation of the decisions on duty-free/quota-free access for LDCs and on cotton
- said that the decisions already on the table reflect years of hard work and the body should secure (fast-track) what has been settled and continue to work on multilateral negotiations

World Intellectual Property Organization (WIPO)

WIPO currently has 185 member states and administers 24 international treaties and is headquartered in Geneva, Switzerland. The current Director-General of WIPO is Francis Gurry

WIPO was formally created in 1970. Under Article 3 of this Convention, WIPO seeks to "promote the protection of intellectual property throughout the world." WIPO became a specialized agency of the UN in 1974. WIPO is responsible "for promoting creative intellectual activity and for facilitating the transfer of technology related to industrial property to the developing countries in order to accelerate economic, social and cultural development.

Unlike other branches of the United Nations, WIPO has significant financial resources independent of the contributions from its Member States. 90% of its income is generated from the collection of fees under the intellectual property application and registration systems which it administers (the Patent Cooperation Treaty, theMadrid system for trade marks and the Hague system for industrial designs).

Foreign Trade

No country is self--sufficient in all the goods and services that it requires. It has to depend on other countries for what it lacks. For example, India depends on other countries for crude oil, edible oil, pulses and so on. That is, we import them. Similarly, India has many surplus items- both goods and services that it can export to other countries. For example, agricultural goods, software services and so on. The exports and imports that a country makes together make up its foreign trade. If exports are more than imports, it is called trade surplus and if imports are more, it is called trade deficit. India almost every year since Independence had a trade deficit.

Exports are foreign exchange earners. They stabilise and strengthen the exchange rate, if they grow.They may be necessary for some imports- for example, jems and jewellery industry imports stones and carves them into jewelry in India. Exports make the domestic economy efficient as international market requires high quality low price goods and services.

Imports are important for exports, domestic capital formation and consumption. They make domestic producers competitive.

India's Exim policy: Its evolution and Content

India's external trade has evolved and witnessed many changes since Independence in 1947. Soon after Independence, the Government followed a policy of protectionism and so import substitution was the norm.

The import substitution policy followed during the restrictive phase gave way to a new phase of trade reforms after mid 1980s aimed at easing trade restrictions to promote economic growth and competitiveness. The pace of change in India's external trade policy and practices gathered real momentum in the 1990's. A slew of reforms were launched which included liberalization of imports. Today, except for a handful of goods disallowed on environmental, health and safety grounds and a few others that are canalized (bulk imports through designated agencies like STC) such as fertiliser, cereals, edible oils and crude, all goods can be imported without a license or other restrictions. Tariff reforms have also been addressed in a more systematic manner with across the board reduction in peak rates rather than selective exemptions. The peak rate of customs duty has been consistently brought down with the aim of converging it with the ASEAN levels. Today it is 10% . The reduction helps in making domestic economy competitive and helps imports for exports.

One of the instruments of shaping the country's trade dynamics is the Foreign Trade Policy. The bold Foreign Trade Policies (FTP) of 2004-09 and 2009-14 recognised that trade is not an end in itself but its primary purpose is to stimulate greater economic activity and employment generation. The FTP identified certain thrust sectors having prospects for export expansion and potential for employment generation. These include: (i) Agriculture; (ii) Handlooms & Handicrafts; (iii) Gems & Jewellery; and (iv) Leather & Footwear. Accordingly, specific policy initiatives for these sectors have been announced in the various "Annual Supplements" to the FTP every year.

The growth performance of trade is a reflection of the trade policies of the Government. Initially, with restrictive trade policies India's share in world export declined continuously from 2.2% in 1948 to 0.42% in 1980. After implementation of a series of trade reform measures India's share in exports rose. Today India has a share of 2% of global trade(2012)

In addition, diversification of exports to high growth locations in Asia, CIS countries, Africa and Latin America through special trading arrangements has given an added fillip to export growth.

Besides trade policy , another initiative of the government is to give a fillip to exports has been the introduction of Special Economic Zones (SEZs) .SEZ Act, 2005 .was intended to instill confidence in investors and signal the Government's commitment to a stable SEZ policy regime. 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:

Exports 2010-11

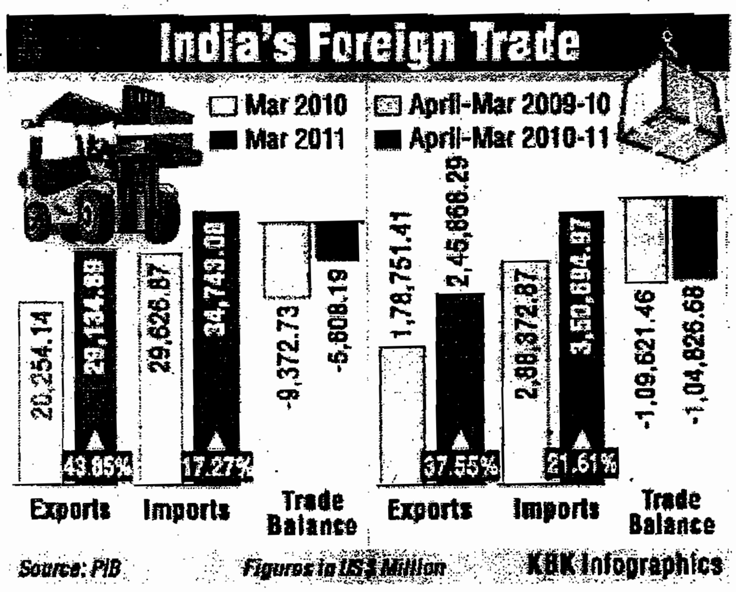
Financial year 2010-11 was exceptionally good for Indian exporters. With overall exports amounting to US$ 245.5 billion, the sector registered a growth of 37.7 percent in 2010-11 over the previous year. And this was a record growth witnessed in exports since independence.

The onset of recovery in the global economy, which was led by the emerging economies, coupled with continuation of export sops(interest rate subvention by 2%) announced by the government as part of the fiscal packages offered during the crisis period gave the sector the much needed impetus. In addition, the strategy of the government to continue exploring new and diverse markets for India's exports proved to be truly rewarding. Destination wise data available for the period April-December 2010 shows a significant increase in exports to regions like Latin America, Africa and other Asian countries.

For a long time India's exports had been concentrated in US and the European countries and the crisis provided a good opportunity to explore these other markets. India's exports to Africa grew by 44.9 percent, to Asia by 43 percent and to Middle East by 31 percent during April-December 2010 over the corresponding period in 2009-10. Given this exemplary performance in exports, India should be able to achieve exports of US$ 500 billion by the year 2013-14. Sectors like engineering goods, petroleum products, gems and jewellery, drugs and pharmaceuticals have done particularly well during the year 2010-11. Engineering goods were India's top exports in the year 2010-11 amounting to US$ 60 billion and registering a growth of over 80 percent vis-à-vis the previous year.

Further, while readymade garments registered a growth of 42.9 percent in the year 2010-11 over 2009-10, gems and jewellery and pharmaceuticals both witnessed a growth of about 15 percent. Petroleum products recorded a growth of 50.5 percent in 2010-11.

The strong momentum in exports, seen particularly during the second half of 2010-11, has continued in the year 2011-12 as well.



India's merchandise trade performance during 2011-12 Highlights

- During 2011-12, exports stood at US$ 303.7 billion and recorded a growth of 20.9 per cent. While the exports performed well during the first half of 2011-12, there was significant deceleration in the second half as global trading conditions deteriorated mainly reflecting weakening of world demand inter alia caused by euro zone crisis.

- During 2011-12, imports at US$ 488.6 billion registered a growth of 32.1 per cent as compared with 28.2 per cent in the preceding year. There has been a significant rise in import of petroleum, oil and lubricants (POL), gold and silver and machinery.
- Petroleum, oil and lubricants (POL) imports at US$ 155.6 billion in 2011-12 largely reflecting increase in international crude oil prices. The average price of Indian basket of crude oil during 2011-12 stood at US$ 111.6 per barrel.

- Gold and silver import at US$ 61.5 billion recorded a growth of 44.4 per cent during 2011-12 as compared with 43.5 per cent in 2010-11.
- Trade deficit during 2011-12 amounted to US$ 184.9 billion, as compared with US$ 118.7 billion during 2010-11.
- The disaggregated data on commodity-wise merchandise exports indicate that during 2011-12 engineering goods, petroleum products, chemicals, textiles, gems & jewellery and agricultural products contributed more than 85 per cent of India's exports.
- Share of exports to countries of European Union in India's total merchandise exports declined marginally India's Merchandise Trade during 2011-12.

Exports

Export growth on monthly basis (year-on-year) remained robust in the first half reflecting the continued impact of export promotional measures announced by the government. However, after peaking in July 2011, monthly export growth started moderating thereafter. In the second half of 2011-12, export growth was as low as 5.1 per cent as compared with 43.9 per cent in the first half.

Exports during 2011-12 stood at US$ 303.7 billion, recording a lower growth of 20.9 per cent as compared with an increase of 40.5 per cent during 2010-11.

Despite the rupee depreciation in the second half of 2011-12, export growth showed significant moderation mainly attributed to the slowdown in global trade caused by dismal economic and financial conditions in the US and euro zone economies. Withdrawal of certain export incentives (e.g., Duty Entitlement Passbook Scheme w.e.f. October 2011) might also have affected performance of certain export products.

As per the commodity-wise exports data available during 2011-12 shares of petroleum products and primary products increased during the period. Within manufacturing sector, the share of engineering goods and textile & textile products declined. Exports of engineering goods seem to have been severely affected during the second half as growth in exports from this sector was significantly lower .

Within engineering sector, growth in exports of transport equipment, manufactures of metals and iron and steel was significantly hit while that of electronic goods moderated marginally.

Within manufacturing, other commodity groups, viz., leather & manufactures, chemicals & related products and textile & textile products witnessed higher growth during April-December

2011 .Exports of petroleum products also grew by 54.2 per cent during April-December 2011 as against 44.9 per cent in corresponding period of 201011.Within primary products, exports of ores and minerals continued to show decline . Decline in exports of iron ore was mainly due to multiple problems pertaining to prolonged ban on mining in Karnataka, restriction on mining in Orissa and Goa, high export duty, differential railway freight and slowdown in international iron ore prices.
During the 2011-12 (April-December), the share of European Union and OPEC countries in India's exports declined as compared to April-December 2010.

(Table 3).

However, share of developing countries was marginally higher during the period. Destination-wise, exports during 2011-12 (April-December) indicate that the UAE continued to remain the biggest destination for Indian goods with a share of 11.6 per cent, followed by the US (11.1 per cent), Singapore and China (5.8 per cent each) and Hong Kong (4.1 per cent). These five countries together accounted for around 38 per cent of India's total exports during April-December 2011. In spite of uncertainties prevailing in Europe, India's exports to Germany, U.K, Netherlands and Belgium grew during April-December 2011 while the same to France showed a decline of 5.8 per cent. Growth in exports to Japan, SAARC region, Africa and some Latin American countries showed moderation .

Imports

During 2011-12, imports at US$ 488.6 billion registered a growth of 32.1 per cent (28.2 per cent a year ago). Import growth was primarily led by a spurt in POL, gold & silver and capital goods.

During 2011-12, the POL imports at US$ 155.6 billion showed a higher growth of 46.9 per cent (21.6 per cent in 2010-11), reflecting increase in international crude oil prices. The average price of Indian basket of crude oil during 2011-12 stood at US$ 111.6 per barrel which was 31.1 per cent higher than US$ 85.1 per barrel during 2010-11 . However, non-oil non-gold & silver imports at US$ 271.5 billion witnessed a lower growth of 22.7 per cent during 2011-12 as compared with 29.0 per cent in 2010-11. As per the data on commodity-wise imports for 2011-12 (April-December), petroleum and petroleum products continued to be a major item of India's imports, followed by capital goods and gold & silver. Petroleum, petroleum products and related material accounted for nearly 30.6 per cent of India's total merchandise imports. Import of gold & silver showed a significantly higher growth of 55.1 per cent as compared with 53.2 per cent in 2010-11.

During 2011-12 (April-December), share of European Union in India's total imports declined marginally .Country-wise, China continued to be the largest source of imports with a share of 12.4 per cent in total imports, followed by the UAE, Switzerland, Saudi Arabia and the US.

These five countries together constituted around 37.5 per cent of India's imports. Iraq replaced Iran as India's second-largest crude oil supplier in 2011-12.

Trade Deficit

The trade deficit during 2011-12 stood higher at US$ 184.9 billion than US$ 118.7 billion during 2010-11 mainly on account of large imports of POL and gold & silver accounting for 44.4 per cent of India's imports. Trade deficit during 2011-12 was 55.8 per cent higher than the level recorded in 2010-11.

Global Trade

According to the WTO, India had the fastest export growth among major economies in 2011, followed by China with the second fastest export growth at 9.3 per cent. World trade growth in 2011 was weighed down by the ongoing sovereign debt crisis in eurozone economies, supply chain disruptions from natural disasters in Japan and Thailand, and turmoil in Arab countries. As a result, global export growth remained lower than anticipated in most advanced economies in 2011.

Further, India's share in world export also showed some improvement during the recent period- 2%. Going forward, downward risks to India's exports continue on account of steeper than expected downturn in Europe, financial contagion related to the sovereign debt crisis, rapidly rising oil prices and geopolitical risks.

South-South Trade

Exports from developing countries now constitute 37% of global trade, of which about half relates to south-south trade. Hence, the need for deeper South-South interaction and collaboration which will help in having commonality of approaches on the major issues of international importance including climate change, UN reforms, reform of the international financial system, dealing with the global financial crisis, WTO etc.

Six fold increase in services sector exports.

Exports from the services sector, the largest and fastest growing sector in the economy, have recorded a more than six fold increase in the last nine years from 20.76 billion USD in 2002-03 to 131.97 billion USD in 2010-11. "If this growth rate is sustained, services export can touch the level of merchandise exports in the coming years, even as India's services trade, both export and imports, stood at 216.28 billion in 2010-11.

While the balance of trade in merchandise has been negative, it was constantly positive for services. While merchandise reported a deficit of 105 billion USD, services reported about 50 billion USD surplus trade in 2010-11.

Under the Foreign Trade Policy, 2009-14, services exporters are eligible for many sops: service exporters shall be entitled to duty credit equivalent to 10% of the foreign exchange earned by them in the current financial year.

Four awareness programmes were undertaken in 2011-12 -- one each in North, East, South and Western regions of the country, the Western regional programme would give special reference to entertainment and distribution sector, the South to education sector, East to environmental and health care service sector and North special reference to Hotel and Tourism related service sector.

Every sector was badly affected in the recession and only the services sector like food, travel and hospitality saw good growth and sustained the economies of many nations.

Export of Engineering goods

The country's shipments of engineering goods have increased almost eight fold in the last decade to become the biggest item of exports.

Engineering goods include metal products, industrial machinery and equipment, auto and its components, and transport equipment.

Experts attribute the rise to the significant competitive edge the Indian companies have acquired in the engineering space and their ability to rise up the value chain. They attribute the rise to low labour costs combined with requisite skill sets which India enjoys, thanks to the continued increase in engineering graduates.

This has allowed India to target a range of markets, from emerging ones in Africa to sophisticated and quality conscious countries in Europe.

"The rest of the world has begun to see India as a good source for engineering goods where we have scale of operations as well as niche and proprietary products.

The government's incentives to exports to non-traditional markets have helped Indian companies. The share of Europe and the US is down nearly 15 percentage points over the decade. The share of Russian Federation, Middle East and Africa is up to 13.5% from decade back.

The engineering goods have moved from the low to the medium end in terms of skill, knowledge and R&D applied.

A lot of credit must go to the automobile industry. Multinationals came here hoping to grab a share of the rising car market but found they could use some of the local edge for their global operations.

Mercedes Benz does not export cars but sends out engineering drawing and components sourced from Indian vendors for Daimler globally.

Local auto components manufactures have managed to ride this opportunity to reach out to global market just when the developed world was finding manufacturing increasingly unviable.

Emerging markets in general are more cost competitive. There seems to be a shift from the high cost-low productivity west to low cost-high productivity east.

Small and medium enterprises and engineering exports

Having grown at 30 per cent annually between 2003 and 2008, the sector saw a sharp 18 per cent fall in 2009/10, from $40 billion in the preceding year to $34 billion. But equally impressive was the recovery in 2010/11 when engineering exports soared 84 per cent to touch $60 billion. And the prime movers were not the engineering giants but the small and medium enterprises, or SMEs, in the sector.

Engineering SMEs, mainly located in clusters across Punjab, Haryana, Tamil Nadu, Maharashtra and Gujarat, dominate the light engineering sector. SMEs contribute over 38 per cent to the overall engineering exports.

Traditionally, the biggest export advantage of the Indian engineering industry has been the low cost of its labour::the labour we employ is 25 to 30 per cent cheaper than in the United States.Our workers' productivity is also higher. Labour in the US will not work for more than eight hours, five days a week. But our people work double shifts, six days a week, sometimes even seven.

Many countries have completely outsourced their requirements for castings, forgings and fasteners to Indian SMEs.

Engineering SMEs also deserve credit for responding quickly as Western markets began to revive, by making fresh investments in capacity building, expanding into new markets and seeking the help of professional consultants.
Many SMEs are also replacing obsolete machines with the latest technology to adapt to a changing world. Engineering SMEs have also been quick to adopt lean manufacturing practices to maximise the use of resources and reduce wastage. SMEs have increasingly invested in professional consultancy to adopt lean manufacturing practices in the past three to four years. SMEs have enthusiastically responded to the government's Lean Manufacturing Competitiveness Programme, launched in August 2009 across 100 SME clusters, bringing in consultants to teach them efficient practices.

Five years ago, the US and Europe accounted for 50 per cent of India's exports; in 2010/11, that slipped to just 30 per cent, but exports to countries in Africa, Latin America and Asia have doubled. Exports to these other regions show very high growth as these economies are also growing fast.

The Commerce Ministry hopes to double engineering goods exports from $60 billion in the last financial year to $125 billion by 2012/13.

QRs

There are four types of restrictions on imports

- tariffs
- quantitative restrictions
- banning and
- non-tariff barriers like quality norms etc.

In general QRs are measures , other than tariffs, to curb exports or imports. It can be in the form of quotas, licensing requirements and canalization(bulk imports/exports are allowed through a designated agency/agencies). Quantitative restrictions on the import of certain goods were placed by India because of the difficult balance of payments situation. However, WTO rules do not allow them unless there are severe BOP pressures. Therefore, they had been lifted progressively culminating in the 2001 exim policy.

Non tariff Barriers

Customs duties are the means through which the domestic economy is protected against competition from the foreign goods and services. However, WTO mandate requires that customs tariffs be reduced so as to promote globalization . However , the developed and other countries are still resorting to barriers though in the form of NTBs . For example , the social clause that is sought to be brought into the scope of the WTO to exclude imports from developing countries on grounds of weak labour laws ; child labour; human rights; weak green laws and so on are the prime examples . It is a form of back door protectionism.

NTBs that are particularly relevant are the sanitary and phytosanitary measures (SPS) and technical barriers.SPS barriers relate to protection of animal , plant and human life within WTO members due to entry and spread of diseases –pests , toxins etc.Technical barriers relate to laying down product characteristics and related processes of production including packaging , labelling and marketing etc .Quantitative restrictions(QRs) are another form of NTB . H1B visa fees hike is quoted as one. The carbon quotas on airlines flying into EU are one more.

Salient Points of Strategy for Doubling Exports in next Three Years (2011-12 TO 2013-14)

The target is to double the country's merchandise exports in dollar terms over the next three years (2011-12 to 2013-14) from US $ 246 billion in 2010-11 to US$ 500 billion in 2013-14.To realize this, exports have to grow at a compound average growth of 26.7 % per annum.

The overall strategy to realize this goal is :

Product Strategy

1. Build on our strength in sectors with great growth potential engineering goods basic chemical industries and organic and inorganic chemical industries pharmaceutical industry (including biotech) electronics

2. Promote light manufacturing exports with high value addition leather products and textiles

3. Encourage high employment generating sectors gems and jewellery agricultural products

Market Strategy

Focus on markets in Asia (including ASEAN), Africa and Latin America. Open up new vistas, both in terms of markets and new products in these new markets Retain presence and market share in our "old developed country markets"; Move up the value chain in providing products in these old developed country markets.

Technologies and R&D
Areas that hold out promise for high technology exports:

- Pharmaceuticals
- Electronics
- Automobiles
- Computer and software based smart engineering.
- Environmental products; green technology and high-value engineering products.
- High end areas in electronics, aerospace, and engineering products.

Building a Brand Image
- thrust for quality upgradation.
- expanded certification of export products encouraged, where needed.
- Brand India promotion campaign for key export products

Essential Support

Essential policy support needed to realize the ambitious export targets for 2013-14 and beyond is:
- Stable policy environment: Continuation of existing incentive schemes
- Preferential access to new markets: putting in place conducive trading arrangements
- Reduction in transaction costs: Implementation of recommendations of Task Force
- Substantial step up in overall Plan support
- Priority strengthening of trade related infrastructure

Non-Traditional Export Markets

The Government of India has identified non-traditional export markets under the Focus Market Scheme and Market Linked Focus Product Scheme in the Foreign Trade Policy. The details of these markets are as below:

1. Focus Market Scheme (FMS):

Under the FMS in the Foreign Trade Policy, fifty two (52) African countries, thirty one (31) Latin American countries, ten (10) Commonwealth of Independent States-Central African Republics, five (05) East European countries, eleven (11) Asia-Oceania block countries and one (01) Asian country have been notified for benefit on exports of all products.

2. Market Linked Focus Product Scheme (MLFPS):

Under the MLFPS in the Foreign Trade Policy, several non-traditional export markets in Africa, Middle East Asia, East Asia, Latin America, Central Asia such as Algeria, Egypt, Kenya, Nigeria, South Africa, Tanzania, Brazil, Mexico, Ukraine, Cambodia, Vietnam, Qatar, Singapore, Bahrain, Kuwait, Bangladesh, Philippines, Saudi Arabia, Iran, Korea PR, Japan and China have been notified for benefit on exports of select products. The list is expanded in the 2012 Supplement.

Board of Trade (BOT)

The Board of Trade was set up in 1989 with a view to providing an effective mechanism to maintain continuous dialogue with trade and industry in respect of major developments in the field of International Trade. The Board is chaired by the Union Commerce Minister. Its role is to, advise the Government on measures connected with the Foreign Trade Policy and how to achieve the desired objective of boosting India's exports. The terms of reference of the Board are -

- To advise the Government on Policy measures for preparation and implementation of both short and long term plans for increasing exports in the light of emerging national and international economic scenario;
- To review export performance of various sectors, identify constraints and suggest industry specific measures to optimize export earnings;
- To examine the existing institutional framework for imports and exports and suggest practical measures for further streamlining to achieve the desired objectives;
- To review the policy instruments and procedures for imports and exports and suggest steps to rationalize and channelise such schemes for optimum use;
- To examine issues which are considered relevant for promotion of India's foreign trade, and to strengthen the international competitiveness of Indian goods and services; and

The Board is required to meet at least once every quarter and make recommendations to Government on issues pertaining to its terms of reference.

Inter State Trade Council

The Inter State Trade Council was set up in 2005 with a view to ensure a continuous dialogue with State Governments and Union Territories. It advises the Government on measures for providing a healthy environment for international trade in the States with a view to boost India's exports. The Council is represented by Chief Ministers of the States or State Cabinet Ministers nominated by Chief Ministers, Lt. Governors or Administrators of the Union Territories or their nominees etc.

Export Promotion Councils

There are at present eleven Export Promotion Councils under the administrative control of the Department of Commerce and nine export promotion councils related to textile sector under the administrative control of Ministry of Textiles. These Councils are registered as non -profit organisations under the Companies Act/Societies Registration Act. The Export Promotion Councils perform both advisory and executive functions. These Councils are also the registering authorities under the Export Import Policy, 1997-2002.These Councils have been assigned the role and functions under the said Policy.

Their relevance is greater to the national export effort in the context of globlisation and economic liberalization.Some Export Promotion Councils are Apparel Export Promotion Council ,Chemicals Pharmaceuticals & Cosmetics Export Promotion Council, (CHEMEXCIL),Carpet Export Promotion Council,Cashew Export Promotion Council of India,Cotton Textile Export Promotion Council,Electronic & Computer Software Export Promotion Council,Engineering Export Promotion Council etc.

Commodity Boards

There are five statutory Commodity Boards under the Department of Commerce. These Boards are responsible for production, development and export of tea, coffee, rubber, spices and tobacco.

Agricultural and processed Food Products Export Development Authority

The APEDA was set up by an Act of Parliament of 1986 and came into being on 13th February 1986. The APEDA is also a statutory body which is entrusted with the tasks of agricultural exports, including the export of processed foods in value added form.

Marine Products Export Development Authority

The MPEDA was set up under Section (4) of MPEDA Act, 1972. It is a statutory body functioning under the Department of Commerce. The MPEDA is responsible for development of the marine products industry with special reference to exports. It has its headquarters at Kochi. Besides, it has Trade Promotion Offices at Tokyo and New York.

GS1-India

GS1(Global Standards) India is a not-for-profit standards body promoted by the Ministry of Commerce (GOI) and Indian Industry to spread awareness and provide guidance on adoption of global standards in Supply Chain Management by Indian Industry for the benefit of consumers, Industry, Govt. etc.

GS1 India is the only organisation in India authorised to issue company prefix numbers for use in barcodes, RFID tags etc. for unique, unambiguous and universal identification of products, cartons, containers etc. GS1 standards find wide application in Supply Chains across sectors . GS1 standards are the de-facto global standards in identification of consumer products in Retail. GS1 India is an affiliate of GS1 Global Office, twin headquartered at Brussels (Belgium) and New Jersey (U.S.A.).

Agri-export zones

The 2002-07 exim policy emphasized the importance of agricultural exports and announced measures like the setting up of agri export zones, removal of procedural restrictions and marketing cost assistance. Agri Export Zones are considered the most important creation of this policy -

Agri Export Zones were formed as a result of this policy. These zones are meant to promote agricultural exports and provide remunerative returns to the farming community regularly. They are to be identified by the State Government, which would evolve a comprehensive package of services to be provided by all State Government agencies, State Agriculture Universities and all institutions and agencies of the Union Government for intensive delivery in these zones. Companies with proven credentials would be encouraged to sponsor new agri export zones or take over already notified agri export zones.

Services that would be managed and coordinated through this scheme include the provision of pre/post harvest operations, plant protection, processing, packaging, storage and related research and development. APEDA will supplement, within its schemes and provisions, the efforts of State Governments for facilitating exports. The list of the Agri Export Zones is as under:

S. No.	Product	State	Districts covered
1	Pineapple	West Bengal	Darjeeling, Jalpaiguri, Uttar Dinajpur, Cooch Behar, Howrah
2	Gherkins	Karnataka	Tumkur, Bangalore Urban, Bangalore Rural, Hassan, Kolar,

			Chitradurga, Dharwad and Bagalkot
3	Lychees	Uttranchal	Udhamsingh Nagar, Dehradun and Nainital
4	Cut Flowers	Tamil Nadu	Dharmapuri
5	Grape & Grapevine	Maharashtra	Nasik, Sangli, Sholapur, Satara, Ahmednagar
6	Mango Pulp & Fresh Vegetables	Andhra Pradesh	Chitoor
7	Pineapple	Tripura	Kumarghat, Manu, Melaghar, Matabari and Kakraban Blocks
8	Mangoes	Maharashtra	Rantagiri, Sindhudurg, Raigarh and Thane
9	Apples	Jammu & Kashmir	Srinagar, Baramula, Anantnag, Kupwara, Kathua and Pulwama
10	Potatoes, Onion and Garlic	Madhya Pradesh	Malwa, Ujjain, Indore, Dewas, Dhar, Shajapur, Ratlam, Neemuch Mandsaur and Khandwa.
11	Cabbage, Broccoli, Okra, Peas, Carrot, Baby Corn, Green Chillies, Green Beans, Tomato	Punjab	Fatehgarh Sahib, Patiala, Sangrur, Ludhiana and Ropar
12	Potatoes	Uttar Pradesh	Agra, Hathras, Farrukhabad, Kannoj, Meerut, Baghpat and Aligarh, Janpad Badaiyun, Rampur, Ghaziabad, and Firozabad
13	Mangoes and Vegetables	Uttar Pradesh	Lucknow, Unnao, Hardoi, Sitapur and Barabanki
14	Mangoes	Uttar Pradesh	Saharanpur, Muzaffarnagar, Bijnaur, Meerut, Baghpat and Bulandshahr, Jyotifulenagar
15	Potatoes	Punjab	Singhpura, Zirakpur Distt. Patiala and satellite centres at Rampura Phul, Muktsar, Ludhiana, Jullundur
16	Kesar mango	Maharashtra	Aurangabad, Beed,Jalna,Ahmednagar and Latur
17	Flowers	Maharashtra	Pune, Nasik, Kolhapur and Sangli
18	Walnut	Jammu & Kashmir	Baramulla, Anantnag, Pulwama, Budgam,Kupwara, Srinagar, Doda, Poonch, Udhampur, Rajouri and Kathua
19	Lychee	West Bengal	Murshidabad, Malda, 24 Pargana(N) and 24 Pargana(S)

20	Lychee & Vegetables	Bihar	Muzaffarpur, Samastipur, Hajipur, Vaishali, East and West Champaran, Bhagalpur, Begu Sarai, Khagaria, Sitamarhi, Saran and Gopalganj
21	Mango & Grapes	Andhra Pradesh	Rangareddy, Medak, Mehboobnagar
22	Mangoes & Vegetables	Gujarat	Ahmedabad, Khaida, Anand, Vadodara, Surat, Navsari, Valsad, Bharuch, Narmada
23	Potatoes	West Bengal	Hooghly, Burdhwan, Midnapore (W), Uday Narayanpur, Howrah
24	Flowers	Uttranchal	Dehradun, Pantnagar, Udhamsingh Nagar, Nainital and Uttarkashi
25	Flowers (Orchids)& Cherry Pepper	Sikkim	East Sikkim
26	Ginger	Sikkim	North, East, South & West Sikkim
27	Rose Onion	Karnataka	Bangalore (Urban), Bangalore (Rural), Kolar
28	Flowers	Karnataka	Bangalore (Urban), Bangalore (Rural), Kolar, Tumkur, Kodagu and Belgaum
29	Apples	Himachal Pradesh	Shimla, Sirmaur, Kullu, Mandi, Chamba and Kinnaur
30	Basmati Rice	Punjab	Gurdaspur, Amritsar, Kapurthala, Jalandhar, Hoshiarpur And Nawanshahar
31	Flowers	Tamilnadu	Nilgiri
32	Mangoes	Andhra Pradesh	Krishna
33	Onion	Maharashtra	Nasik, Ahmednagar, Pune, Satara, Jalgaon, Solapur
34	Ginger and Turmeric	Orissa	Kandhamal
35	Vegetables	Jharkhand	Ranchi, Hazaribagh and Lohardaga
36	Seed Spices	Madhya Pradesh	Guna, Mandsaur, Ujjain, Rajgarh, Ratlam, Shajapur and Neemuch
37	Basmati Rice	Uttaranchal	Udham Singh Nagar, Nainital, Dehradun and Haridwar
38	Mango	West Bengal	Maldah and Murshidabad
39	Vegetables	West Bengal	Nadia, Murshidabad and North 24 Parganas
40	Mangoes	Tamil Nadu	Madurai, Theni, Dindigul, Virudhunagar and Tirunelveli

41	Wheat (including sharbati wheat for Bhopal Zone)	Madhya Pradesh	Ujjain Zone (Neemuch, Ratlam, Mandsaur and Ujjain), Indore Zone (Indore, Dhar, Shajapur and Dewas) and Bhopal Zone (Sehore, Vidisha, Raisen, Hoshangabad, Harda, Narsinghpur and Bhopal)
42	Horticulture Products	Kerala	Thrissur, Ernakulam, Kottayam, Alapuzha, Pathanamthitta, Kollam, Thiruvanthapuram, Idukki and Pallakad
43	Fresh and Processed Ginger	Assam	Kamrup, Nalbari, Barpeta, Darrang, Nagaon, Morigaon, Karbi Anglong and North Cachar
44	Basmati Rice	Uttar Pradesh	Bareilly, Shahjahanpur, Pilibhit, Rampur, Badaun, Bijnor, Moradabad, JB Phulenagar, Sharanpur, Mujjafarnagar, Meerut, Bulandshahr, Ghaziabad And Baghpat
45	Medicinal & Aromatic Plants	Uttaranchal	Uttarkashi, Chamoli, Pithoragarh, Dehradun, Nainital, Haridwar and Udhamsingh Nagar

100% Export oriented units

Introduced in the year 1981, the EOU Scheme's main thrust is to boost and attract sector specific exports from all parts of India having huge potential near to raw material source. The Scheme covers manufacturing/processing and services. The main objectives of the scheme is to increase exports, earn foreign exchange to the country, transfer of latest technologies stimulate direct foreign investment and to generate additional employment. 50% of physical exports can be sold in domestic market on payment of concessional duty

Fiscal Incentives available to 100% EOUs are exemption from Customs and Central Excise duties on import/local procurement of Capital goods, raw materials, consumables, spares, packing material etc.;Reiumbursement of Central Sales Tax (CST) on purchases made from Domestic Tariff Area (DTA) ;Corporate Tax Holiday upto 2010 .There are more than 1800 EOUs in the country today.

Regional Trade Arrangements and Trade

India views Regional Trading Arrangements (RTAs) as 'building blocks' of trade liberalisation and as complementary to the multilateral trading system. About 50% of world trade is now conducted on a preferential basis within FTAs. Recognising the importance of

RTAs, India has engaged with its trading partners/blocks to begin concluding, in-principle agreements to move towards Comprehensive Economic Cooperation Agreements (CECA) which cover FTA in goods, services, investment and identified areas of economic cooperation.

The India-Sri Lanka FTA, Agreement on SAFTA, India-Singapore CECA, Ceca with Malaysia and South orea and Cepa with Japan are important to note. Btia with EU is under negotiations. India inked the FTA with Asean in August 2009 and will come into effect on Jan 1, 2010.(Read along with the notes on WTO)

The India-Mercosur (Brazil, Argentina, Uruguay and Paraguay)PTA is to be implemented shortly.

India's trade reforms since 1991

One of the major dimensions of the economic reforms undertaken since 1991 was globalizing Indian economy of which liberalization of foreign trade is a central aspect. The following reforms were made

- Devaluation of the currency in 1991 to boost exports
- Rupee convertibility on the trade account since 1992 to incentivize exporters
- Cutting down the peak customs duty that stood at above 300% in 1991 to 10% in 2009 to import goods and services primarily for facilitating exports
- Simplification of procedures
- SEZs
- FTAs/Cepa/Ceca/BTIA
- WTO-led schedule for global trade integration
- Incentives for exporters like interest rate subsidy(subvention) etc
- Sector specific packages
- diversification

The effect is that exports have registered remarkable growth; created employment; given the country adequate forex; made the economy competitive; brought in FDI etc.

Exports and employment

In recent years, one of the important objectives of trade policy has been to integrate it with the process of economic development and creation of more employment opportunities.

However, in recent years, the employment-intensive exports have not been doing well and their share in the country's exports has been declining.

This share has declined by 18 per cent from 76 per cent of total exports in 1995-96 to 58 per cent by 2003-04.

Government identified 12 export sectors as employment-intensive: textiles and garments, leather goods, gems and jewellery, cereals, horticulture, flowers, fruits and vegetables, dairy products, processed foods, toys and sports goods, pharmaceuticals, automobiles and auto-components, consumer electronics and electronic hardware.

Special efforts are needed to promote exports from these labour-intensive sectors.

According to experts, if only the cumbersome labour laws are made flexible, it should be possible to provide the much-needed boost to labour-intensive exports.

Also the small and medium enterprises (SMEs), which account for over 50 per cent of our total exports and which are also relatively more labour-intensive, deserve much greater financial and marketing support, testing facilities and better infrastructure, to enable them to increase their exports.

Some Important Schemes

Market Access Initiative (MAI)

MAI scheme is intended to provide financial assistance for medium term export promotion efforts with sharp focus on a country / product.

Financial assistance is available for Export Promotion Councils (EPCs), Industry and Trade Associations (ITAs), Agencies of State Governments, Indian Commercial Missions (ICMs) abroad and other eligible entities as may be notified.

A whole range of activities can be funded under MAI scheme. These include, amongst others,

- Market studies,
- Setting up of showroom / warehouse,
- Sales promotion campaigns,
- International departmental stores,
- Publicity campaigns,
- Participation in international trade fairs,
- Brand promotion,
- Registration charges for pharmaceuticals, and term export promotion efforts with sharp focus on a country / product,
- Testing charges for engineering products.

Marketing Development Assistance (MDA)

MDA Scheme is intended to provide financial assistance for a range of export promotion activities implemented by EPCs, ITAs on a regular basis every year. Assistance includes participation in

- Trade Fairs and Buyer Seller meets abroad or in India, and
- Export promotion seminars.

Towns of Export Excellence (TEE)

A number of towns have emerged as dynamic industrial clusters contributing handsomely to India's exports. It is necessary to grant recognition to these industrial clusters with a view to maximizing their potential and enabling them to move higher in the value chain and tap new markets.

Selected towns producing goods of Rs. 1000 Crore or more will be notified as TEE based on potential for growth in exports. However for TEE in Handloom, Handicraft, Agriculture and Fisheries sector, threshold limit would be Rs. 250 Crores. Kannur in Kerala – that accounts for 11 per cent of the nation's gross handloom exports – is a TEE.

Recognized associations of units will be able to access funds under MAI scheme for creating focused technological services. Common service providers in these areas shall be entitled for EPCG scheme- Export Promotion Capital Goods. Further such areas will receive priority for assistance under ASIDE scheme.

Export and Trading Houses

Merchant as well as Manufacturer Exporters, Service Providers, Export Oriented Units (EOUs) and Units located in Special Economic Zones (SEZs), Agri Export Zones (AEZs), Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Bio-Technology Parks (BTPs) shall be eligible for Status. Applicant shall be categorized depending on his total FOB export performance during current plus previous three years (taken together) upon exceeding limit given below.

Status Category	**Export Performance FOB(Rupees in Crores)**
Export House (EH)	20
Star Export House (SEH)	100
Trading House (TH)	500
Star Trading House (STH)	2500
Premier Trading House (PTH)	7500

A Status Holder shall be eligible for facilities like athorisation and Customs clearances for both imports and exports on self-declaration basis;100% retention of foreign exchange in EEFC account(Exchange Earners' Foreign Currency) etc.

Served from India

Its objective is to accelerate growth in export of services so as to create a powerful and unique 'Served From India' brand, instantly recognized and respected world over. Eligibility is based on certain minimum forex earnings. They qualify for Duty Credit scrip it means that what they pay as duty on certain amount of their imports is credited to them for set off later.

Vishesh Krishi and Gram Udyog Yojana

Objective of VKGUY is to promote exports of agricultural produce and their value added products; minor forest produce and their value added variants etc.
Duty Credit scrip benefits are granted to the exporters.

Focus market scheme (FMS)

Objective is to offset high freight cost and other externalities to select international markets with a view to enhance our export competitiveness in these countries. Duty Credit scrip benefits are one available.
FOCUS (LAC), Focus (Africa), Focus (CIS) and Focus (ASEAN + 2) programmes are operating.
Helps the country diversify the geographical base and withstand any economic crisis.

Focus product scheme (FPS)

Objective is to incentivise export of such products, which have high employment intensity in rural and semi urban areas, so as to offset infrastructure inefficiencies and other associated costs involved in marketing of these products. Some Special Focus Initiatives are for Agriculture, Handicrafts, Handlooms, Gems & Jewellery and Leather & Footwear sectors.
Exports of notified products to all countries (including SEZ units) shall be entitled for Duty Credit scrip

Hitech products export promotion scheme(HPEPS)

Objective is to incentivise export of High Technology products. Exports of High Technology products to all countries shall be entitled for Duty Credit Scrip

States and Export Efforts

To involve States and UTs in export efforts, the following initiatives are taken

- ASIDE- assistance to states for the development of infrastructure for exports- for which Rs.330 crores are allocated
- SEZs can be set up by the States
- AEZs are set up in States for agroexports
- states are encouraged to set up export promotion councils and draw up export plans

Export-Import Bank

The Export-Import Bank of India (Exim Bank) is a public sector financial institution created by an Act of Parliament, the Export-import Bank of India Act, 1981. The business of Exim Bank is to finance Indian exports. Bank's primary objective is to help export-related companies by offering them a comprehensive range of products and services.

Annual Trade Policy Review 2010
(Important selectively)

In an attempt to boost exports, the government has announced stimulus measures in the annual review of the Foreign Trade Policy (FTP) 2009-2014. The fresh export promotion sops will cost Rs 1050 crore.

Six-month extension of the Duty Entitlement Pass Book scheme (DEPB) which will now expire on 30 June 2011.

Zero duty on Export Promotion Capital Goods Scheme (EPCG) scheme has been extended by a year.

Interest subvention plan of 2% each for leather, jute and textile have also been extended.

A number of additional products from sectors like engineering, leather, textiles and jute have also been added to the existing two per cent interest subvention scheme.Handloom, handicrafts, carpet and the SMEs have been getting this facility, which will now be available till March 31, 2011.

Steps to reduce transaction cost of exports too were announced in the policy. At present, transaction costs are estimated at 7-8 per cent of the exports value.

Most chambers, including Ficci and CII, welcomed the policy supplement, amid promises that the transaction cost for exporters would be brought down by 40 per cent.

As per the IMF projection, the world economy is recovering at a varying speeds. There has been marginal improvement in some of the developed economies like US, UK, Germany and France.

However, there is still nervousness in the markets about the fiscal situation and sovereign indebtedness in several high-income countries of Europe.

In order to give immediate relief, the annual policy review provided a two per cent bonus incentive under Focus Product Scheme (FPS) to 135 items from sectors that are not still doing well. This would benefit labour intensive sectors such as handicrafts, handlooms, silk, carpets, leather, sports, toys and bicycles. 2% additional bonus covers Leather industry completely and also the finished leather products for the first time. In the carpets, we have brought in the silk carpets in handicraft.

To compensate for infrastructural bottlenecks, 256 more products from sectors like rubber and oil meals have been added under FPS.

Besides, instant tea and CSNL cardinol would now also get the five per cent duty benefit under the Vishesh Krishi and Gram Udyog Yojna (VKGUY).

The two per cent duty benefit to garment exporters under the Market Linked Focused Product Scheme for shipments to the 27-nation bloc European Union has been extended from October 2010 to March 2011.

Barmer (handicrafts), Bhiwandi (textiles) and Agra (leather goods) would now be 'Towns of Export Excellence'.

Commerce Minister Shri.Anand Sharma's speech with details of the Annual Supplement (June 2012)to Five Year FTP (2009-2014)

Three years ago, the Government had announced the 5-year Foreign Trade Policy for the period 2009-14 with the target of US$ 500 billion exports by 2013-14.

The difficult economic situation in the Euro Zone crisis poses a real risk of destabilizing the fragile recovery and sinking the world into yet another recession. We are also faced with an unprecedented volatility in commodity prices and the crude oil prices touched a new high last year, adding pressure on our import bill.

The Indian economy has also not remained insulated from these developments and the GDP figures of last quarter are indeed a cause of serious worry. The Index of Industrial Production has also highlighted the slowdown in manufacturing. The Gross Fixed Capital Formation has also slipped to less than 30% indicating a deceleration in investments. The weakening of the rupee will have its own implication on our annual import bill. Clearly Indian economy is passing through a difficult phase.

However, as we look at the achievements of the year gone by, we can derive some satisfaction from the fact that Indian exports maintained their momentum registering a 20.9% growth last year to touch US$ 303 billion. This by all accounts is a commendable achievement and a critical turnaround, given the fact that exports had declined to US$ 178 billion in 2009-10. We have been able to reach thus far by providing a stable policy environment and the market diversification strategy which enabled an outreach to newer markets in Asia, Africa and Latin America has clearly paid off. Partnership between government and the exporting community and stimulus to the struggling sectors helped exports.

We had unveiled an Action Plan in May 2011 for doubling India's merchandise exports to US$ 500 billion which was based on a strategy which hinged on four pillars:

a. Developing products with a considerable growth potential
b. Market diversification strategy
c. Nurturing high technology exports
d. Build a Brand India

In the last 3 years, we have significantly expanded the scope and coverage of the Focus Market Scheme which now covers 112 markets across the world. This has clearly yielded results as last year, India's exports to Asia, Africa and Latin America put together totaled US$188 billion which constitutes 62% of India's total export basket which is a significant development. Another redeeming feature of our export performance last year was substantial increase in value added exports, engineering exports touched US$ 60 billion, gems and jewellery crossed US$ 46 billion, and textiles exports crossed US$ 14 billion and pharmaceutical exports stood at US$ 13 billion.

Free Trade Agreements (FTAs) are an important element of India's trade strategy and through FTAs, we have sought to enhance our presence in new and emerging markets to increase our market share. We also view these agreements as vehicles for ensuring raw-material and intermediate products for our domestic industry at competitive prices. In the last 3 years, we have signed Trade in Goods Agreement with ASEAN, Comprehensive Economic Partnership Agreements with Republic of Korea, Japan, and Malaysia and are now negotiating similar Agreements with New Zealand, Australia, Canada. We are at an advanced stage of concluding an ambitious Broad based Trade and Investment agreement with EU. We expect that as a result of these agreements, Indian exports will be able to gain significant market access in newer territories.

A stable policy regime has been a key ingredient of our Foreign Trade Policy and the schemes which were put in place earlier have served us well and we intend to continue with these schemes in this Annual Supplement as well with suitable modifications.

The underlined philosophy of 2012-13 Annual Supplement is based on seven broad principles:

a. Give a focused thrust to employment intensive industry because we view exports not only in terms of their economic contribution but as a means of generating gainful employment
b. Encourage domestic manufacturing for inputs to export industry and reduce the dependence on imports
c. Promote technological upgradation of exports to retain a competitive edge in global markets
d. Persist with a strong market diversification strategy to hedge the risks against global uncertainty
e. Encourage exports from the North Eastern Region given its special place in India's economy
f. Provide incentives for manufacturing of green goods recognising the imperative of building capacities for environmental sustainability
g. Endeavour to reduce transaction cost through procedural simplification and reduction of human interface

Last year FM had agreed to create a special dispensation for labour intensive industry by extending the facility of 2% interest subvention for Handlooms, Handicrafts, Carpets and SMEs. We have now decided to extend the scheme for another year till 31st March 2013 and expand its coverage to include other labour intensive sectors namely Toys, Sports Goods, Processed Agricultural Products and Ready-Made Garments.

One of the key objectives of our Foreign Trade Policy has been to give a thrust to technology upgradation of exports in order to enhance global competitiveness of our products. The Zero Duty EPCG Scheme which was operational till 31st March 2012 has been a key policy instrument to achieve this objective and we have taken a decision now to extend it upto 31st March 2013 . We have also decided to enlarge the scope of the Scheme.

Three new towns are being declared as towns of export excellence- Ahmedabad (Textiles), Kolhapur (Textiles), and Saharanpur (Handicrafts)

In order to promote manufactured exports of green technology products, export obligation under EPCG scheme is being reduced to 75% of the normal export obligation for 16 identified products like solar cells, wind turbines, water treatment plants, electrically operated vehicles etc.

The need of promoting manufacturing activity and generating employment in the North Eastern States is recognised and so government decided to reduce the Export Obligation under the EPCG Scheme to 25% of the normal export obligation and this facility will be applicable to North Eastern States and Sikkim.Sharma. Image courtesy PIB

(Export Promotion Capital Goods (EPCG) is an export promotion scheme under which an exporter can import certain amount of capital goods at either zero or three per cent customs duty, for upgrading technology related with exports.However, to avail the scheme, the exporter has to meet a pre-determined export obligation over a certain period.(Given elsewhere)

Also, Myanmar has been included in the list of Focused Market Scheme (FMS), which aims to offset high freight cost to certain select international countries with a view to make India more competitive in those markets.

This is also likely to benefit exports from the region as Myanmar borders four North Eastern states — Mizoram, Manipur, Nagaland and Arunachal Pradesh.

The inclusion of Myanmar in FMS list comes close on the heels of Prime Minister Manmohan Singh's visit to South Asian neighbour.

Also, export of specified products through notified Land Customs Stations (LCS) of North Eastern Region would be provided additional incentive to the extent of 1 per cent of Free on Board (FOB) value of exports.

The Foreign Trade Policy allows duty free scrips for procurement of goods from domestic market for payment of excise duty. This decision has been taken to promote domestic manufacturing and value addition and employment and will be a significant measure of import substitution.

Recognizing the efficacy of the market diversification scheme, this year we are adding 7 new markets to Focus Market Scheme (FMS). These countries are Aruba, Austria, Cambodia, Myanmar, Netherland Antilles, and Ukraine

7 new markets are being added to the Special Focus Market Scheme (Spl FMS)- Belize, Chile, El Salvador, Guatemala, Honduras, Morocco, and Uruguay.

46 new items are being added to Market Linked Focus Product Scheme (MLFPS). This would have the effect of including 12 new markets for the first time.

Market linked focus product scheme is being extended till 31st March 2013 for export to USA and EU in respect of the apparel sector.

100 new items are being added to the Focus Product Scheme (FPS) list.

Roasted cashew kernel, and protein concentrates & textured protein substances are being made eligible for benefits under VKGUY.

The Agri-infrastructure Incentive Scrips were envisaged to promote agricultural exports and strengthen and upgrade infrastructure including establishment of cold storages, pack house etc. Recognising that these scrips have not been used so far, we have now made them eligible for 14 specified equipments which will have a beneficial impact in strengthening agri export infrastructure.

The Status Holder Incentive Scrips (SHIS) allow import of capital goods for technology upgradation in specified sectors. Now, 10% of the value of these scrips will be allowed to be utilized for import of components, spare parts of these capital goods as well.

Visakhapatnam Airport has been identified as a new Port for the purpose of benefits under export promotion schemes.

The nature of world trade has changed considerably and today a large quantity of exports are being made by post, courier as well as through E-commerce. We have now decided that exports shipped through Courier and E-Commerce platform will be eligible for export benefits if shipments are effected from Delhi and Mumbai.

The SEZs have been a key instrumentality for providing robust infrastructure for export promotion. Today, these Zones provide direct employment to over 8.45 lakh people and last year contributed to exports of Rs. 3.65 lakh crores. They have received investment of over Rs. 2.02 lakh crores which is a significant achievement. However, after imposition of MAT and DDT, there has been a visible slowdown in growth of exports from SEZs.

Deemed Exports Scheme which provides benefit of exemption and remission of duty for supplies to specified projects, to domestic manufacturers. This scheme is also undergoing comprehensive review and after concluding inter-ministerial consultations, we shall be announcing changes in this Scheme as well.

Electronic Data Interchange (EDI) is a core driver for facilitating international trade and one of the key initiatives this year is electronic transmission of foreign exchange realization details on exports by banks on a daily basis under the "e-BRC" (Electronic Bank Realization Certificate) initiative. Exporters will not be required to make any request to banks for issuance of Bank Export and Realization Certificate and this scheme will ensure seamless connectivity amongst DGFT, Customs, Banks and exporters for settlement and release of export benefits. This has been done with the objective of ensuring minimum human interface and reducing transaction cost.

The guidelines for the Scheme for assistance to States for development of infrastructure and allied activities (ASIDE) to strengthen export related infrastructure has been re-formulated. The new guidelines will ensure that States should take up relatively larger projects which would have a visible impact for boosting exports.

In order to provide facility to Indian exporters to reach out to new markets, we administer another scheme MAI (Market Access Initiative) under which assistance is provided to exporters to organize buyer-seller meets, exhibitions abroad following an approach on specific focused products and focused countries. 13 India Shows have been planned for this financial year which will be held in different parts of the world to showcase the best of Indian industry and manufactured products and promote Brand India.

E-biz

e-Biz Project, an initiative of the Department of Industrial Policy and Promotion (DIPP) was launched in 2009.

The e-Biz project will leverage the capabilities and potential of Information and Communication Technology to consolidate regulatory frameworks, re-engineer regulatory processes, and provide a platform that can be leveraged for enhanced G2B service offerings.

This project aims at creating an investor-friendly business environment in India by making all regulatory information – starting from the establishment of a business, through its ongoing operations, and even its possible closure - easily available to the various stakeholders concerned. In effect, it aims to develop a transparent, efficient and convenient interface, through which the government and businesses can interact in a timely and cost effective manner, in the future.

Glossary

DGFT Directorate General of Foreign Trade, which is headed by the Director General of Foreign Trade. The office of the DGFT is responsible for formulating and execution of Exim Policy, including licensing. Formerly (till 1991), was known as the Chief Controller of Imports & Exports (CCI&E).

EPZs/EOUs EPZ means Export Processing Zones which are special enclaves, separated from the Domestic Tariff Area (DTA), to provide an internationally competitive duty-free environment for export production. EOU means Export Oriented Units. The EOU scheme is complementary to the EPZ scheme, except that it is widely dispersed in location, unlike EPZs, which are set up at specific locations.

Forfaiting

In trade finance, forfaiting involves the purchasing of receivables from exporters. The forfaiter will take on all the risks involved with the receivables.

Mercusor

Mercusor was created by Argentina, Brazil, Paraguay and Uruguay in 1991. It originally was set up with the ambitious goal of creating a common market between the participating countries on the basis of various forms of economic co-operation

Deemed exports

They are inputs into exports and concessions are given to them for export promotion

E-Commerce Refers to electronic commerce(trade on the net). In the context of Exim Policy, e-commerce relates to electronic filing and processing of applications etc.

EPCG EPCG refers to the Export Promotion Capital Goods (EPCG) Scheme, which gives the manufacturer facility for import of capital goods for export production at concessional rate against certain level of export obligation.

Duty Exemption allows duty-free import of inputs for exports under Advance Licence, Duty Entitlement Pass Book (DEPB) and Duty Free Replenishment Certificate (DFRC) Scheme.

Free Import of Inputs

Advance Licence Advance Licence is granted for import of inputs without payment of customs duties. It is issued in accordance with the Policy and procedures in force and subject to fulfilment of time-bound export obligation. Such licences can be issued for import of inputs for use in the export production as well as for replenishment of the inputs already used in the export product.

DEPB Refers to the Duty Entitlement Pass Book to neutralise the incidence of basic and special customs duty on the import content of export product. This is provided by way of grant of duty credit against the export product at specified rates.

Input-Output Norms The norms which define the amount of input/inputs required to manufacture a unit of output.

Replenishment Licence Refers to Replenishment of such imports as per the Input-output norms required for the purpose of export of products.

DFRC Refers to the Duty Free Replenishment Certificate Scheme. The scheme is available to merchant exporters as well as to manufacturer exporters. However, it covers only items which are covered under standard input-output norms notified by DGFT.

Deemed Exports Refer to those transactions in which the goods supplied do not leave the country and the payment for the goods is received by the supplier in India. They are the inputs into exports that are sourced from India.

FoB means Free on Board -- i.e., when an exporter delivers goods `free on board`, he pays all charges involved in getting them actually onto the ship- it excludes freight and insurance.

NFE refers to Net Foreign Exchange. Net Foreign Exchange earning is calculated as a percentage of exports (NFEP).

Value addition refers to the increment added in the process of manufacture of a particular item, which also becomes part of its price.

Ad Valorem - Literally means According to Value. It is the primary method by which Customs duties are calculated. An Ad Valorem duty is a duty based on the value of the merchandise. This is in contrast to specific duties which are calculated on the weight, volume or item count and compound duties which are a combination of ad valorem and specific duties.

Compound Duty - A duty which is calculated based on both the value of the goods as well as the weight, volume or number.

Countervailing Duty - A duty unilaterally imposed by India against specific products from certain countries in order to offset improper subsidies provided by the government of that country. It is imposed at the end of a countervailing duty investigation.

Exchange Earners Foreign Currency Account Scheme

Exchange Earners Foreign Currency (EEFC) Account Scheme was introduced in 1992, which enabled exporters and other exchange earners to retain a portion of their receipts in foreign exchange with an authorised dealer in India.

Transaction costs

The costs other than the money price that are incurred in trading goods or services.Costs associated with transacting trades. They are being brought down in India for making exports problem-free and competitive. For example, the paper work is being reduced and electronic means are being permitted.

Barriers to entry

Conditions or circumstances that make it very difficult or unacceptably costly for outside firms to enter a particular market to compete with the established firm or firms that are already selling the good or service involved.

ITC (HS)

It refers to Indian Trade Classification (Harmonised System). It is a system of classification of products for the purposes of export and import.

"Counter Trade" is international barter where goods are paid for in goods.

Anti-Dumping Duty

When a country exports any goods at a rate that is less than one of the following,it is considered dumping and against it the importing country can impose antidumping duties

- cost of production
- domestic price or
- less than fair value'.

The importing country should show that such dumping damages its domestic industry and the damage should be proved to be linked to dumping.

Safeguard Duty

The central government after conducting an enquiry is satisfied that any article is imported into the country in such increased quantities and under such conditions so as to cause or threatening to cause serious injury to domestic industry, then it may by notification impose a safeguard duty on that article.

Non-market economy: It means an economy not operating on market principles of cost and pricing structure so that sales of merchandise in that country do not reflect the fair value of the merchandise. For example, China, Russia, Albania, North Korea.The expression is used essentially in the context of imposition of anti dumping duties.

Target Plus

A scheme to accelerate growth of exports called 'Target Plus' hasbeen introduced. Exporters who have achieved a quantum growth in exports would be entitled to duty free credit based on incremental exports substantially higher than the general actual export target fixed.

Assistance to States for Development of Export Infrastructure and other activities (ASIDE) Scheme

The ASIDE scheme aims at encouraging the active involvement of State Governments for development of export infrastructure through assistance linked to export performance. The scheme provides an outlay for development of export infrastructure which is distributed among the States, inter-alia, on the basis of the States' export performance in the previous year. The specific purposes for which the funds allocated under the scheme that can be sanctioned and utilized are as follows: -

- Creation of new Export Promotion Industrial Parks/Zones (including Special Economic Zones (SEZs)/Agri-Business Zones) and augmenting facilities in the existing Zones.
- Setting up of electronic and other related infrastructure in export conclaves.
- Equity participation in infrastructure projects, including the setting up of SEZs.
- Development of complementary infrastructure such as roads connecting the production centres with ports

Export Credit Guarantee Corporation of India Ltd. (ECGC)

In order to promote the country's exports by covering the risk of export on credit, the ECGC provides a range of insurance covers to Indian exporters against the risk of non-realisation of export proceeds due to commercial or political causes

Electronic Commerce (EC) / Electronic Data Interchange (EDI) for Trade

The world is witness to rapid growth in e-commerce which would have positive impact on small businesses that have established themselves as legitimate, trustworthy merchants. Most companies have initiated measures to create and execute an e-commerce strategy. The project entitled "Electronic Commerce (EC) / Electronic Data Interchange (EDI) for Trade (e-Trade)" is pursued in various trade regulatory and facilitating agencies like Customs, DGFT, Ports, Airports, RBI, Exporters, Importers, Agents, CONCOR, Banks, etc. to facilitate international trade. The objectives of this project are to facilitate electronic delivery of services; to simplify procedures; to provide 24 hour access to users with their partners; to make procedures transparent; to reduce the transaction cost and time, and to introduce international standards and best practices.

EDI

It is the inter-organizational, computer-to-computer exchange of information.

India as a trading nation has arrived: HS Singhania.

Performance of exports in 2010-11 has been a remarkable achievement of the Indian economy. Against a target of $200 billion, actual export turnover stood at over $245 billion, exceeding the target by 22.5%.

Actually, except in 2009-10 when exports actually fell 4.7% during the global economic crisis, our exports have been doing well for quite some time. Between 2003-04 and 2008-09, average annual export growth in dollar terms has been 23.4%, and exports nearly trebled from $63.8 billion to $185.2 billion. And now we have reached $245 billion, which together with imports make a trade turnover of nearly $600 billion. This can be reasonably projected as the emergence of India as a major fast-moving trading nation.

If we can add some extra effort, and achieve average annual growth of 25%, we can exceed a turnover of $600 billion by 2014-15 in exports alone. This will firmly place us a major exporting nation, or, more significantly, a major trading nation, with a strong clout in the global economy. What is required is that we must continue to be ambitious and stay steady on the road to export competitiveness.

We may still have a negative trade balance, but that does not matter really. On the contrary, our image as an economy with more than a trillion dollar trading interests, with an open internal market, might actually be enhanced.

For a large trading nation, like the kind we would be, trade deficit is not a matter of concern really, as long as capital inflows remain vibrant. The size of trade and size of capital flows, I presume, are positively correlated. For the present, we need not bother about the balance of trade, not at least till our current account position is comfortable.

For the purpose of maintaining comfortable current account balance, I feel it is important for us to ensure steady high growth in export of services. A surplus on the invisibles account can finance the deficit on the merchandise account.

What we need to appreciate at the moment is the fact that finally Indian exporters have come of age and broken the barriers to entry into global markets. Now we can be confident that we are in the high league of exporting nations.

This we have been able to achieve, it may be mentioned, without pursuing the East Asian type of export-led growth model, wherein governments were highly aggressive on exports but defensive on imports. We, on the contrary, have pursued a strategy of export push while opening our domestic markets to global competition. In our case, it has been a perfect working of globalisation that allowed free mingling of competitive forces within the domestic economy.

The current export success has vindicated the benefits of trade liberalisation. It is well established that trade liberalisation helps in pushing exports on one hand and strengthening the domestic economy on the other. For us in India, this has been a perfect experiment with globalisation as a vehicle for export promotion.

One more aspect of our export performance is that, quite different from the case in China, foreign direct investment (FDI) has played little or no role in developing the export sector. There have been hardly any FDI flows in our export sector, though we have our own version of SEZs and FTZs. It is only recently that we are beginning to see a surge in exports from our FTZs and 100% Export Oriented Units (EOUs), but the observed surge is more due to new generation of entrepreneurs.

Further, unlike in many emerging market economies, export success has been achieved without India participating in a game of exchange rate manipulation. On the contrary, India's exports have grown in spite of some significant appreciation of rupee vis-A -vis dollar since 2002-03, when average exchange rate was 48.4 to a dollar against average 45.5 in 2010-11. Certainly, our exporters have found a way out of a situation of volatility in exchange rates movement. At this stage, one can recall with some satisfaction how in the aftermath of liberalisation policies the Indian industry had undergone total restructuring and reorganisation, but only to come up stronger and return as global players.

The export success has much to do with that resurgence of Indian industry subsequent to liberalisation. This is very well reflected in the changing composition of our export basket, where some high-value non-traditional items such as petrochemicals, pharmaceuticals, chemicals, automobiles and so on are leading export growth.

In some traditional sectors as well, like textiles and garments, gems and jewellery, there has been a significant increase in competitiveness and a surge of confidence in our exporting community that has mastered the art of global networking. In most traditional items, there has been a noticeable upward shift across market segments. This product diversification has been yet another driving force behind the resurgence of exports.

Finally, one must talk of one more driving force at work, and that is where one has to give full credit to the government. Initially, there were lot of concerns and anxieties in our minds about implications of bilateral free trade agreements (FTAs), and there was some opposition as well. It was for the government to take the lead and push for several FTAs with countries, helping diversification of export markets in an important way.

Without such bilateral FTAs, it would have been difficult for India to diversify its export market. Today, our exports are no longer dependent on a few advanced markets only, and are poised to perform even after being subject to global economic shocks.

With the government steering the course on trade and economic relationships with our partners, a new relationship has emerged with the industry.

It is like the government giving a sort of MasterCard to the exporting community for access to global markets. Do you recall Sachin Tendulkar saying, 'MasterCard, go and get it?' It has been exactly like that in our case. With more and more FTAs, the government is showing MasterCard. It was for the exporters to go and get it. Now, they have learnt it.

Trade finance

Trade finance is related to international trade. Trade finance refers to financing international trading transactions. In this financing arrangement, the bank or other institution of the importer provides for paying for goods imported on behalf of the importer. Trade Finance is necessary to reduce the risks and uncertainties associated with commercial transactions, thus, facilitating trade.

While a seller (the exporter) can require the purchaser (an importer) to prepay for goods shipped, the purchaser (importer) may wish to reduce risk by approaching a bank. Banks may assist by providing various forms of support. For example, the importer's bank may provide a letter of credit to the exporter (or the exporter's bank) providing for payment upon presentation of certain documents, such as a bill of lading. The exporter's bank may make a loan (by advancing funds) to the exporter on the basis of the export contract.

Bank guarantee is one important instrument in this regard: A bank guarantee is an undertaking by the Bank on behalf of its client to pay a certain sum of money to a beneficiary.

Other forms of trade finance can include trade credit insurance, export factoring(forfaiting). In many countries as in India, trade finance is often supported by quasi-government entities known as export credit agencies that work with commercial banks and other financial institutions.

Trade Finance in India

Various export related agencies of State & Central Government play a vital role in assisting/providing various kind of service/facilities to traders / manufactures to encourage exports from the country. The following are the few agencies who support for promotion of exports.

Department of Customs is a regulatory body for Levy & collection of export duty / cess wherever applicable. It extends services in Scrutiny of Shipping Bills and accompanying documents, Appraisal / Assessment of goods presented for export, Physical examination wherever necessary, Drawal of samples of export goods for tests wherever necessary.
EXIM Banks through its LINES OF CREDIT (LOC) PROGAMME provides a safe mode of non-recourse financing option to Indian exporters, especially to SME sectors.

Reserve Bank India monitors the flow of credits to exporters and extends interest subvention benefits as an incentive for promotion of exports. RBI has prescribed time schedule for commercial banks for speedy sanctioning of exports credit limit. Commercial banks are advised that 12% of their total credit should be under export finance. RBI ensures to realize and repatriate the export proceeds in the specified time limit.

Export Credit Guarantee Corporation of India Limited (ECGC) provides cost effective credit insurance to Indian Exporters to protect them against commercial and political risks. It also provides Insurance cover for Banks and financial institutions to facilitate adequate finance to the Indian Exporters. ECGC also assists exporters in recovering bad debts.

The Central Excise Department by its notification grant exemption / rebate on central excise payable on such excisable goods and on raw materials used in the manufacture or processing of exportable goods. The rebate shall be subject to such conditions or limitations, if any, and fulfillment of such procedure, as may be specified in the notification.

The Commercial Tax Department is a statutory body for levy and collection of sales tax arising in the sale of goods. The Department extends the vat reimbursement /credit facility by its notification for the exporters. Value added Tax wherever paid could be recovered subsequently within specified time limits, if proper receipt is obtained for the export of goods / commodities. The Export Promotion Councils (EPCs) also have a role in it.

EEFCA

Exchange Earners' Foreign Currency (EEFC) account is foreign currency-denominated account maintained with banks dealing with foreign exchanges. The Reserve Bank of India introduced this scheme in 1992 to enable exporters and professionals to retain their foreign exchange receipts in banks without converting it into the local currency. Any person residing in India who receives inward remittances in foreign currency or a company with foreign currency earnings can open EEFC account but they don't earn any interest from the deposits and it is a non-interest bearing scheme. They can convert it into rupees when the exchange rate is attractive. Remittances received on account of foreign currency loan or investment received from abroad can't be deposited in EEFC. While the rupee was sliding in 2012, RBI compelled the account holders to convert a part of their earnings into rupee.

Agriculture

With about 14.5% contribution at 2004-05 prices, to the gross domestic product (GDP), agriculture provides livelihood support to about two-thirds of country's population. The sector provides employment to 57% of country's work force and is the single largest private sector occupation. Agriculture accounts for about 10% of the total export earnings and provides raw material to a large number of Industries (textiles, silk, sugar, rice, flour mills, milk products). Besides, the rural areas are the biggest markets for low-priced and middle-priced consumer goods, including consumer durables. It means, if agriculture performs, rural demand is high. Rural domestic savings are an important source of resource mobilisation.

The agriculture sector is crucial in maintaining food security and, in the process, national security as well. The allied sectors like horticulture, animal husbandry, dairy and fisheries, have an important in improving the overall economic conditions and health and nutrition of the rural people. Thus, any change in this sector, positive or negative, has a multiplier effect on the entire economy India is the world's largest producer of milk, pulses, and spices, and has the world's largest cattle herd (buffaloes), as well as the largest area under wheat, rice and cotton. It is the second largest producer of rice, wheat, cotton, sugarcane, farmed fish, sheep & goat meat, fruit, vegetables and tea.

Recognising the crucial role played by the agriculture sector in enabling the widest dispersal of economic benefits, the Eleventh Plan has emphasised that agricultural development is central to equitable and fast economic development of country.

Considerable progress has been made on this front. Foodgrains production rose from 52 million tonnes in
1951-52 to 253 million tonnes in 2011-12. The share of agriculture in real GDP has fallen given its lower growth rate relative to industry and services. However, what is of concern is that growth in the agricultural sector has quite often fallen short of the Plan targets. During the period 1960-61 to 2010-11, foodgrains production grew at a compounded annual growth rate (CAGR) of around 2 per cent. In fact, the Ninth and Tenth Five Year Plans witnessed agricultural sectoral growth rate of 2.44 per cent and 2.30 per cent respectively compared to 4.72 per cent during Eighth Five Year Plan. During the 11th Five Year plan, agriculture growth is estimated at 3.28 per cent against a target of 4 per cent. The Approach Paper to the Twelfth Five Year Plan emphasises the need to "redouble our efforts to ensure that 4.0 per cent average growth" is achieved during the Plan if not more. Without incremental productivity gains and technology diffusion across regions, achieving this higher growth may not be feasible and has implications for the macroeconomic stability given the rising demand of the 1.2 billion people for food.

Achieving minimum agricultural growth is a pre-requisite for inclusive growth, . reduction of poverty levels, development of the rural economy and enhancing of farm incomes

Food deficit to food surplus

After remaining a food deficit country for about two decades after Independence, India has become self-sufficient in foodgrains.

From the mid 1960s , food security improved with the introduction of high yielding varieties (HYVs) of crops, and the development of agriculture infrastructure for irrigation, input supply, storage and marketing. The HYVs motivated farmers to adopt improved production technologies with the use of water, fertilisers and agrochemicals. Besides the public sector rural infrastructure, farmers developed their own 'onfarm' resources. The extension support for production technology and the marketing support through procurement operations encouraged farmers to step up production. The production of various crop commodities has increased substantially, over the various Plan periods.

Accounting for Success in Agriculture

The main factors for the all-round success of agriculture have been

- increase in net sown area
- expansion of irrigation facilities
- land reforms, especially consolidation of holdings
- development and introduction of high yielding seeds
- fertilizers
- improved implements and farm machines
- technology for pest management
- price policy based on MSP and procurement operations
- infrastructure for storage/cold storage
- improvements in trade system
- increase in investments, etc.

However, in spite of the spectacular achievements, various constraints and disturbing trends continue to hamper the requisite growth of the agriculture sector.

Foodgrain production 2012

India's foodgrains production was an all-time high of 252.56 million tonne in 2011-12.The country produced 244.78 million tonne in the previous year.

Rice production has been revised to a record 103.41 million tonne .Wheat output, too, has been pegged higher at 90.23 million tonne. However, the production figure of coarse cereals and pulses has been revised downwards to 41.91 million tonne and 17.02 million tonne, respectively.

In the 2010-11 crop year, rice production stood at 95.98 million tonne, wheat — 86.87 million tonne, pulses — 18.24 million tonne and coarse cereals — 43.68 million tonne.

Crisis and Challenge in Agriculture

One of the major challenges of the 12th Plan is to reverse the deceleration in agricultural growth from 3.2% observed between 1980 and 1996-97 to a trend average of less than 2% subsequently. This deceleration is the root cause of the problem of rural distress that has surfaced in many parts of the country- unemployment, underemployment, declining incomes, distress migration etc.

Low farm incomes due to inadequate productivity growth, high prices of inputs and lack of credit at reasonable rates pushed many farmers into crippling debt. Uncertainties have increased- prices, quality of inputs ,weather and pests which, coupled with unavailability of proper extension and risk insurance have led farmers to despair. This has also led to widespread distress migration, a rise in the number of female headed households in rural areas and a general increase in women's work burden and vulnerability.

To reverse this trend, corrective policies are being implemented under the 11th Plan- focused not only on the small and marginal farmers who continue to deserve special attention, but also on middle and large farmers who suffer from productivity stagnation arising from a variety of constraints. Bharat Nirman with irrigation component is an example.

It is vital to increase agricultural incomes for reasons of employment; equity; food security etc. A second green revolution is urgently needed to raise the

growth rate of agricultural GDP to around 4% in an ever green way(ecologically friendly). This is not an easy task since actual growth of agricultural GDP, including forestry and fishing, was below 2% for the 10th Plan period. The challenge posed, therefore, is to at least double the rate of agricultural growth. The 12th plan Approach Paper(2012-17) targets 4% growth rate for agriculture.

Causes for low agricultural growth since mid-1990s

There are region-specific causes for the decelerating growth in the agriculture sector during the 1990s. Some of these are:

- Low public investment in irrigation.
- Poor maintenance of rural infrastructure, specially canals and roads.

- Decline in investments in rural electrification and in its availability. This has greatly affected production in eastern India, where huge groundwater potential remains untapped.
- Rising level of subsidies for power, water, fertilisers and food are eroding public sector investments in agriculture, besides encouraging inefficient use of scarce resources such as water. This further aggravates environmental problems leading to loss of soil fertility and decline in groundwater, which reduces returns on capital. Farmers then demand further subsidies to maintain the same level of production.
- Inadequate credit support till 2004
- Distortions brought in marketing mechanism
- Continuing imbalanced use of NP &K fertilisers, (6.4:2.5:1) as against the desirable norm of 4:2:1 and increasing deficiency of micro nutrients in the soil.
- Stringent controls on movement, marketing, credit, stock and export of agri-products that affect their profitability.
- Controls on the agro-processing industry.
- Poor extension service.

Remedies

In recent years, several new initiatives have been taken which included :

- Announcement of National Policy for Farmers (2007).
- Kisan Credit Card (1998-1999).
- Creation of a Watershed Development Fund
- Bharat Nirman
- National Horticulture Mission.
- Technology Mission on Cotton (1999-2000).
- Implementation of the National Agriculture Insurance Scheme/Rashtriya Krishi Bima Yojana .
- programmes for elimination of post-harvest losses
- Lifting some of the restrictions and controls on the movement and storage and exports of foodgrains/agri produce.
- De-reservation of the manufacture of some farm implements/machines from the smallscale industries sector
- Vishesh Krishi Upaj Yojana: The objective of the scheme is to promote export of fruits, vegetables, flowers, minor forest produce, and their value added products, by incentivizing exporters of such products. Exporters of such products shall be entitled for duty rebates.
- AEZs
- Contract farming
- Loan waiver to revive farming
- NRAA was set up in 2006(read ahead)
- Nutrient based fertilizer subsidy (2008-09)

11th Plan and Agriculture: Some areas

Accelerating Agricultural Growth

The crisis of stagnation in agriculture needs urgent attention. As pointed out by the National Commission on Farmers, we need a new deal that rebuilds hope about farming by making it a viable and profit-making enterprise. This involves finding larger public resources.

Concerns

Initially, public sector investment played a crucial role in the development of infrastructure like irrigation, electricity, agriculture research, roads, markets and communications. Investment in agriculture declined in the last three five year plans This decline was due to a fall in public investment. This calls for a review of policies so that productive investment is made in capital formation. Diversion of scarce resources from creation of productive assets - rural electricity, irrigation, credit and other agricultural inputs to subsidies needs to be resisted. The declining trend in public sector investment will need to be reversed by better targeting of subsidies. Following are the concerns:

Firstly, the share of agriculture in GDP has declined from 61 per cent in 1950-51 to 17 per cent (2009), whereas the dependence of population on agriculture has declined only marginally from 3/4ths to 2/3rds during the period. In all the developed countries, there has been a major shift of population from agriculture as an occupation to other sectors. However, this has not happened in India.

Secondly, the average size of holdings has reduced from 2.28 ha in 1970-71 to less than 1 ha in 2009 with the pressure on land increasing proportionately . Small plots do not permit introduction of modern technology due to high costs.

Thirdly, during the 1990s, foodgrains production growth rate and productivity growth rate declined: the growth rate of foodgrains production declined to 1.92 per cent per annum from 3.54 per cent per annum during 1980s. Similarly the growth rate of productivity in food grains decelerated to 1.32 per cent per cent as compared to 3.33 per cent per annum during the 1980s. The per unit area productivity of our crop commodities is much lower as compared to that of the other major crop producing countries . There is also a wide gap in the yield levels among and within States.

Fourthly, during the 1990s, the policy of various States has been to increase production through subsidies on inputs such as power, water and fertilisers, rather than by building new capital assets in irrigation and power. These problems are particularly severe in the poorer states. Lower public investment and deteriorating quality of public services in agriculture are the major problems. The poor base of rural productive assets and poorer technological base because of past public/private patterns of spending has been recognised as a serious constraint in increasing production and productivity.

11th Plan strategy to raise agricultural output is based on the following elements:

- Double the rate of growth of irrigated area;
- Improve water management, rain water harvesting and watershed
- development;
- Reclaim degraded land and focus on soil quality;
- Bridge the knowledge gap through effective extension;
- Diversify into high value outputs, fruits, vegetables, flowers, herbs and
- spices, medicinal plants, bamboo, bio-diesel etc., but with adequate measures to ensure food security;
- Promote animal husbandry and fishery;
- Provide easy access to credit at affordable rates;
- Improve the incentive structure and functioning of markets;
- Refocus on land reforms issues.

Boosting agricultural productivity by making available institutional credit adequately and affordably, support for investments in land development structures, farm mechanisation, biotechnology, cold storages, value adding enterprises and marketing to improve productivity and profitability in
Agriculture is the need of the hour.

12th FYP and agriculture

The Planning Commission set annual agriculture growth target for the 12th Five Year Plan (2012-17) at 4 per cent as it was in the previous two plans.

During the 11th five year plan (2007-12) average farm growth of about 3.5 per cent was achieved ."The investment in farm research should be 2 per cent of agriculture gross domestic product (GDP) which ranges from 0.5-0.6 per cent at present.

12th Plan expressed concerns over relatively lower agriculture yields in India compared to the developed world.Production could be increased by reducing knowledge deficit.

The farm growth is crucial in the back drop of high food prices in the country. The performance of the farm sector was dismal in the previous fiscal as the growth was just 0.2 per cent against the annual average target of 4 per cent in the 11th Plan (2007-12), on account of widespread drought.

The annual average farm growth during the 10th Plan (2002-07) also missed the 4 per cent target, and grew instead at the rate of 2.13 per cent.

The annual average farm growth which was 4.72 per cent in 8th Plan (1992-97), slowed down to 2.44 in 9th Plan and further to 2.13 per cent in 10th Plan period.

Capital Formation in Indian Agriculture

Capital formation is one of the basic factors for increasing production. It means addition to the physical stock of dams, roads, power plants and other infrastructure. This is all the more important in agriculture where we are faced with the need of increasing production against vagaries of weather to keep pace with the increase in population. Judicious use of natural resources for sustainable production of agriculture, adoption of advanced technology and development of infrastructure for facilitating all agricultural activities, ensuring food security in the broader sense of making adequate nutritious food available and accessible to all and making agriculture a profitable commercial activity at par with other industries in the arena of global economy are the problems that can be successfully tackled only with a strong capital base.

It is necessary to have a broader measure of agricultural capital formation which can be called **capital formation for agriculture** in comparison with **capital formation in agriculture.** That is, rural roads, powers etc should also be considered capital formation for agricultural growth while they may not be directly related to agriculture.

As agriculture is getting diversified, there is a need to not only augment but also re-structure the pattern of investment in agriculture. Historically, the public sector has taken the lead in directing the growth and pattern of agriculture investment. Steps should be taken to improve capital formation for agriculture in both Public and Private Sectors. Otherwise, it may be difficult to sustain the agriculture growth and rural purchasing power. Currently, irrigation accounts for the bulk of public investment in agriculture (above 90%).

The new strategy of agriculture growth and diversification of agriculture from traditional crop cultivation to horticulture etc. would require more investments on cold storage, rural roads, communication, marketing network and facilities, warehouses etc.

Simultaneously efforts should be made to revitalize agriculture through introduction of bio-technology and other innovations. This would require substantial increase in investment on research & development for agriculture.

Recent steps are showing positive results: gross capital formation in agriculture as a proportion of agriculture GDP improved.

he Gross Capital Formation (GCF) in the agriculture and allied sectors in the country rose by 87 per cent to Rs 1,42,254 crore in the 2010-11 fiscal as compared to 2004-05.Capital investment in agriculture and allied sectors has witnessed a steady increasing trend in recent years. It has risen from 13.5 per cent of GDP in 2004-05 to 20.1 per cent in 2010-11.

This growth has been possible because of initiatives taken by the government to make agriculture a sustainable vocation- Bharat Nirman is responsible for the good performance. **Bharat Nirman** is the plan for creating basic rural infrastructure. It comprises projects on irrigation, roads (Pradhan Mantri Gram Sadak Yojana), housing (Indira Awaas Yojana), water supply, electrification (Rajiv Gandhi Grameen Vidyutikaran Yojana) and telecommunication connectivity..

Investment in public sector includes irrigation works, command area development, land reclamation, afforestation and development of state farms, it added.

Private sector investment includes construction activities including improvement/reclamation of land, construction of non-residential buildings, farm houses, wells and other irrigation works, it said.

The share of public investment in gross investment increased.

Efforts are being intensified to boost investment in agriculture .These programmes are likely to increase capital formation in agriculture by the public sector and induce the private sector to increase investment in agriculture. The improved availability of credit for agriculture and liberalized trade for agricultural products should enhance private investment in agriculture.

Government stepped up public investment significantly for rural roads and rural employment programmes. Major measures taken for agricultural development through enhanced capital formation include the following:

- A roadmap for agricultural diversification has been prepared with focus on horticulture, floriculture, animal husbandry and fisheries.
- Strengthening of agriculture marketing infrastructure.
- National scheme for the repair, renovation and restoration of water bodies.
- Focus on micro irrigation, micro finance, micro-insurance and rural credits.
- Setting up a Knowledge Centre in every village.
- Setting up a National Fund for strategic agricultural research.
- Provision of urban amenities in rural areas through creation of new growth poles
- New fertilizer subsidy regime that is nutrient based so as to fortify soil .

- Bharat Nirman
- Pradhan Mantri Gram Sadak Yojana
- Loan waiver also will enable fresh investment as farmers become eligible for loans again due to write off.

Sustainable Agriculture: Water Management and Irrigation

Sustainable development of land and water resources becomes important for the nation like India, which shares about 16 per cent of the global population but has only 2.4 per cent of the total land and 4 per cent of the total water resource. Scarcity of water in rainfed areas is causing serious hardships. Ground water resources are dwindling fast due to poor water harvesting leading to excessive run off and poor recharging of ground water. This is accompanied by excessive drawal/ exploitation mainly to meet the household needs of growing population as also irrigation needs of new high yielding crops. The number of dark blocks/mandals where there is over exploitation of groundwater (over 85 per cent) is increasing in most of the States with large rainfed areas (Andhra Pradesh, Karnataka, Rajasthan, Madhya Pradesh, Chattisgarh etc.). If this continues, the number of over exploited blocks will double over a period of every twelve and a half years.

Water is a critical input for agriculture and this calls for more effective utilization of existing irrigation potential, expansion of irrigation where it is possible at an economic cost, flood forecasting and better water management in rainfed areas where assured irrigation is not possible. The Bharat Nirman programme envisages creation of 10 million hectares additional assured irrigation during the 4 years period (2005-2009).

Along with expansion of irrigation facilities, steps need to be taken to ensure that water is distributed equitably and that it is used efficiently. The pattern observed in the past where tail-enders are denied water because upper end-users appropriate it for highly water intensive crops must be avoided. Participatory Irrigation Management (PIM) by democratically organised water user associations empowered to set water charges, collect and retain substantial part of it, would help to maintain field channels, expand irrigated area, distribute water equitably and provide the tail enders their just share of water. Experience in Andhra Pradesh and Gujarat has shown the effectiveness of such PIM.

Watershed management, rainwater harvesting and ground water recharge can help augment water availability in rainfed areas. Micro-irrigation is also important to improve water use efficiency.

Warabandi

Warabandi means fixing of turns for irrigation water for each farmer so as to make it available to its potential users, i.e. farmers. It aims at use of water judiciously and equitably.

Soil Health

Soil health is a critical factor for agricultural productivity and human health. The following steps are being taken to improve it.

Government will issue Soil Health Cards to all farmers in the country detailing the deficiencies in the soil and the amount of fertilizers needed, Soil Health Cards would give farmers information about the quality of the soil and what is the normal quantity of fertilizer to be used for a particular crop. For this, setting up of 500 new soil testing laboratories and 250 new mobile soil testing laboratories had been sanctioned in the Budget for 2008-09.
Studies have found that over-dose and injudicious use of conventional chemical fertilizers and pesticides affect soil fertility, vegetation, human and animal health.The government is also encouraging use of organic fertilizer and wormicompost as overdose of conventional fertilizers has been found to affect fertility of the soil in many places.Land under organic farming has increased from 42,000 hectares in 2003-04 to 464,000 hectares currently.

The introduction of nutrient based fertilizer subsidy will enhance soil health as it will be demand driven and not price driven.

Soil reclamation

It is necessary to offset the loss of agricultural land by bringing more land under cultivation.There is a large amount of degraded land that can be reclaimed through watershed development. There is also a considerable amount of saline and sodic land, which can be brought back to cultivation with treatment. It is being done by making many government programmes including MNAREGA. Vast areas of cultivated land are acidic, where significant yield increases are possible through treatment using waste material from industry. There is sulphur deficiency in large parts of the country, but this can be treated effectively, particularly for pulses and oilseeds. More generally, Indian soils are relatively deficient in organic matter and are suffering inadequate manuring and composting, aggravated in many regions by unbalanced use of chemical fertilisers, especially excessive application of nitrogen. This raises prospects of large yield increases by applying nutrients, including micronutrients, that have been seriously depleted. .

The NBS based fertilizer subsidy can restore soil fertility.

Extension services

The National Commission on Farmers (NCF) has drawn attention to the knowledge deficit that exists at present and explains much of the difference between yields realised in experiments and what farmers actually get. One reason for this is the virtual collapse of extension services in most states,.Farmers are not fully aware of the adverse consequences of unbalanced fertiliser use or of benefits of micronutrient application and soil testing to determine optimal nutrient requirements is hardly practised on a regular basis even by State Agriculture Departments. Similarly, although many new varieties of seeds and pesticides have entered the market during the last decade and farmers are using these, they do not appear to have significantly higher productivity and there are frequent complaints about quality. A problem is that input dealers, who have narrow commercial interests have emerged as the main vehicle for technology diffusion and farmers do not have access to reliable third-party advice which an effective and knowledgeable extension service should be able to provide. Lack of credit also pushes farmers to purchase inputs from local suppliers who often provide sub-standard inputs.

To overcome information gaps and for advice in contingencies such as pest-attacks, it is necessary to revitalise the extension system in a manner which links universities and best practices effectively to farmers. States need to take urgent steps in this area. Central initiatives on this also need to be strengthened. Krishi Vigyan Kendras set up by Indian Council of Agricultural Research (ICAR), can be better used. Agricultural Technology Management Agency (ATMA) model of extension being promoted by Department of Agriculture & Cooperation (DAC) will deliver results.

The Department of Agriculture and Cooperation, along with NABARD, has introduced a scheme for establishment of agri-clinics / agri-business centres / ventures by the agricultural graduates.

The ICAR is also associated in agriculture extension activities not only through KVKs but also Institute Village Linkage Programme (IVLP) and also its institutes / centres all over the country. The interaction of KVKs activities with the State / district extension machinery is being strengthened. It is planned to strengthen linkages between research and extension to improve quality and effectiveness of research and extension system. The extension system , thus, is being revitalised and broad based through KVKs, NGOs, farmers' organisations, cooperatives, the corporatesector and agri-clinics / agri-business centres. KVKs and ICAR/SAUs units are designated nodal agencies for quality certification including organic products, bio-fertilisers, and bio-pesticides. The supply of inputs, agro-processing and trade through such cooperatives / companies is encouraged through the availability of credit with the help of NABARD.

The NFC has suggested ways to synergise at the village level, for example through Farmer Knowledge Centres, and this is already being implemented in some places with PRI and NGO help. Since synergies across line departments and Centrally sponsored schemes can be derived best through district plans, the Planning Commission and Ministry of Panchayati Raj have begun strengthening the process of district planning. The recent MoA initiative to set up technical bodies such as the National Fisheries Board and the National Rainfed Areas Authority should help to improve synergy.

Agri clinic and agri business centre

The Ministry of Agriculture, Government of India, in association with NABARD has launched a unique programme to take better methods of farming to each and every farmer across the country.This programme aims to tap the expertise available in the large pool of Agriculture Graduates. AgriClinic offers professional extension services to innumerable farmers.

Government is now also providing start-up training to graduates in Agriculture, or any subject allied to Agriculture like Horticulture, Sericulture, Veterinary Sciences, Forestry, Dairy, Poultry Farming, and Fisheries, etc. Those completing the training can apply for special start-up loans for venture

Agribusiness Centres would provide paid services for enhancement of agriculture production and income of farmers. Centres would need to advise farmers on crop selection, best farm practices, post-harvest value-added options, key agricultural information (including perhaps even Internet-based weather forecast), price trends, market news, risk mitigation and crop insurance, credit and input access, as well as critical sanitary and phyto-sanitary considerations, which the farmers have to keep in mind.

Farmers could make use of the clinic to undertake soil testing and get professional counsel.The programme was started in 2002 as a supplement to government's extension services.

ITC's e-choupal is another development in the field of strengthening extension services.

SFAC

Small Farmers' Agribusiness Consortium (SFAC), a specialized agency of the Dept. of Agriculture & Cooperation, Govt. of India, supports entrepreneurs, farmer producer groups, cooperatives, companies and other entities to set up agribusiness enterprises which add value to agriculture produce by offering risk capital through its Venture Capital Assistance Scheme.

Rainfed agriculture

The ministry of agriculture classifies areas, which receive less than 750 mm rainfall annually, and have less than 30 per cent land under irrigation (both surface and ground water) as drylands.

Rainfed regions are those where crop production is exclusively dependent upon rainfall. In India rainfed regions cover 177 districts and exist in all agro-climatic zones. However, they are mostly concentrated in arid and semi-arid areas. Most of these districts are country's poorest. Rainfed regions account for 68 per cent of the total net sown area in the country, according to the Union Ministry of Agriculture.

Rainfed agriculture plays an important role in India's economy. Rainfed crops account for 48 per cent of the total area under food crops and 68 per cent of the area under non-food crops in the country.

Nearly 50 per cent of the total rural workforce and 60 per cent of the livestock in the country are concentrated in the dry districts.

As opportunities for further agricultural growth in irrigated regions get exhausted, food security and productivity growth in agriculture in India in the coming years will increasingly depend on improved utilisation of resources and productivity growth in rainfed regions.

Most agricultural lands in rainfed areas in Orissa, West Bengal, Bihar and Chhattisgarh suffer from sulphur and phosphorous deficiency. Thus soil has become acidic in nature. These areas need interventions from agriculture scientists in dealing with the crisis.

Promotion of appropriate cropping patterns and livestock development is necessary. Development of suitable varieties and lab to land transfer is required.

Region specific watershed programmes need to be developed.

There is a need to divert a portion of the population dependent on agriculture to areas like fisheries, agro-processing and horticulture.Fisheries have a lot of potential in areas, which get good rainfall. It is quite clear that agriculture cannot sustain such a large mass of people in rainfed areas. The policy towards rainfed areas has to look beyond crop production and rainwater management.

National Rainfed Area Authority

National Rainfed Area Authority was set up in 2006 to coordinate the work of five ministries and improve productivity of the 85 million hectares of non-irrigated agricultural land- panchayati raj, rural development, agriculture, water resources and environment and forests. NRAA works under the agriculture ministry

NRAA aims to build synergy among these ministries on their schemes, programmes and policies that are relevant to non-irrigated lands. It works for wholistic and integrated development of the rainfed areas.

The NRAA would prepare a national prospective plan, which would look at regional variations. The plan would be flexible and dynamic.

Drought

Droughts is of the following three types

Meteorological drought is when the actual rainfall in an area is significantly less than the climatological mean of that area. The country as a whole may have a normal monsoon, but different meteorological districts and sub-divisions can have below normal rainfall.

India Meteorological Department (IMD) defines a rainfall range between 96 and 104 per cent of the LPA as being "near normal", while 90 to 96 per cent is considered "below normal", 104 to 110 per cent "above normal", above 110 per cent "excess" and below 90 per cent "deficient".

Hydrological drought means marked depletion of surface water causing very low stream flow and drying of lakes, rivers and reservoirs.

Agricultural drought means inadequate soil moisture resulting in acute crop stress and fall in agricultural productivity.

Droughts can throw out of gear the rural and national economy.Cattle, human beings and crops suffer a water shortage.

Drought occurs mainly due to failure of monsoon.

With wide variations in agro-climatic zones, drought occurs somewhere in India each year. While parts of Rajasthan and Andhra's Anantpur and Chittoor districts see two droughts in five years, western UP and northern Gujarat face it once in three years. Maharashtra alone has about a quarter of India's drought-prone districts. About 50 million Indians are affected every year.

Climate change is accelerating drought attacks. There were six between 1900 and 1950 and 12 in the following 50 years. We have already faced three droughts between 2000 and 2009.

There is an official checklist of symptoms to diagnose drought.. The early warning signs include delay in onset of SW monsoon, long 'break' within a monsoon, less rain in July, rise in fodder prices, fall in water reservoir levels, dwindling water supply, slower crop sowing.

Initially, government advises farmers to grow less water-seeking crops, increase fodder supply, and keep the Centre's National Crisis Management Committee (NCMC) informed.

It becomes an emergency when there is virtually no rain during the sowing period; monsoon withdraws mid-season; and a dry spell for more than a month. The deficit in rainfall by now grows and could be as much as 40% and crops start to wilt with no water and excessive heat.

The problem becomes acute and gets classified as a potential disaster when there is no rain for more than six weeks in a crop area, and the monsoon withdraws early, leaving behind parched land and people.

If 20%-40% of India's area is affected , it is called a drought year. If more than 40% of the country is reeling from rainfall shortage, the met department calls it an All India Severe Drought Year.

The primary responsibility of catching the early signs, offering relief and managing droughts lies with states.

The situation may warrant loan rescheduling ,, insurance premium waivers, and relief from the Centre. The state's budget can come under severe strain.

Once a drought is declared, Central government starts considering deferring/rescheduling farm loans, moving water and fodder by rail, hiking food allocation to poor families, creating more jobs, importing foodgrains to meet likely demand-supply gap, and check inflation.

A ministerial task force is set up to take rapid decisions. Drought-declared states are monitored individually and more carefully by the Centre. The Essential Commodities Act is used to prevent hoarding, and states get money for relief programmes.

Landless labourers and marginal farmers move to cities in search of casual jobs. Families with loans from moneylenders get further entrapped in poverty. Health suffers and schooling is disrupted as money dwindles. The impact on cities is by way of migration stress; declining farm growth pulls down industry, urban goods and services.

Proper water management, drought-resistant agriculture, income diversification, smarter subsidies and technology can ensure no one is left devastated by it anymore.

Drought-resistant varieties of seeds should be made available sufficiently.

Remedies lie in the form of better water management; sprinkler irrigation; drought resistant varieties of seeds; creation of irrigation; better credit facilities; shifting to dairy and other animal husbandry activities.

Contingency plan 2012

According to India Meteorological Department data, rains in the country are deficient by 21 per cent as of the beginning of August 2012.Sowing area of total kharif crops has declined by 10 per cent so far at 66.82 million hectare. Coarse cereals is worst affected with 23 per cent shortfall, followed by pulses (18 per cent), paddy (9 per cent) and cotton (7 per cent).

Government prepared contingency plans for 320 districts where monsoon rains have been poor. The plan has been prepared by the Central Research Institute for Dryland Agriculture (CRIDA), Hyderabad.

Among various measures being taken to tackle the drought-like situation, the Centre is providing knowledge input twice a week from ICAR besides seeds for alternate crop.

The government is also trying to provide states with additional electricity to draw water from tubewells.

Centre has sanctioned 300 mega watt (MW) of power to Punjab and Haryana and about 275 MW for Uttar Pradesh for the purpose.

Centre has taken decisions to introduce diesel subsidy scheme, hike seed subsidy and release funds under National Rural Drinking Water Programme (NRDWP) and Integrated Watershed Management Programme.

A new Calamity

Since 2012, , damage to crops due to cold wave/frost will be eligible for central and state assistance following the government's decision to consider such weather condition as natural calamity.At present, cyclone, drought, earthquake, fire, flood, tsunami, hailstorm, landslide, avalanche, cloud burst and pest attack are treated as natural calamities and are eligible for relief under the State Disaster Response Fund (SDRF) and National Disaster Response Fund (NDRF).

The proposal was taken by the GoM on requests from the chief minister of Madhya Pradesh, which faced damage to rabi crops like wheat and pulses last year due to extreme cold conditions.

NDRF and SDRF

Government has created State Disaster Response Fund (SDRF)/National Disaster Response Fund (NDRF) to mitigate hardships due to natural calamities including drought. There is ready availability of funds with State Governments under SDRF to take immediate relief measures. Government of India supplements efforts of State Governments with financial assistance and logistic support. Government of India and State Governments contribute to SDRF in ratio of 3:1 for 17 General Category States and 9:1 in case of 11 Special Category States covering North-Eastern States including Sikkim and 3 hill States of Himachal Pradesh, Uttarakhand and Jammu & Kashmir.

Additional financial assistance, over and above SDRF, is considered from NDRF for natural calamities of severe nature. Allocation for SDRF/NDRF is made on the basis of recommendations of the 13th Finance Commission.

UN and drought

WMO, UN weather agency says that there's an urgent need for nations to adopt drought-management policies as farmers from Africa to India struggle with lack of rainfall and the United States endures the worst drought it has experienced in decades. The World Meteorological Organization says the US drought and its ripple effects on global food markets show the need for policies with more water conservation and less consumption.WMO Secretary-General Michel Jarraud said. the world must "move away from a piecemeal, crisis-driven approach and develop integrated risk-based national drought policies" because of climate change projections for more drought.

WMO

The **World Meteorological Organization (WMO)** is an intergovernmental organization with a membership of 189 Member States and is a specialised agency of the United Nations for meteorology (weather and climate), operational hydrology and related geophysical sciences. It has its headquarters in Geneva, Switzerland, and is a member of the United Nations Development Group. The current president is David Grimes and the current Secretary-General is Michel Jarraud.

As weather, climate and the water cycle know no national boundaries, international cooperation at a global scale is essential for the development of meteorology and operational hydrology as well as to reap the benefits from their application. WMO provides the framework for such international cooperation.

Since its establishment, WMO has played a unique and powerful role in contributing to the safety and welfare of humanity. Under WMO leadership and within the framework of WMO programs. National Meteorological and Hydrological Services contribute substantially to the protection of life and property against natural disasters, to safeguarding the environment and to enhancing the economic and social well-being of all sectors of society in areas such as food security, water resources and transport.

Rural credit

Nabard

The National Bank for Agricultural and Rural Development (Nabard) was set up in 1982, as the apex development bank for agriculture and rural development under an Act of Parliament. The bank began by taking over the agriculture credit functions of the Reserve Bank of India and the refinance functions of the then Agricultural Refinance and Development Corporation (ARDC).

Nabard's mission is to "promote sustainable and equitable prosperity in rural India through effective credit support, related services, institution development and other innovative initiatives." Its prime function continues to be that of refinancing, supplementing the resources of co-operative banks, regional rural banks (RRBs) and commercial banks against the amounts lent at the grassroots level for agriculture and rural development.

Apart from its developmental role, Nabard has also been entrusted with certain supervisory functions in respect of co-operative banks and RRBs under the Banking Regulation Act, 1949.

Nabard is now a major shareholder in the Agricultural Insurance Corporation of India. It also has equity stake in NCDX (National Commodity and Derivatives Exchange) in association with other national-level institutions such as ICICI Bank, the LIC and the NSE (National Stock Exchange).

Promoting self-help groups reflects Nabard's capabilities in capacity-building and nurturing the rural credit delivery system.

Nabard manages RIDF.

RIDF is made up of the priority sector shortfalls of public sector commercial banks, which were assigned the task of channelling at least 18 per cent of their total lending to agriculture.

The fund was set up in 1995-96 for providing loans to State governments and state-owned corporations for projects relating to minor and medium irrigation, soil conservation, watershed management and rural infrastructure (such as roads, bridges and market yards). Investment projects under social infrastructure, such as construction of primary health centres/schools, providing drinking water, and so on, were also supported under the RIDF. (Read ahead)

Rural credit institutions

They comprise cooperative banks, RRBs and LABs.

Co-operative credit structure

Co-operative credit institutions continue to play a crucial role in dispensation of credit for agriculture and rural development.

She short-term credit structure is managed by State co-operative banks (SCBs) and district central co-operative banks (DCCBs). Primary agricultural credit societies (PACSs) are short-term co-operative credit institutions dealing directly with individual borrowers.

The long-term co-operative credit structure is managed by State co-operative and agriculture rural development banks (SCARDBs) and primary co-operative agriculture and rural development banks (PCARDBs).

RRBs

Regional rural banks were set up in 1975 under an Act of Parliament to exclusively cater to the credit needs of the rural population, especially small and marginal farmers. The ownership structure of RRBs is, the Central Government (50 per cent), the State government concerned (15 per cent) and the sponsor commercial bank (35 per cent). The sponsor bank manages the RRB concerned.

At present, the 86 RRBs in the country are sponsored by 26 PSU banks . RRBs have a strong branch network across the country and the branches are located in 588 out of the 622 districts of the country.Since 2005, the Union Government has taken up a process for consolidation through amalgamation of different RRBs in a particular state sponsored by the same bank. As a result of this process of consolidation , the number of RRBs in the country had reduced from 156 to 82.

There are 11.55 crore farmer households in the country, of which, 9.27 crore belong to small and marginal farmers. Institutional rural credit is accessible to only around 50 per cent of these farmers.

Local area banks

LABs were started in 1996 with a view to providing institutional mechanisms for promoting rural savings as well as for the provision of credit for viable economic activities in the local areas. They are in the private sector. This is expected to bridge the gaps in credit availability and enhance the institutional credit framework in the rural and semi-urban area.

The bank shall be registered as a public limited company under the Companies Act, 1956. It will be licensed under the Banking Regulation Act, 1949 and will be eligible for including in the Second Schedule of the Reserve Bank of India Act, 1934.

The minimum paid up capital for such a bank shall be Rs.5 crore. The promoters' contribution for such a bank shall at least be Rs.2 crore.

The area of operation of the proposed bank shall be a maximum of three geographically contiguous districts in one or more states. Backward and less developed districts are considered for area of operation of LABs.

Priority sector

The Government of India through Reserve Bank of India (RBI) directs certain type of lending from the Banks operating in India irrespective of their origin. RBI sets targets in terms of percentage (of total money lent by the Bank) to be lent to certain sectors, which would not have had access to organised lending market or could not afford to pay the interest at the commercial rate. This type of lending is called Priority Sector Lending. Financing of Small Scale Industry, Small business, Agricultural Activities and Export activities fall under this category. This is also called directed credit 40% of net bank credit should be for the priority sector and of the 40%, 18% should be for the agriculture.22% is for the non-agri sectors.Rate of interest charged on such loans is less. The targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are given below

	Domestic banks (both public sector and private sector banks)	**Foreign banks operating in India**
Total Priority Sector advances	40 percent of NBC	32 percent of NBC
Total agricultural advances	18 percent of NBC	No target

SSI advances	No target	10 percent of NBC
Export credit	Export credit does not form part of priority sector	12 percent of NBC
Advances to weaker sections	10 percent of NBC	No target

(NBC denotes net bank credit)

Direct Agricultural advance means advances given by banks directly to farmers for agricultural purposes. These include short-term loans for raising crops i.e. for crop loans. Indirect finance denotes to finance provided by banks to farmers indirectly, i.e., through other agencies. For example, credit for financing the distribution of fertilisers, pesticides, seeds, etc.The weaker sections under priority sector include small (1-2 hectares)and marginal farmers(upto 1 hectare) landless labourers, tenant farmers and share croppers;beneficiaries of Differential Rate of Interest (DRI) scheme where loans are given at 4% interest rate. It is an example of financial inclusion.

(Read along with the Nair Committee recommendations and the RBI policy changes in July 2012 as given in the Chapter on Banking)

RIDF

RIDF was introduced by Government of. India during the year 1995-96 for implementation and timely completion of various rural oriented schemes/ projects in the States which were languishing for shortage of funds. The fund is placed with NABARD for providing loan assistance to the State. It is composed of priority sector shortfalls of public sector banks, as mentioned above.

In the Union Budget 2012-13, allocation under RIDF enhanced to Rs 20,000 crore. Rs 5,000 crore earmarked exclusively for creating warehousing facilities.

Nabard and SHGs

A pioneer in the self-help group (SHG)-bank linkage concept, Nabard has brought banking to the doorsteps of the poor people, especially the women.

SHGs represent a unique approach to financial intermediation. Self Help Groups (SHGs) are small groups of 10-20 members. These groups collect savings from their members and provide loans to them. These groups also obtain loans from banks and on-lend them to their members. SHGs are formed and supported usually by NGOs or banks or by Government agencies. Linked not only to banks but also to wider development programmes, SHGs are seen to confer many benefits, both economic and social. SHGs enable women to grow their savings and to access the credit which banks are increasingly willing to lend. SHGs can also be community platforms from which women become active in village affairs, stand for local election or take action to address social or community issues (the abuse of women, alcohol, the dowry system, schools, water supply).

Being made up mostly of women, their default rate is negligible. Group lending ensures peer pressure to repay. Transaction costs are also dramatically reduced. With extension services and counseling, deployment of funds is effective.

Microfinance

Microfinance is defined as provision of credit and other financial services like insurance of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve living standards. Micro finance Institutions are those which provide these facilities.

Microfinance covers not only consumption and production loans for various farm and non-farm activities of the poor but also include their other credit needs such as housing and shelter improvements.

A Self-Help Group (SHG) is a registered or unregistered group of micro entrepreneurs having homogenous social and economic background voluntarily coming together to save small amounts regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis.

While the SHG-bank linkage programme has surely emerged as the dominant micro finance dispensation model in India, other models too have evolved as significant micro finance channels.

Government allows 'Micro Credit/Rural Credit' (non-banking financial company, NBFC) activities for Foreign Direct Investment (FDI)/Overseas Corporate Bodies (OCB)/Non-Resident Indians (NRI) investment to encourage foreign participation in micro credit projects.

Types of micro credit providers in India

- Domestic Commercial Banks:Public Sector Banks; Private Sector Banks & Local Area Banks
- Regional Rural Banks
- Co-operative Banks
- Co-operative Societies
- Registered NBFCs

- Unregistered NBFCs
- Other providers like Societies, Trusts, etc.

In the area of microfinance, there are many areas of concern in India. They are

a) unjustified high rates of interest
b) lack of transparency in interest rates and other charges.
c) multiple lending
d) upfront collection of security deposits
e) over-borrowing
f) ghost borrowers
g) coercive methods of recovery

Malegam Committee

Aimed at reviving the crisis- ridden micro finance sector, Reserve Bank of India Committee suggested that micro finance institutions (MFIs) be allowed to charge a maximum interest of 24 per cent on small loans which cannot exceed Rs.25,000.

The committee, headed by Reserve Bank's Central Board Director Y. H. Malegam, also recommended creation of a separate category of non-banking financial companies (NBFC-MFI) for the micro finance sector.

The panel also said small loans of up to Rs.25,000 could be given to families having an income up to Rs.50,000 per annum.

It further said at least 75 per cent of loans extended by MFIs should be for income generation purposes. It further recommended that a borrower cannot take loans from more than two MFIs.

These recommendations, the committee said, should be implemented from April 1, 2011.

The RBI constituted the committee in October last in the wake of allegations of overcharging and using coercive recovery practices by MFIs that led to a spate of suicides in Andhra Pradesh.

About the regulations of MFIs, the Malegam Committee, suggested that it should be done by the National Bank for Agriculture and Rural Development (NABARD) in close coordination with the RBI.

With regard to NBFC-MFIs, the committee suggested that they should have a minimum net worth of Rs.15 crore.

It recommended that bank lending to NBFCs, which qualify as NBFC-MFIs, will be entitled to the 'priority lending' status.

It has made a number of recommendations to mitigate the problems of multiple-lending, over borrowing, ghost borrowers and coercive methods of recovery. These include: a borrower can be a member of only one self-help group or a joint liability group(where money is lent to the whole group, it is called JLG); not more than two MFIs can lend to a single borrower; there should be a minimum period of moratorium between the disbursement of loan and the commencement of recovery; the tenure of the loan must vary with its amount; a credit information bureau has to be established; the primary responsibility for avoidance of coercive methods of recovery must lie with the MFI and its management; and the RBI must prepare a draft customer protection code to be adopted by all MFIs.

National Vegetable Initiative

The union government has launched a new scheme called vegetable initiative for urban clusters during 2011-12 with an outlay of Rs. 300 crore under the aegis of the Rashtriya Krishi Vikas Yojana.

The scheme envisages development of vegetable clusters for ensuring supply of good quality vegetables to one city or town in every state having a population of one million and above. In the case of states which do not have any city with one million population such as in the North East and the Goa, the state capital city or township having less than one million population is covered.

The scheme covers all aspects relating to vegetable production, from production and supply of planting material to marketing upto the retail level along with support for conducting base line survey, formation of farmer groups, their linkage to aggregators/markets besides training and capacity building of vegetable growers in the identified clusters.

The production of vegetables in the country has increased from 111.39 million tonnes in 2005-06 to 133.7 million tonnes in 2009-10. Accordingly, per capita availability of vegetables has increased from 279 gm per day to 317 gm per day over a period of 5 years. However, there are issues relating to enhancement of productivity, post-harvest losses and improvement in quality of vegetables.

NMFP

National Mission on Food Processing has been launched from 2012.The National Mission on Food Processing (NMFP) is a new Centrally Sponsored Scheme for giving of greater role to State/UTs; decentralized administration, better outreach and effective supervision and monitoring. The NMFP would also provide flexibility to States / UTs in the selection of beneficiaries, location of projects etc. for the development of food processing sector. This initiative of the Ministry would give an impetus to food processing industries in the country.

NMFP Scheme provides for sharing of the cost between Government of India (75%) and States (25%) for all States except North Eastern States, where, it is at 90:10 pattern. All Union Territories would be provided funds on 100% basis.

Kisan Credit Cards

The scheme of Kisan Credit Card (KCC) was introduced in 1998-99 for timely, easy and flexible availability of production credit to farmers.Commercial banks, cooperative banks and RRBs are implementing this scheme. Each farmer is provided with a Kisan Credit Card and a passbook for providing revolving cash credit facilities. The farmer is permitted any number of drawals and repayments within a stipulated date, which is fixed on the basis of land-holdings.

All categories of farmers including tenant farmers, share croppers, oral lessees are eligible for a Kisan Credit Card .

Agricultural Price Policy in India

Prices of agricultural produce are important for farmers as these determine their Incomes. Farming should become economically viable and profitable for agriculture to boom and country to have food security. Agricultural produce shows maximum price fluctuation. So farm sector needs a price policy for price stabilisation.

The main objective of the Government's price policy for agricultural produce continue to aim at ensuring remunerative prices to the growers for their produce with a view to encouraging higher investment and adoption of modern farm technology for achieving higher levels of production as also to safeguard the interests of consumers by making available supplies at reasonable prices. Each season Government announces Minimum Support Price (MSP) for 24 major agricultural commodities and organises purchase operations through public and cooperative agencies. It operates effectively only for rice and wheat.

At the beginning of the sowing season for kharif and rabi crops, the Government announces Minimum Support Price (MSP) at which it is prepared to procure the produce that the farmer is willing to sell to the FCI for the PDS and buffer stock operations. When it actually procures when harvesting is done, the MSP is added to and the procurement price is arrived at. The grain is sold at the PDS outlets at issue price. The FCI's economic cost is what it costs the FCI to procure, store, distribute etc.

The Government decides on the support price for various agricultural commodities based on the recommendations of the commission for agricultural costs and prices (CACP).

Commission for Agricultural Costs and Prices (CACP), while recommending prices takes into account all-important factors, viz.

- Cost of Production
- Changes in Input Prices
- Input/Output Price Parity
- Trends in Market Prices
- Inter-crop Price Parity
- Demand and Supply Situation
- Effect on Industrial Cost Structure
- Effect on General Price Level
- Effect on Cost of Living
- International Market Price Situation
- Parity between Prices Paid and Prices Received by farmers (Terms of Trade).

CACP recommends MSPs for 24 important crops.Of all the factors, cost of production is the most tangible factor and it takes into account all operational and fixed demands. Government organises Price Support Scheme(PSS) of the commodities, through various public and cooperative agencies such as FCI, CCI, JCI, NAFED, Tobacco Board, etc., for which the MSPs are fixed. For commodities not covered under PSS, Government also arranges for market intervention on specific request from the States for specific quantity at a mutually agreed price. The losses, if any, are borne by the Centre and State on 50:50 basis. The price policy paid rich dividends. Production improved and food security is being realized.

However, the criticism of MSP is that it is promoting rice and wheat while the need is for diversification. It helps the big farmer while the majority of farmers in India are subsistence farmers. Food subsidy burden is increasing and needs to be rationalized so as to spend on infrastructure.

National Food Security Mission

The Department of Agriculture & Cooperation, Ministry of Agriculture, has launched a Centrally-sponsored scheme on National Food Security Mission (NFSM) in pursuance of the resolution of the National Development Council (NDC) to increase the production of rice, wheat and pulses by 10, 8 and 2 million tonnes, respectively, over the benchmark levels of production, by the end of the Eleventh Five Year Plan period.

The Mission aims at increasing foodgrains production of the above crops through area expansion and productivity enhancement; restoring soil fertility and productivity; creating employment opportunities; and enhancing farm level economy to restore confidence of farmers of targeted districts.

Various activities of NFSM relate to demonstration of improved production technology, distribution of quality seeds of HYVs and hybrids,popularization of newly released varieties, support for micronutrients, and training and mass media campaign including awards for best performing districts. The identified districts are given flexibility to adopt any local area specific interventions as are included in the Strategic Research and Extension Plan (SREP) prepared for the agriculture development of the district. Rs. 2 crore each will be provided during the Eleventh Five Year Plan period to those districts which have a programme for two or more crops of the NFSM and Rs. 1 crore to the districts having a programme for any one of the crops.

The national food security mission (NFSM) is being implemented in 312 identified districts of 17 states of the country.

Food subsidy

Provision of minimum nutritional support to the poor through subsidized foodgrains and ensuring price stability in different states are the twin objectives of the food security system. In fulfilling its obligation towards distributive justice, the Government incurs food subsidies. The difference between economic cost of foodgrains and the issue price is reimbursed to FCI. Food subsidy is provided to FCI and states/ UTs undertaking DCP operations . Food subsidy is provided to distribute wheat and rice to the poor and also maintain a buffer stock. In 2012-13, food subsidy is budgeted at Rs.75,000 crores.

However, it is expected to go up due to the concessional food planned to be supplied through the Food security Act.

Rashtriya Krishi Vikas Yojana (RKVY)

The NDC in its 53rd meeting (2007) decided to launch a programme to incentivise the States to increase the share of investment in agriculture in their State plans. Accordingly, the Government approved the Rashtriya Krishi Vikas Yojana (RKVY) with an allocation of Rs. 25,000 crore for the Eleventh Five Year Plan.

The RKVY aims at achieving the 4 per cent annual growth in the agriculture sector during the Eleventh Five Year Plan period by ensuring a holistic development of agriculture and allied sectors. The RKVY will be a State Plan Scheme and the eligibility for assistance under the scheme would depend upon the amount provided in the State budgets for agriculture and allied sectors, over and above the baseline percentage expenditure incurred on agriculture and allied sectors. The funds under the RKVY would be provided to the States as 100 per cent grant by the Central Government.

The main objectives of the schemes are:

- To incentivise the States to increase public investment in agriculture and allied sectors
- To provide flexibility and autonomy to the States in planning and executing agriculture and allied sector schemes
- To ensure the preparation of plans for the districts and the States based on agro-climatic conditions, availability of technology and natural resources.
- To ensure that the local needs/crops/ priorities are better reflected.
- To achieve the goal of reducing the yield gaps in important crops, through focused interventions.
- To maximize returns to the farmers.

Under the Scheme of RKVY, the following indicative broad activities have been identified for focused attention – Integrated Development of Food Crops, including coarse cereals, minor millets and pulses; agriculture mechanization; soil health and productivity; development of rain-fed farming systems; integrated pest management; market infrastructure; horticulture; animal husbandry, dairying and fisheries; organic and biofertilizers; and innovative schemes.

Second Green Revolution

The first Green Revolution has run its course. Cereal yields are rising very slowly, water tables are plunging, and agricultural growth now averages only 2% annually.

Second Green Revolution is necessary and is being ushered in , spearheaded by the corporate sector and helped by new laws. Second Green Revolution, focusing on fruits and vegetables, can double agricultural growth to 4% per year.

Land reform laws ban corporates from farming. But contract farming is possible: corporates contract to provide high-tech farm inputs on credit, and lift the output at guaranteed prices.

The biggest rural initiative comes from ITC, whose e-choupals.

E-choupals are electronic buying and selling centres, which also provide information to farmers on prices, weather, and scientific farming practices.

By cutting out middlemen, e-choupals can pay farmers a higher price than they get in mandis, yet lower ITC's procurement costs. The company started with soyabeans, wheat and shrimps, and is now diversifying into oilseeds, spices and fruit.

FieldFresh, run by Sunil Mittal of Bharti Telecom, already has 1,000 acres under horticulture in Punjab. Pepsi and McDonalds have started contract cultivation of citrus fruits and lettuce respectively. Godrej is into contract cultivation of maize, used to make cattle feed.

Global Green, a Thapar company, uses contract cultivation for gherkins and other products for export, and has a turnover of over Rs 100 crore.

Paper companies like Ballarpur and ITC provide farmers with fast-growing clonal varieties of trees that mature in just four years, and buy the output.

This corporate upsurge is being encouraged by a new political urgency to uplift rural India. A raft of new laws aim to end historical hurdles.

The Agricultural Produce Marketing Committee Act forces farmers to sell only at mandis, ostensibly to protect them from rapacious traders. But this makes contract farming illegal; companies cannot directly buy from farmers.

However, many states have now repealed their versions of the APMC Act, Second, India has long been plagued by a maze of 16 different food laws, some of which are self-contradictory (one law permits sweeteners in jams and another bans the practice!).

Chilli paste is a widely sold product in Asia but cannot be produced in India because the law prohibits the use of thickeners. The central government wants to make a new comprehensive model law - integrated food law to replace the old laws.

Third, the government proposes a Warehousing Receipts Act, which will make warehousing receipts negotiable instruments, and thus qualify for bank financing.

This, along with futures trading in the NCDEX and other commodity exchange, can modernise agricultural trading just as stock market reforms earlier modernised the capital market.

Fourth, in order to curb hoarding, the Essential Commodities Act has long placed limits on commodity stocks. This makes large-scale corporate investment impossible.

Now that chronic agricultural shortages have given way to surpluses, the list of essential commodities has been drastically cut and optimists hope that the Act will soon be scrapped.

Fifth, tax laws and incentives are being liberalised to encourage private investment.

Sixth, banks are very keen to get into rural business, and many are now lending to self-help groups, which can enter into contracts with companies.

Cheap credit from banks and corporates can facilitate horticulture.

If new GMOs are added to it along with rural infrastructure(Bharat Nirman) and sustainability, the second green revolution can be the ever green revolution unlike the first one.

Horticulture

Vast areas of India have tropical and agro-climatic conditions which are well suited for cultivation of horticulture and plantation crops. They are also ideal substitutes for marginal and degraded lands, which are unsuitable for crop husbandry. They can help in diversification of agriculture. The horticulture sector contributes about 24.5 per cent towards agriculture GDP from only about 8 per cent of the cultivated area. Besides, providing nutritional and livelihood security and helping poverty alleviation and employment generation, this sub-sector sustains a large number of agro-Industries, which generate huge additional non-farming employment opportunities. The range of horticultural products includes fruits, vegetables, spices, coconut, medicinal and aromatic plants, mushrooms, cashew, cocoa etc. India accounts for 10 per cent of the world production of fruits and stands second after Brazil and is second largest producer of vegetables after China, contributing 13.4 per cent of the world vegetables production. The thrust areas for providing boost to the horticulture sector are as follows:

- Area Expansion
- Improving production
- Improving productivity
- Reducing cost of production
- Improving quality of products
- Value addition
- Promotion of marketing and exports
- Strengthening of credit and organisational
- support
- Human resource development
- Addressing relevant policy issues
- Cold chains.

National Horticulture Mission (NHM)

The National Horticulture Mission (NHM) is facilitating the holistic development of horticulture by promoting latest technologies involving production and supply of good quality planting material through tissue culture as well as nurseries, area expansion with improved cultivars, rejuvenation of senile orchards, organic farming, protected cultivation, integrated pest management/ integrated nutrient management along with creation of infrastructure for post harvest management and marketing. The post harvest management component includes the setting up of primary/mobile processing facilities. Besides, the cluster approach adopted under mission provides opportunities for setting up of food processing units for fruits and vegetables.

The Government has allocated a sum of Rs.1100.00 crore under the National Horticulture Mission during 2008-09 for taking up various activities involving production and productivity enhancement, post harvest management and marketing which in turn will create job opportunities in the field of horticulture.

Vishesh Krishi Upaj Yojana

The objective of the scheme is to promote export of fruits, vegetables, flowers, minor forest produce, and their value added products, by incentivizing exporters of such products.Exporters of such products shall be entitled for duty rebates.

AGRINDIA

The Union Cabinet has approved the proposal of Ministry of Agriculture, Department of Agricultural Research & Education (DARE) for setting up of a new company, called AGRINDIA.

AGRINDIA is a registered company under the Companies Act, fully owned by Government of India in the Department of Agricultural Research and Education (DARE) with a share capital of Rs.100 crore and initial paid up capital of Rs.50 crore.The company will undertake protection and management of intellectual properties generated in the system and its commercialization/distribution for public benefit. It will also set up research and development farms adn assist in setting up production units outside India, especially in Africa and the Asia Pacific regions, besides Latin America.

Livestock

India's livestock sector is one of the largest in the world. In 2010-11 livestock generated output worth Rs 2075 billion (at 2004-05 prices) which accounted for 4 per cent of the national GDP and 26 per cent of the agricultural GDP. The output worth was higher than the value of food grains. Distribution of livestock is more equitable compared to that of land. Livestock sector grew about 1.5 times larger than in the crop sector over the years. Livestock, however, received only about 12 per cent of total public expenditure on agriculture and allied sector and about 4-5 per cent of the total institutional credit that went into agriculture and allied sector.

In the livestock sector, poor contribute to growth directly instead of getting benefit from growth generated elsewhere. The ownership of the livestock is more evenly distributed with landless labourers and marginal farmers owning bulk of livestock. The progress in the sector results in balanced development of the rural economy particularly in reducing the poverty amongst the weaker sections. The rural women play a significant role in Animal Husbandry and are directly involved in most of the operations relating to feeding, breeding, management and health-care of the livestock.

Livestock biodiversity is a valuable asset and provide insurance and buffer in adverse situation. The sector is playing a major role in the rural economy and a driving force for food security and sustainable agriculture in India. Livestock provide a diverse range of output for agriculture, irrigation, transport, fiber, leather, manure besides production of 90.7 million ton milk, 45 billion eggs and around 45 million kg wool.

Livestock is the major source of animal protein through milk, meat, eggs, etc, the demand for which is constantly increasing.

Problems

The livestock sector is presently facing serious constraints due to huge unproductive population, with low genetic potential, e.g. low milk yield, low body weight etc., shortage of feed grains, fodder and pasture lands and the presence of a large number of animal diseases. All these contribute to poor productivity and low levels of production inspite of large population of livestock. In the dairy sector, only 15% of the milk produced gets processed in the organized sector. There is also very little awareness on the safe and clean production system of livestock.

It was being contemplated for quite some time now to bring out a National Livestock Policy for holistic development of the livestock sector in the country. The Policy aims at higher growth rate of the sector to meet the future and increasing demand of livestock products without disturbing the existing fabric of small-holding system of production. The Policy also contemplates to double the per capita availability of protein from approximately 10 gm at present to 20 gm within a decade. The main focus of the Policy is on improving productivity, infusion of technologies, enhanced farmer participation, safety and quality assurance, marketing linkages, restructuring of institutions and enhanced investments.

Shortage of fodder is a major constraint. Various actions like distribution of quality fodder seeds, appropriate land use planning, promoting of fodder development technologies, assistance of Krishi Vigyan Kendras to promote these technologies and training on balanced feeding of livestock with appropriate supplementation are being taken. Encouraging mineral supplement, use of by-pass protein and by-pass fat are other interventions proposed. Better utilization of crop residues and use of unconventional crop residues, e.g., bagasse for supplementation of feed are being considered. Growing fodder trees in degraded forest will also be encouraged. **(Dairy farmers do not want the protein in their cow's feed to be digested by the microbes in the rumen. This means the protein has to be protected so it can bypass the stomachs and can be absorbed in the intestines.)**

Two important schemes are being launched during XI Plan on sheep and goat Development and on Piggery Development. While the first one is targeted towards generating rural livelihood opportunities by promoting goat and sheep husbandry the later is more oriented towards the North_Eastern States, where there is huge demand for pork and other pig meat products .

Livestock diseases take a huge toll on our livestock every year. FMD is most economically important disease prevalent in the country for many years.

Bird-flu as a exotic disease took a heavy toll on our poultry industry consecutively on three occasions in the last three years.

In order to mitigate the threat of breach on biosecurity and thereby compromise nutritional security, the quarantine system in the country is being revamped.

The issue of climatic stress on livestock productivity is also being addressed and research areas have bee prioritized. Special emphasis is being laid on protection and conservation of indigenous breeds, who have high endurance as well as more resistance to disease etc.

Livestock development has been as an important tool for poverty alleviation and sustainable livelihood security in terms of income generation for more than 500 million people in the country. In India 70-80 percent of the total livestock produce is contributed by underprivileged families and livestock are central to their livelihood and culture. According to FAO (2012), India ranks top in milk, third in egg and fifth in meat production but still insufficient to provide food security.

Livestock biodiversity: The Indian sub-continent occupies a pre-dominant position in so far as its animal genetic resources are concerned. Over 140 breeds of livestock including cattle (30), buffaloes (10), sheep (40), goats (20), camel (4), horse (6), pigs, donkey, mule, yak and mithun including poultry (18) have been distributed over the large area spread in different afro-ecological zones of the country. The usefulness of a breed is now judged not only on the basis of physical fitness and utility but also on monetary return.

Role of livestock: Livestock systems, if managed properly, play an important role in alleviating hunger and counteracting environmental degradation. These days concepts of organic farming and increased demand for cow based products such as bio-fertilizers, bio-pesticides, bio-energy and panch-gavya medicines gives an opportunity to make agriculture economically viable on a sustainable basis. The livestock production systems of the rural poor and underprivileged families are different from those of resource-rich farmers since they aim at optimizing use of the limited available resources and minimizing external input and avert risks, as against maximizing profits by the resource-rich. Livestock have strong socio-cultural linkages and for most rural families particularly for women, livestock are a part of the family. The multi-functionality of livestock and their existence in developing countries particularly in smallholder production systems directly link them with poor rural communities.

Animal production practices: In the early part of this country, most farms integrated both crop and livestock operations. Indeed the two were highly complementary both biologically and economically. Livestock activities are normally integrated in the existing farming systems. Animals are kept mainly for the purpose of food security and poverty alleviation, which involves millions of small, landless and marginal farmers.

The growing population of the world need not only more animal proteins and products but also specific constituent and there is a pressure to multiply livestock species and make improvements and conservation of dwindling resources with modern biotechnological methods. The potential of livestock to reduce poverty is enormous.

Milk

Milk production increased from about 20 million tonnes in 1960s to 115 million tonnes in 2010-11. It grew at an annual rate of 4.4 per cent during 1990's and 3.8 per cent during 2000s. Although per capita availability of milk has increased from 128 gms per day in 1980-81 to 276 gms per day in 2010-11, it is far below the requirement of 280 gms per capita. In an effort to increase milk production, the Government of India has been implementing the National Project for Cattle and Buffalo Breeding since 2000 with focus on genetic upgradation of cattle and support system. Over the years the availability of feed resources has improved. But the deficit of dry fodder, concentrate and green fodder is high.

Milk is the main output of livestock sector accounting for 66.7 per cent of the total value of output of livestock. The growth in milk production decelerated from 4.4 per cent during 1990s to 3.8 per cent during 2000s. There remains a huge gap between the potential and realised yields in Indian livestock, on account of constraints relating to feeding, breeding, health and management. Crossbreeding of indigenous species with exotic stocks to enhance genetic potential has been successful only to a limited extent. Even after more than three decades of crossbreeding, the crossbred cattle population is just 16.6 per cent. Livestock sector did not receive the policy and financial attention it deserved. Further, livestock extension has remained grossly neglected — only about 5 per cent of farm households in India have access to information on livestock technology. The Working Group reports that the number driven progress in livestock production may not sustain in the long run due to increasing stress on the limited natural resources and that future growth has to come from improvement of technology and service delivery system leading to accelerated productivity, processing and marketing.

The Working Group has analysed various programmes related to cattle and buffalo development, particularly, National Project on Cattle and Buffalo Breeding (NPCBB). It has observed that NPCBB has significantly contributed to strengthening of semen stations . The group has suggested reformulation of strategy on breeding programme during the 12th Plan to achieve a sustained growth rate of at least 5 per cent in milk production. Technologies on sexed semen, embryo transfer and ovum pick up should be integrated in breed improvement programme. In view of climate changing scenario, improvement of indigenous breeds that have the potential to contribute and be part of production system should be identified, evaluated and improvement programmes for them initiated on priority basis. These should include *Gir, Red Sindhi, Sahiwal, Kankrej* and *Rathi*breeds.

National Dairy Plan

Launched in 2012 at an initial outlay of Rs 2242 crore, the six year NDP-1 will be implemented in 14 major milk producing states including Andhra Pradesh, Bihar, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. While 80 per cent of the scheme will be financed through International Development Association (IDA) of World Bank, the rest will be funded by the Government of India and implemented by National Dairy Development Board (NDDB) through end implementing agencies (EIA)s in the states.

The total outlay for the National Dairy Plan has been set at Rs 17,000 crore.

As of today, milk production is growing at four per cent which should increase to six per cent in the next few years. Through the NDP we intend to enhance breeding, feeding and milk procurement in the country to increase milk production. The demand for milk is projected to be around 200 million tonnes in 2021-22 as against the production of 122.8 million tonnes in 2010-11. The plan is expected to cover about 1.2 million milk producers in 23,800 villages.

National Dairy Plan-Phase 1 (NDP-1) looks to increase milk procurement by co-operatives from current 30 per cent to 65 per cent in next 15 years.

The project aims at boosting milk production using scientific breeding and feeding programmes covering about 2.7 million milch animals in 40,000 villages. It will also focus on modernising village-level infrastructure for milk collection and bulking such as milk cans, bulk milk coolers for a cluster of villages, associated weighing and testing equipment and related IT equipment.

India was the largest milk producing nation in 2010-11 with a production of 116.2 million tonne. This is close to 16% of world milk production. Milk production in the country is growing at 3.3% per annum while consumption is growing at 5% leaving a gap in demand and supply. We need to plug that gap to steady the domestic supply and milk prices.The National Dairy Plan (phase-1) was launched at Anand (Gujarat)

Modified Crop insurance

In 2010, the Government of India approved the modified National Agricultural Insurance Scheme (mNAIS), moving from a social crop insurance program with ad-hoc funding from the Government of India to a market-based crop insurance program with actuarially sound premium rates and product design. Given the technical and operational challenges associated with moving from the NAIS to the mNAIS, implementation began with a three-season pilot, starting with 34 districts across 12 states for the Rabi 2010-11 crop. Over time it could be expanded to India's 110 million farmer households.

Under the actuarial regime, farmer premiums and government subsidies will both be paid upfront at the start of the crop season to the insurer. The insurer, which could be the public insurer AICI or a private sector

competitor at the choice of each state, will then be responsible for settling all claims as they fall due.

Increasing competition and expanding the role of the private sector in crop insurance contributes to the promotion of effective public-private partnerships in agricultural insurance.

With the introduction of the modified scheme, it is expected that an increased number of farmers will be able to manage risk in agriculture production in a better way and will succeed in stabilizing farm income particularly at the times of crop failure on account of natural calamities.

Keeping in view the various risks involved in agriculture production, the Ministry of Agriculture has been implementing the National Agricultural Insurance Scheme (NAIS) as a Central Sector Scheme since Rabi season 1999-2000 to insure the farming community against these risks. The modified scheme has the following features:

(i) Actuarial premiums will be paid for insuring the crops

(ii) The unit area of insurance for major crops is village panchayat;

(iii) Indemnity amount shall be payable for prevented sowing/planting risk and for post harvest losses due to cyclone;

(iv) payment up to 25% of likely claims would be released as advance for providing immediate relief to farmers;

(vi) More accurate basis for calculation of threshold yield and minimum indemnity level of 70% instead of 60%;

(vii) Modified NAIS with improved features will have two components i.e. compulsory and voluntary. Loanee farmers will be insured under 'compulsory category' while non-loanee farmers will be insured under 'voluntary category';

(viii) Private sector insurers with adequate infrastructure and experience would also be allowed in the implementation of MNAIS.

Marketing reforms

An **agricultural produce market committee** is a marketing board established by a state governments of India.

The state governments make the APMC Acts and lay down the conditions. In order to facilitate farmers to sell their produce and get reasonable prices, created APMCs in many towns. Most of the APMC have market where traders and other marketing agents are provided stalls and shops for purchase of agriculture produce from farmers. Farmers can sell their produce to agents or traders under supervision of APMC.

Farmers cannot sell produce outside the APMC mechanism. This makes them vulnerable to traders' and marketing agents' price manipulations. The Government of India is considering improving the ecosystem to benefit all parties involved.

The role of the agriculture market is to deliver agricultural produce from the farmer to the consumer in the most efficient way. Agriculture markets are regulated in India through the APMC Acts. According to the provisions of the APMC Acts of the states, every APMC is authorized to collect market fees from the buyers/traders in the prescribed manner on the sale of notified agricultural produce. The relatively high incidence of commission charges on agricultural /horticultural produce renders their marketing cost high, which is an undesirable outcome.

Another point to be highlighted is that the cleaning, grading, and packaging of agricultural produce before sale by the farmers have not been popularized by these market committees on a sufficient scale.

Nevertheless, there have been some achievements in leading states like Maharashtra, Karnataka, Andhra Pradesh and Gujarat since the Model APMC Act 2003 has been implemented in those states. Some state governments have granted licences to the private sector for setting up of markets and direct purchase from the farmers in order to provide alternative marketing channels.

Considerable potential for agricultural markets to be competitive. As the APMC was created to protect the interests of farmers it will be in the fitness of things to give farmers the choice of going to the APMC or not. In the light of this, the need is to pursue further reforms in the state APMC Acts. Farmer needs to sell perishables speedily and so there is an argument that perishables should be out of APMC scope.

Nutrient based fertilizer subsidy

Government has shifted to a nutrient-based fertilizer pricing system to help farmers get fertilizers such as di-ammonium phosphate (DAP), muriate of potash (MOP) and complexes at cheaper rates l.

The new pricing would help farmers get complexes at cheaper rate as these fertilizers were not covered under the previous subsidy regime that covered fertilizers which mainly contained primary nutrients — nitrogen, phosphorous and potassium.

By initiating a new pricing policy, where all fertilizers would be available at uniform rates, the Centre wanted to create a set-up where farmers would be able to use fertilizer based on the requirement of the land and not be swayed by cost alone. Also, the Agriculture Ministry was in favour of restricting over-use of urea as it had pushed the nitrogen level in the soil high, which was adversely affecting production of crops.

It helps farmers select the appropriate fertilizer with the right micronutrients that suits the soil; soil fertility will improve; production and productivity along with incomes will grow. It thus augurs well for food security.

Considered along with the direct cash transfer for fertilizer subsidy to small and marginal farmers, it is a step in the right direction.

Pulses development

India's allocation of funds for boosting pulses production has multiplied eight fold in the last four years. India, leading producer and consumer of pulses in the world, has been investing more for food security(pulses are poor man's protein) and reducing imports . The allocations have risen from 105.59 crore in 2007-08 to 837.03 crore in 2010-11. A total of Rs. 1805.87 has been allocated for pulses development in these four years.

Government has approved Accelerated Pulses Production Programme (A3P) under National Food Security Mission (NFSM)on Pulses from 1.04.2010 for the remaining period of 11th Plan.

In the next two years, 10 lakh hectares of total pulses area would be targeted for coverage for village level demonstrations in 1000 blocks for five major crops of pulses namely Arhar (Tur), Moong, Chana, Urad, Masoor covering an area of 1000 hectares each in NFSM Pulses districts.

Farmers would be provided institutional support for supply of quality seeds, kits of nutrients and plant protection chemicals. Development and research projects focusing on inherent constraints of pulses production would also be encouraged for increased pulses production.

Implementation of A3P is estimated to bring in additional pulses production of 0.5 million tonnes.

Besides, a sum of Rs.300 crores has also been earmarked for organizing sixty thousand "Pulses and Oilseeds Villages" in the rainfed areas during 2010-11 for agricultural development under RKVY. The states which are not covered under NFSM Programme get assistance for pulses development under the Macro Management of Agriculture (MMA) scheme.

Government raised the minimum support prices (MSP) for pulses in mid-2010.

The major schemes such as the National Food Security Mission (NFSM), the Rashtriya Krishi Vikas Yojna (RKVY) and the Macro Management of Agriculture Scheme, now have special components for pulses development.

Under NFSM, 10 lakh hectares would be covered in the next two years for village level demonstrations for five major crops - arhar (tur), moong, chana, urad and masoor.

Under RKVY, Rs.300 crore have been earmarked for organising 60,000 "pulses and oilseeds villages" in the rainfed areas.

It is envisaged that productivity of pulses would increase by at least 10 percent with the implementation of this new programme. 2010-11 saw a record pulses production of over 18mt.

Extending Green Revolution to Eastern India

Union Budget 2010 has allocated additional Rs.400 crore under Rashtriya Krishi Vikas Yojana for extending green revolution to the Eastern Region of the country comprising of Bihar, Jharkhand, Eastern UP, Chhattisgarh, Orissa and West Bengal.

Green revolution envisages adoption of new seed varieties, farm machines, nutrients, pesticides and knowledge based intervention as developed for different agro climatic zones. Essentially, the objective is to increase the crop productivity by intensive cultivation through promotion of recommended agriculture technologies and package of practices.

Eastern Region is primarily rice-based farming system, the efforts envisaged are to increase the productivity of the rice and other crops of the farming system like maize, oilseeds and pulses. There are crop development programs and schemes that are promoting technologies for increasing the productivity of these crops in these States particularly targeting the low productivity districts. The current initiative should develop the missing links in the agriculture infrastructure in a manner that enhances the efficacy of such schemes and programs. For example programs relating to drainage in the flood prone area, shallow tubewells, farm machinery, soil improvement for salinity, rainwater harvesting etc could be planned as per the needs of the different agro ecological sub regions.

In this context it was decided that each State would prepare a strategic plan prioritizing the key areas in terms of technology promotion for addressing the main constraints that were impeding the agriculture productivity despite there being a good potential for development. This strategic plan would also take into account the current ongoing initiatives for the identified priorities and would seek to supplement those efforts with the budgetary allocation made available this year.

The following strategies are being adopted, in general, for maximising productivity and production of crops in the eastern region. Each concerned State has evolved its own micro-level strategies.

- *In situ* water harvesting/conservation through adoption of cultural practices like bed furrow in deep black cotton uplands and flat sowing & ridging later in red soils.
- Reclamation of soil salinity through application of gypsum particularly in oilseed crops along with micro-nutrients like zinc, iron & sulphur in deficient soils.
- Reclamation of acidic soils through liming/paper mills sludge/application of organic manures/green manuring to improve physical condition of the soil.

- Promotion of Integrated Nutrient Management to ensure balanced use of fertilizers/organic manures/bio-fertilizers.
- Adoption of soil & water conservation practices namely; summer ploughing, broad bed furrow, compartmental bunding, pre-monsoon sowing and rain water harvesting (Farm ponds) to check soil erosion and recycling runoff.
- Enhancement of irrigation Water Use Efficiency through adoption of micro-irrigation system (Sprinkler & Drip).
- Promotion of high value crops namely; sweet sorghum, maize, pulses and oilseeds in addition to hybrid rice in the region.
- Adoption of sustainable crop sequence by discouraging rice after rice in the region. The suggested crop sequence for the region are:

    Rice-groundnut-green gram;

    Rice-groundnut-green manure;

    Rice-green gram/ black gram;

    Cotton-green gram/green manure; and

    Soybean-sunflower-green gram.
- Promotion of IPM through Farmers Field Schools (FFSs).
- Strengthening of extension system in the region.
- Promotion of credit link insurance in the region.
- Strengthening of agro-processing industries through promotion of contract farming.

India Celebrates Declaration of Global Freedom from Rinderpest

A national ceremony was held to celebrate the declaration of global freedom from Ruinderpest, the dreaded cattle plague.

It took almost 150 years to wipe-out the disease once called Cattle-Plague due to very high level of mortality.

Productivity of Foodgrains UP from 1756 Kg to 1921 Kg per hectare in Last 4 Years

The productivity of foodgrains has increased from 1756 kg/ha during 2006-07 to 1921 kg/ha during 2010-11. Similarly, productivity of oilseeds has also increased from 916 kg/ha during 2006-07 to 1159 kg/ha during 2010-11.

The crop-wise productivity of various foodgrains crops and oilseeds from 2006-07 to 2010-11 is as under:

(Yield in Kg/ha)

Crop	Yield (Kg/ha)				
	2006-07	2007-08	2008-09	2009-10	2010-11*
Rice	2131	2202	2178	2125	2240
Wheat	2708	2802	2907	2839	2938
Coarse cereals	1182	1431	1459	1212	1528
Pulses	612	625	659	630	689
Foodgrains	1756	1860	1909	1798	1921
Oilseeds	916	1115	1006	959	1159

* Fourth Advance Estimates.

For enhancing the productivity of various foodgrains and oilseeds crops further in the country, various crop development programmes such as National Food Security Mission (NFSM), Integrated Cereals Development Programmes (ICDP) under Macro Management Mode of Agriculture, Rashtriya Krishi Vikas Yojana (RKVY) and Integrated Scheme of Oilseeds, Pulses, Oilpalm & Maize (ISOPOM) are being implemented. Besides, new initiatives have also been taken by the Government to enhance productivity of various crops by launching Bringing Green Revolution in Eastern India (BGREI), Initiatives for Nutritional Security through Intensive Millet Promotion (INSIMP) and Integrated Development of 60,000 Pulses Villages inRainfed Areas as sub-schemes of RKVY.

In addition, frontline demonstrations of various crops are also organized by Indian Council of Agricultural Research (ICAR) for transfer of latest technology among the farmers at their fields.

Agrisnet Scheme to Provide IT Enabled Services to Farmers

The Government has launched the Agriculture Information System Network (AGRISNET) in the country.

AGRISNET envisages promotion of e-Governance by use of Information & Communication Technology (ICT). The objective of the programme is to provide IT enabled services to farmers and also for computerization of various offices in the States in agriculture & allied sectors.

Kisan Call Centres

Kisan Call Centres function from 6.00 AM to 10.00 PM on all days throughout the year. They receive calls through the toll-free number 1800-180-1551. Call Centre agents reply farmers' queries instantaneously by using their own expertise as well as by referring to reference material available with them. They also browse Kisan Knowledge Management System data base for answering farmers' queries in local language. If some of the queries cannot be answered by the Call Centre agents, such calls are referred to experts. Call Centre agents record the details of every call in terms of farmer's details, query asked, reply given etc.

Precision Farming or **Precision Agriculture** is a concept of using the new technologies and collected field information, growing the right crop in the right region and soil at the right time. Collected information may be used to more precisely evaluate optimum sowing density, estimate fertilizers and other inputs needs, and to more accurately predict crop yields.It helps in avoiding unwanted practices to a crop, regardless of local soil/climateconditions, i.e., it reduces labour, water, inputs such as fertilizers, pesticides etc. and assures quality produce. **Tata Kisan Sansars, the agricultural extension service provided by Tata Chemicals, are leveraging satellite and information technology to help farmers maximise the yield from their land.**

Precision farming is helping small farmers harness sophisticated modern technology, such as satellite mapping and geographical information systems (GIS), to maximise the yield from their land.

GISs are computerised systems that record, store, analyse and produce maps and geographic products based on information obtained from different sources. These help farmers adapt quickly to changing conditions. The result: healthier crops, higher yields and enhanced incomes for farmers.

Using GIS to maximise profits: The **precision-farming** project leverages satellite and information technology to serve the needs of Indian farmers. The operation involves combining satellite maps, census data, and socioeconomic and other data collected within the GIS to create a valuable agricultural database.

The agronomist uses the analysis of topography, soils, climate, hydrology, cropping systems and crop suitability to advise farmers on which crops to grow, how to manage his crops, when to sell what (market trends), and which fertiliser to use where, etc. The goal is to maximise the yield from each farmer's landholding.

10th March, 13

SRIRAM'S IAS

Key Features of Budget 2013-2014

During 2013-14, total expenditure of ` 16,65,297 crore and of Plan Expenditure at ` 5,55,322 crore.

New National Health Mission to be launched Government committed to the creation of Nalanda University as a centre of educational excellence.

A multi-sectoral programme aimed at overcoming maternal and child malnutrition. Programme to be implemented in100 districts during 2013-14 to be scaled to cover 200 districts the year after.
Proposal to carve out PMGSY-II and allocate a portion of the funds to the newprogramme that will benefit States such as Andhra Pradesh, Haryana, Karnataka,Maharashtra, Punjab and Rajasthan.

Bringing green revolution to eastern India a remarkable success. ;` 500 crore allocated to start a programme of crop diversification that wouldpromote technological innovation and encourage farmers to choose cropalternatives.;Allocation made for pilots programme on Nutri-Farms for introducing new crop varieties that are rich in micro-nutrients.;National Institute of Biotic Stress Management for addressing plant protection issues will be established at Raipur, Chhattisgarh.;The Indian Institute of Agricultural Bio-technology will be established at Ranchi, Jharkhand.

Farmer Producer Organizations Matching equity grants to registered Farmer Producer Organization (FPO);Credit Guarantee Fund to be created in the Small Farmers'Agri Business Corporation ; National Livestock Mission be set up.;Food Security Additional provision of Rs. 10,000 crore for National Food Security Act. Measures such as Infrastructure Debt Funds (IDF) to be encouraged,;IIFCL to offer credit enhancement.; Infrastructure tax-free bond of 50,000 crore in 2013-14, Build roads in North eastern states and connect them to Myanmar with assistance from WB & ADB, Raising corpus of Rural Infrastructure Development Fund (RIDF) to ` 20,000 crore and;A regulatory authority for road sector.

Asian Highway – Mekong Ganga Project
Asian Railways – Moreh to Mandalay

→ Angel Investor – who incubates a new idea to bring about change in economy.
↳ considered as venture capital.

→ CSR, → Innovation

* Corporate Debt fund includes IDF.
FII limit allowed in Govt. debt & Corporated as per 31st March, 2013 —

Companies investing ` 100 crore or more in plant and machinery during the period 1.4.2013 to 31.3.2015 will be entitled to deduct an investment allowance of 15 per cent of the investment.

Need to incentivise greater savings by household sector in financial instrumnets.Following measures proposed:
Rajiv Gandhi Equity Savings Scheme to be liberalised.,eligibility uptoRs.12 lkhs
Additional deduction of interest upto ` 1 lakh for a person taking first home loan upto ` 25 lakh during period 1.4.2013 to 31.3.2014
In consultation with RBI, instruments protecting savings from inflation to be introduced.
Industrial Corridors:Plans for seven new cities have been finalised and work on two new smart industrial cities at Dholera, Gujarat and Shendra Bidkin, Maharashtra will start duing 2013-14

Chennai Bengaluru Industrial Corridor to be developed.Preparatory work has started for Bengaluru Mumbai Industrial Corridor.Two new major ports will be established in Sagar, West Bengal and in Andhra Pradesh to add 100 million tonnes of capacity.A new outer harbour to be developed in the VOC port at Thoothukkudi,Tamil Nadu through PPP at an estimated cost of ` 7,500 crore.

National Waterways A bill to declare the Lakhipur-Bhanga stretch of river Barak in Assam as the sixth national waterway to be moved in Parliament.Preparatory work underway to build a grid connecting waterways, roads and ports.

A policy to encourage exploration and production of shale gas will be announced.The 5 MMTPA LNG terminal in Dabhol, Maharashtra will be fully operational in 2013-14.
Guidelines regarding financial restructuring of DISCOMS have been announced.
Another sum of ` 100 crore provided to India Microfinance Equity Fund.
Ministry of Corporate Affairs to notify that funds provided to technology incubators located within academic Institutions and approved by the Ministry of Science and Technology or Ministry of MSME will qualify as CSR expenditure.

paradigm

- Target of skilling 50 million people in the 12th Plan period, including 9 million in 2013-14.
- Allocation for Defence increased to ` 2,03,672 crore including ` 86,741 crore for capital expenditure.

Imp. Schemes after Rajiv Gandhi

National Institute of Sports Coaching to be set up at Patiala. All cities having a population of more than 1,00,000 will be covered by private FM radio services. 10Augmentation in the Budget allocation of *Rajiv Gandhi Panchayat SashaktikaranAbhiyan (RGPSA) to ` 455 crore in 2013-14. (Google) (Kishor Singh Interview)

→ Capacity Building for Panchayats (optical Fibre Broadband, audit).

Post Offices An ambitious IT driven project to modernise the postal network at a cost ofRs. 4,909 crore. Post offices to become part of the core banking solution and offer real time banking services. Government to fund the conversion of the Ghadar Memorial in San Francisco into a museum and library. (The Ghadar Party was an organization founded by Punjabi Indians, in San Francisco the United States and Canada in 1913 with the aim to liberate India from British rule. The movement began with a group of immigrants known as the Hindustani Workers of the Pacific Coast. After the outbreak of World War I, Ghadar-party members returned to Punjab to agitate for rebellion alongside the Babbar Akali Movement. In 1915 they conducted revolutionary activities in central Punjab and attempted to organize uprisings, but their attempts were crushed by the British Government. The party was formally dissolved in 1948.)

(1500 is now)

Chaturvedi Committee ← Centrally Sponsored Schemes (CSS) and Additional Central Assistance (ACA) Schemes to be restructured into 70 schemes. Central fund for the schemes to be given to the States as part of central plan assistance. (Backward Region) → def.

2 schemes for women :-

A fund - "Nirbhaya Fund" - to be setup with Governmentcontribution of ` 1,000 crore.

Fiscal deficit for the current year contained at 5.2 per cent and for the year 2013- 14 at 4.8 per cent.

Revenue deficit for the current year at 3.9 per cent and for the year 2013-14 at 3.3 per cent.By 2016-17 fiscal deficit to be brought down to 3 per cent, revenue deficit to 1.5 per cent and effective revenue deficit to zero per cent.

Investment led Growth
→ Invest, create employment, Higher Income, Demand, more [illegible] cycle [illegible] go on.
→ Demand [illegible]

Consumption Led Growth
- Reduce the rates, throw the cash & compel consumption.
- In an economy plagued by inflation like India [illegible]

A standing Council of Experts to be constituted in the Ministry of Finance to analyse the international competitiveness of the Indian financial sector.Compliance of public sector banks with Basel III regulations to be ensured.` 14,000 crore provided 2013-14 for infusing capital.All branches of public sector banks to have ATM by 31.3.2014.Proposal to set up India's first Women's Bank as a public sector bank. Provision of ` 1,000 crore as initial capital. 6,000 crore to Rural Housing Fund in 2013-14.National Housing Bank to set up Urban Housing Fund. Rashtriya Swasthya Bima Yojana to be extended to other categories such as rickshaw, auto-rickshaw and taxi drivers, sanitation workers, rag pickers and mine workers.

Proposal to amend the SEBI Act, to strengthen the regulator, under consideration.

Rule that, where an investor has a stake of 10 per cent or less in a company,it will be treated as FII and, where an investor has a stake of more than 10 per cent, it will be treated as FDI will be laid.

Small and medium enterprises, to be permitted to list on the SME exchange without being required to make an initial public offer (IPO).

Stock exchanges to be allowed to introduce a dedicated debt segment on the exchange.

Support to municipalities that will implement waste-to-energy projects.

Government to provide low interest bearing fund from the National Clean Energy Fund (NCEF) to IREDA to on-lend to viable renewable energy projects.

'Generation-based incentive' reintroduced for wind energy projects and Backward Regions Grant Fund.New criteria for determining backwardness to be evolved and reflect them in future planning and devolution of funds. In his budget speech, Chidambaram said, "the present criteria for determining backwardness are based on terrain, density of population and length of international borders. "It may be more relevant to use a measure like the distance of the state from the national average under criteria such as per capita income, literacy and other human development indicators. I propose to evolve new criteria and reflect them in future planning and devolution of funds".

- Clarity in tax laws, a stable tax regime, a non-adversarial tax administration, a fair mechanism for dispute resolution and independent judiciary for greater assurance is underlying theme of tax proposals. Tax Administration Reforms Commission to be set up. (e-governance, staffing, procedures, simplification, identifying loopholes)
In short term need to reclaim peak of 11.9 per cent of tax GDP ratio achieved in 2007-08.

A tax credit of ` 2000 to every person with total income upto `5 lakhs. Surcharge of 10 percent on persons (other than companies) whose taxable incomeexceed ` 1 crore to augment revenues.Education cess to continue at 3 percent. Investment allowance (Imp) at the rate of 15 percent to manufacturing (not service or agriculture sector) companies that invest more than ` 100 crore in plant and machinery (equipment) during the period 1.4.2013 to 31.3.2015 (2 years). Proposal to introduce Commodity Transaction Tax (CTT) in a limited way.Agricultural commodities will be exempted.Modified provisions of GAAR (Imp) will come into effect from 1.4.2016.Rules on Safe Harbour will be issued after examing the reports of the Rangachary Committee appointed to look into tax matters relating to Development Centres & IT Sector and Safe Harbour rules for a number of sectors. No change in the normal rates of 12 percent for excise duty and service tax. No change in the peak rate of basic customs duty of 10 perent for non-agricultural products. *Kelkar, Chaturvedi, Rangrajan *Shomitro Chatterjee *Ashok Chawla *Parikh committee.

Imp for promotes job creation in MSME & diversification growth ... organised sector

Out of nearly 17 lakh registered assesses under Service Tax only 7 lakhs file returns regularly. Need to motivate them to file returns and pay tax dues. A onetime scheme called 'Voluntary Compliance Encouragement Scheme' (VCES) proposed to be introduced. Defaulter may avail of the scheme on condition that he files truthful declaration of Service Tax dues since 1st October 2007. Good and Services Tax. A sum of ` 9,000 crore towards the first instalment of the balance of CST compensation provided in the budget. Work on draft GST (Imp) Constitutional amendment bill and GST law expected to be taken forward. We don't have consolidated responsibility... there is friction among the Centre & state govt.

Not in GST → Petroleum Product → Power

* Tax Collection is jumping by 20%.

Tax Revenue – 7.2 (this year) – 8.4 (next year) } Nominal rate in growing.

Make Administration Efficient, Broaden Tax Base → More Growth

* If economy grows, buoyancy increase ⇒ More money

SBI - 40% — selling of ... of ...
15% — SU-UTI (Unit Trust ...)
SU-UTI owns the money in the Axis Bank ... in LST.

Tax-GDP Ratio

CAD. (Govt. is trying to cover up CAD & reducing CAD)

बजट का सार Budget at a Glance

(करोड़ रुपए) (In crore of Rupees)

		2011-2012 वास्तविक Actuals	2012-2013 बजट अनुमान Budget Estimates	2012-2013 संशोधित अनुमान Revised Estimates	2013-2014 बजट अनुमान Budget Estimates
1. राजस्व प्राप्तियां	**1. Revenue Receipts**	**751437**	**935685**	**871828**	**1056331**
2. *कर राजस्व (केन्द्र को निवल)*	*2. Tax Revenue (net to centre)*	*629765*	*771071*	*742115*	*884078*
3. *कर-भिन्न राजस्व*	*3. Non-Tax Revenue*	*121672*	*164614*	*129713*	*172252*
4. पूंजी प्राप्तियां (5+6+7)$	**4. Capital Receipts (5+6+7)$**	**552928**	**555241**	**558998**	**608967**
5. *ऋणों की वसूली*	*5. Recoveries of Loans*	*18850*	*11650*	*14073*	*10654*
6. *अन्य प्राप्तियां*	*6. Other Receipts*	*18088*	*30000*	*24000*	*55814*
7. *उधार और अन्य देयताएं **	*7. Borrowings and other liabilities **	*515990*	*513590*	*520925*	*542499*
8. कुल प्राप्तियां (1+4)$	**8. Total Receipts (1+4)$**	**1304365**	**1490925**	**1430825**	**1665297**
9. आयोजना-भिन्न व्यय	**9. Non-Plan Expenditure**	**891990**	**969900**	**1001638**	**1109975**
10. *राजस्व खाते पर जिसमें से*	*10. On Revenue Account of which,*	*812049*	*865596*	*919699*	*992908*
11. *ब्याज भुगतान*	*11. Interest Payments*	*273150*	*319759*	*316674*	*370684*
12. *पूंजी खाते पर*	*12. On Capital Account*	*79941*	*104304*	*81939*	*117067*
13. आयोजना व्यय	**13. Plan Expenditure**	**412375**	**521025**	**429187**	**555322**
14. *राजस्व खाते पर*	*14. On Revenue Account*	*333737*	*420513*	*343373*	*443260*
15. *पूंजी खाते पर*	*15. On Capital Account*	*78639*	*100512*	*85814*	*112062*
16. कुल व्यय (9+13)	**16. Total Expenditure (9+13)**	**1304365**	**1490925**	**1430825**	**1665297**
17. *राजस्व व्यय (10+14)*	*17. Revenue Expenditure (10+14)*	*1145785*	*1286109*	*1263072*	*1436169*
18. *जिसमें, पूंजी परिसम्पत्तियों के सृजन हेतु अनुदान*	*18. Of Which, Grants for creation of Capital Assets*	*132582*	*164672*	*124275*	*174656*
19. *पूंजी व्यय (12+15)*	*19. Capital Expenditure (12+15)*	*158580*	*204816*	*167753*	*229129*
20. राजस्व घाटा (17-1)	**20. Revenue Deficit (17-1)**	**394348** *(4.4)*	**350424** *(3.4)*	**391245** *(3.9)*	**379838** *(3.3)*
21. प्रभावी राजस्व घाटा (20-18)	**21. Effective Revenue (ERD) Deficit (20-18)**	**261766** *(2.9)*	**185752** *(1.8)*	**266970** *(2.7)*	**205182** *(1.8)*
22. राजकोषीय घाटा {16-(1+5+6)}	**22. Fiscal Deficit {16-(1+5+6)}**	**515990** *(5.7)*	**513590** *(5.1)*	**520925** *(5.2)*	**542499** *(4.8)*
23. प्राथमिक घाटा (22-11)	**23. Primary Deficit (22-11)**	**242840** *(2.7)*	**193831** *(1.9)*	**204251** *(2.0)*	**171814** *(1.5)*

इस दस्तावेज में वर्ष 2011-12 के वास्तविक आंकड़े अनंतिम हैं। Actuals for 2011-12 in this document are provisional.

$ बाजार स्थिरीकरण योजना के अंतर्गत प्राप्तियों को छोड़कर। Excluding receipts under Market Stabilisation Scheme.

* इसमें नकदी शेष में आहरण द्वारा कमी शामिल है। Includes draw-down of Cash Balance.

टिप्पणियां: 1. सीएसओ द्वारा जारी 2012-2013 के अग्रिम अनुमानों (₹10028118 करोड़) की तुलना में 13.4% की वृद्धि मानते हुए 2013-2014 के बजट अनुमान में सघउ बढ़कर ₹11371886 करोड़ होने का पूर्वानुमान है।

2. इस दस्तावेज में पृथक-पृथक मदें पूर्णांकन के कारण संभवतः जोड़ से मेल न खाएं।

Notes: 1. GDP for BE 2013-2014 has been projected at ₹ 11371886 crore assuming 13.4% growth over the Advance Estimates of 2012-2013 (₹ 10028118 crore) released by CSO.

2. Individual items in this document may not sum up to the totals due to rounding off.

08/03/13

SRIRAM'S IAS

Poverty and Inequality: 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.

Many different factors have been cited to explain why poverty occurs. No single explanation has gained universal acceptance. The factors responsible for poverty include:

- Historical factors, for example imperialism and colonialism.
- Overpopulation.
- Growth is not fast enough to eradicate poverty
- Models of growth may be unsuitable for poverty alleviation. For example, capital-intense growth in a labour surplus country
- Poverty itself, preventing investment and development.
- Widespread reliance on traditional methods of agriculture.About 60% of the population depends on agriculture whereas the contribution of agriculture to the GDP is 20%.While services and industry have grown at double digit figures, agriculture growth rate has dropped from 4.8% to 2%
- 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
- War, including civil war, genocide
- Lack of education and skills.
- gender discrimination
- For Women → Matelda effect; Matthew effect (for Men)— the phenomenon, widely observed across advanced welfare states, that the middle classes tend to be the main beneficiaries of social benefits and services, even if these are primarily targeted at the poor. Matthew effect refers to those already having an asset base benefiting from it while those without it continue to be denied the same. Matthew Effect sharpens inequality (If u have something, i'll give u more, otherwise go to hell)

Eradication of poverty

The strategy of the Government includes the following elements

- The main plank of anti-poverty strategy is reducing poverty through the promotion of economic growth. In India, after reforms began in 1991 when

#

growth rates increased , poverty levels fell quite steeply.(NSSO 2005) .

- Socio economic planning
- Food security through the nation wide PDS- largest in the world
- 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 – NREGA 2005
- Massive social sector expenditure for skill building
- Decentralization through PRIs and Nagarapalikas for better delivery models

Poverty concepts

Types of Poverty

Human Poverty is the lack of essential human capabilities- literacy and nutrition.

Income Poverty: The lack of sufficient income to meet minimum consumption needs.The World Bank defines extreme poverty as living on less than one US$ per day, and moderate poverty as less than $2 a day.

Poverty line

It is the level of income below which one cannot afford to purchase all the resources one requires to live. People who have an income below the poverty line have no disposable income.

When comparing poverty across countries, the purchasing power parity exchange rates are used. These are used because poverty levels otherwise would change with the normal exchange rates. Thus, 'living for under $1 a day' should be understood as having a daily total consumption of goods and services comparable to the amount of goods and services that can be bought in the U.S. for $1.

Poverty lines are defined as the per capita monetary requirements an individual needs , to afford the purchase of a basic bundle of goods- only food or food and other goods. The value of this basic basket of goods can be determined in many ways, for example:

Absolute Poverty is a fixed measure in terms of a minimum calorific requirement plus essential non-food components, if any. It is used in India. Individuals are considered as poor if the per capita real income/consumption of the household to which they belong is below the benchmark poverty line. In India monetary requirement to

Calory consumption & health, education, ... taken into account
(Urban - Only calorie consump[n])

SRIRAM'S IAS

Lakdawala since 1993 (specific Absorption Ratio)
→ Tendulkar Line is used

consume 2100 calories in urban areas and 2400 calories in rural areas per day per person is the absolute poverty line- monthly per capita consumption expenditure below Rs. 356.35 for rural areas and Rs. 538.60 for urban areas.

Relative poverty lines set the line in relation to another variable: the average expenditure or income in a country, for example, the line is derived as 60 percent of the country's per capita income.

Minimum Wage

Headcount ratio

The most common standard indicator is the incidence of poverty (also called poverty rate or headcount rate). This describes the percentage of the population whose per capita incomes are below the poverty line, that is, the population that cannot afford to buy a basic basket of items . In many instances, a different poverty line--a much more austere one that generally only includes food items--is applied to derive the extreme poverty rate.

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.

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. The creation of employment

* 4 steps for poverty alleviating prog:-
1. define Poverty (standard of living ... define Poverty).
2. Estimate the no. of poor people (NSSO)
3. Identification of poor (Name, Address, ...)
(There is a difference b/w the no. of poor given ... & the no. of poor ...)

SECC — some ...
→ will determine who requires additional help & who is reqd to be scissored out of the affirmative list.
→ In Economic Survey 2013-14 it has been discussed.
SL

opportunities for the unskilled workforce has been a major challenge for development planners and administrators.

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. 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.The latest NSSO round was 68th in 2011-12 whose provisional findings were released in August 2012.

History and methodology of Poverty estimate in India

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. It submitted its report in 2009. It used the latest data to construct a new poverty line basket to replace the outdated 1973-74 consumption basket. It moved away from the calorie intake as anchor for poverty estimation and included price indices for health and education. The all-India rural poverty line adopted by the Tendulkar Committee was 446.68 for 2004-05.For urban poverty, the ratio of "25.7% at the all-India level was accepted as it was not controversial like its rural counterpart. In other words, the rural poverty level was criticized as being too low at 28.3%.

New NSSO findings showed that poverty declined by 1.5 percentage points per annum between 2004-05 to 2009-10. It is the fastest decline of poverty compared to earlier periods. Both growth and public intervention have contributed. The 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. There are questions on whether one can live with this money. 350 million lived below even this minimalist poverty line in 2009-10 in India. This is a matter of concern and the need for increase in incomes for these people is obvious.

The purpose of these estimates at the macro level is to see progress over time (these are already delinked from entitlements). For example, one can examine whether poverty declined faster in the post-reform period as compared to pre-reform period or whether anti-poverty programmes have had an impact on poverty. Which regions/states and social groups benefited during the reform period?

The rate of reduction in Bihar, Chhattisgarh and Uttar Pradesh was low while poverty declined by 20 percentage points in Orissa. Some other findings are: Scheduled Tribes have high poverty ratio (47%) in rural areas while Muslims have the highest poverty (33.9%) in urban areas. Despite the MGNREGS and increase in agriculture wages, the poverty ratio among agricultural labourers was 50%. These are the concerns regarding poverty estimates and have immense policy implications.

The government has taken a decision to appoint a technical group to revise/revisit 'the methodology for estimating poverty in a manner that is consistent with current realities'. The government is also waiting for the socio-economic and caste census, 2011, based on Saxena and Hashim committees. It may be noted that the Planning Commission poverty estimates relate to income poverty estimates based on private consumer expenditure (PCE). The Saxena and Hashim Committee recommendations on deprivation may relate more to non-income indicators.(See ahead).

Exclusive calorie method for estimating poverty can be misleading . Some studies have shown that if we use direct method of calorie deprivation, two-thirds of the population would be poor. Equally, Orissa and Bihar would be richer states than Tamil Nadu and Kerala!

Arjun Sengupta Commission on unorganised enteprises estimated 77% of the population can be categorised poor and vulnerable.

Rangarajan committee has to review, from time to time, the methodologies for measuring poverty in keeping with changing needs of the population.

Rangarajan Committee

(definition of poverty)

The government in mid-2012 announced the formation of a new expert committee under C Rangarajan, to revisit the methodology for estimation of poverty and identification of the poor, months after a poverty line cut-off, based on the method proposed by Suresh Tendulkar, had created a flutter. It will give the report in one year and has 4 members. The panel would also look into the issue of linking poverty estimates with providing benefits under the Centre's social welfare schemes. The panel would also assess whether poverty can be determined on any criteria other than the consumption basket. The panel will also assess if the two (consumption basket and other methods) can be effectively juxtaposed for estimating poverty in rural and urban areas..

On the basis of Rangarajan Committee recom. & SECC data, new measures will be taken to tackle with poverty.

The panel would examine the divergence between consumption estimates based on the National Sample Survey Organisation (NSSO)'s methodology and those emerging from the National Account aggregates. It would also suggest a method to update the consumption poverty line, using the nationa, urban and rural consumer price index data being released since 2011.

The committee would study the various poverty estimation models used across the world and suggest the best alternative for India.

This committee has been appointed due to concern over estimating poverty using the Tendulkar committee's method. We need to look at how to define and measure poverty. So far, the level of consumption expenditure has been used as a way to estimate poverty. This is based on the basket of goods and services, and estimated using the least possible level to sustain someone. It is adjusted for price increases and consumption patterns every five years.

Tendulkar committee's approach is based on updating rural consumption data on prevailing prices, while not revising the urban consumption data simultaneously. Rangarajan committee has see if this is the right way to do it.

Poverty can be estimated in different ways. First, the absolute method, in which one considers how the economy has changed over time and the number of people living below a certain income level. The other is the relative method, in which you consider the current level of average income and the income distribution in the country. This has been widely used in India. So far, we have only looked at consumption expenditure. Now, we will also look at alternative ways—how to combine the current method with poverty estimation techniques used in other countries.

NC Saxena Committee

The rural development ministry in 2008 appointed a committee headed by NC Saxena to look at revising the parameters laid out by the earlier Sanjeeva Reddy committee 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 which means fiscal and administrative challenges.

While advocating exclusion of large number of families from the BPL lists, the committee has 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.

While pointing out that the present poverty line which allows only 6.52 crore BPL cards is flawed, the committee has recommended a poverty line that would allow 50% of the country's population to get BPL cards as compared to the 28% at present. The panel has 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 has 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 idenitification 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.

The expert group is yet to finalise the detailed methodology for an ordinal ranking of the poor on the basis of vulnerability.

BPL survey will be done by staff of municipalities or urban departments in 45 major cities.

In smaller towns, district magistrate will be the nodal officer.

Questionnaire prepared for urban BPL survey will obtain information on several parameters including income, number of members, type of house and availability of amenities.

The survey will also give us information about housing shortage and deficiency in services in urban areas.

It is for the first time that such a survey is being done. This is important in the context of the proposed food security act and the Rajiv Awas Yojana (RAY) which aims to make cities free of slums besides better targeting of other schemes.An estimated 90 million of the 300 million living in India's roughly 45 cities and over 5,000 towns are poor.

JNNURM and RAY

The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) was launched in 2005. Within JNNURM, we have urban infrastructure and governance (UIG), basic services to urban poor (BSUP), urban infrastructure and development scheme for small and medium towns (UIDSSMT) and integrated housing and slum development programme (IHSDP).

What's the difference between BSUP and IHSDP? BSUP suggests basic services that may extend to more than integrated housing and slum development. But it is also about housing and slum development. BSUP is restricted to 65 JNNURM mission cities and IHSDP is meant for non-mission cities and towns.That's the only difference.

Under both BSUP and IHSDP, there is provision for infrastructure (water, sanitation, sewerage, roads and street lights).

In 2009, Rajiv Awas Yojana (RAY) was announced, and launched in 2010 to provide housing to the urban poor . Under the ministry of housing and urban poverty alleviation, RAY aims to make the country free of slums by 2014.

States are required to prepare a plan of action based on geographic information system-enabled mapping for specific cities to be made slum-free.

Unlike previous schemes, RAY seeks to provide property rights to slum dwellers.

Tthe government is likely to use the public-private partnership (PPP) model to build infrastructure under the project.

The expenditure will be shared between the beneficiary and states and the central government.

The ministry has also decided to be more inclusive in defining slums and responded positively to the suggestion of an expert committee which said a contiguous area with 20-25 households having slum-like characteristics be considered as slums.

The States would be required to include all the mission cities of JNNURM, preferably cities with more than 3 lakh population as per 2001 Census; and other smaller cities, with due consideration to the pace of growth of the city, of slums, predominance of minority population, and areas where property rights are assigned.

Mortgage Risk Guarantee Fund

The government in 2011 proposed the creation of a Mortgage Risk Guarantee Fund under Rajiv Awas Yojana. This would guarantee housing loans taken by Economically Weaker Sections and Low Income Group households and enhance their credit worthiness.

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 has 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.
- For the slum census 2011, the committee has recommended that for policy formulation purposes it is absolutely essential to count the slum population even in cities having less than 20,000 populations. For the purpose of planning for Rajiv Awas Yojana and slum free India it would be necessary to count the population of slums in all statutory towns in the country in 2011.

- The committee has suggested a different definition for slum than the definition adopted by the census of India 2001 and the states. The committee has 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 has 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 has recommended that a contiguous area with 20-25 house holds having slum like characteristics be counted as slum.

Q Inequality is always accompanied by intensification of poverty
Ans Not Always.

Inequality

When discussing poverty, inequality often refers to the income gap between the rich and poor of society. The greater the gap, the greater the inequality. It essentially refers to disparities in the distribution of economic assets and income among individuals and groups within a nation and among nations.

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.

Lorenz Curve

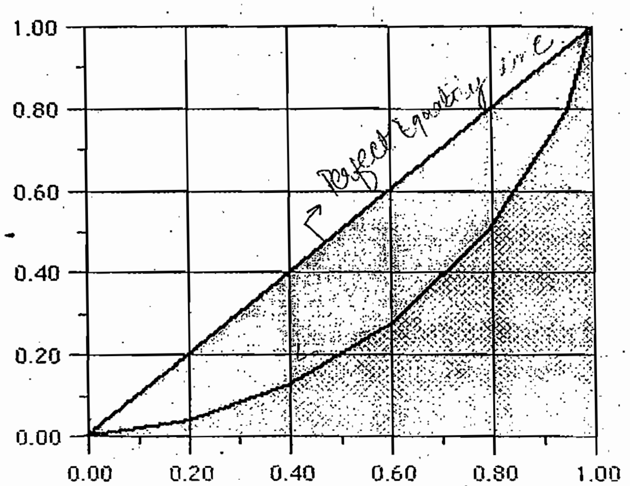
The Lorenz curve was developed by Max O. Lorenz as a graphical representation of income inequality. It can also be used to measure inequality of income or assets or any other facility.

The Lorenz curve is used to calculate the Gini coefficient which is the numerical indicator of inequality in a country. Gini coefficient is derived by taking the following tow

- 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)

poor people (have none)

Gini number is arrived when a is divided by b.



Gini Coefficient

To compute the Gini Coefficient, we first measure the area between the Lorenz Curve and the 45 degree equality line. This area is divided by the entire area below the 45 degree line (which is always exactly one half). The quotient is the Gini coefficient, a measure of inequality. The Gini index is the Gini coefficient expressed as a percentage, and is equal to the Gini coefficient multiplied by 100.

For a perfectly equal distribution, there would be no area between the 45 degree line and the Lorenz curve -- a Gini coefficient of zero. For complete inequality, in which only one person has any income (if that were possible) the Gini coefficient would be one. Real economies have some, but not complete inequality, so the Gini coefficients for real economic systems are between zero and one. 0 - 1

Gini coefficients : Sweden 0.250, Germany 0.283, India 0.325, France 0.327, Canada 0.331, Australia 0.352, UK 0.360, United States 0.408, China 0.447 and Russia 0.456. More we are going towards zero, we are getting more equal.
In BRICS, India is the best in Gini Coefficient.

Ahluwalia-Chenery Welfare Index

GDP may grow and the distribution of wealth 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

Mains. ...

from the prosperity. It is an alternative measure of income growth, one that gave equal weight to growth of all sections of society.

Economic reforms, globalization and inequality

Globalisation has worsened the Gini across the world.

In India the LPG since 1991 contributed to prosperity but the rich have become richer faster than the poor improved. That is , even while poverty levels reduced impressively, inequality has grown too.

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 limits growth by restricting the number of people who can participate in markets.

To examine why growth is not reducing inequality: income growth is concentrated in certain urban centers, and those whose incomes increase are usually already above average in income and education. The reality is 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. ADB has given a report.

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 governments 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.

ICDS, SSA, NRHM, Mahatma Gandhi Backward Region Development Fund, Bharat Nirman etc are the initiatives in public policy by Government to bring down the divides.

In sum, main reasons for widening wealth 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.

Adverse impact of inequality

- Growing inequalities can dampen growth due to potential instability;weaken social cohesion.
- 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.
- In societies where wealth is concentrated in the hands of a few, there is danger of policy levers being captured by the rich for their own benefit and a weakening of the institutional foundations of the growth process.

According to the ADB, absolute and relative inequality have widened . Although basic poverty levels have fallen as economy expanded, the living standards of the wealthiest in society have improved at a much faster rate compared to the poor.In a region as dynamic and vibrant as India , low growth in incomes of the poor is reflective of weakness in the pattern of growth. Incomes of the rich or top 20 percent have increased much more than those of the poor or the bottom 20 percent. That is, relative inequality is increasing.

Public Policy Challenge

ADB analyses the challenges to the government as follows:

Inequalities in life start early and they begin with extreme circumstances that deny millions the opportunity to have adequate nutrition, health and basic education. Governments must ensure their health and education programmes were "targeted" and implemented well. More spending is needed on education, training and healthcare to alleviate the situation .Government should implement complementary policies to counter negative impact of market-oriented reforms, such as social protection mechanism and skills and training programmes. There is a need to step up investment through PPPs to develop new economic activities and industries that generate employment opportunities that do not bypass the poor.

Public policy should also focus on radically improving the quality of basic health care and education.The key challenge to public policy here lies on not just increasing the quantum of public expenditures, but the outcomes are satisfactory- the target group is reached.

Summary

The growing wealth and wealth gap are a byproduct of globalization, which has brought higher incomes to urban, skilled, English-speaking workers in China, India and other countries, the bank's report said.The gap could slow the spread of prosperity, because the poorest people have less access to education, health care, bank loans and other things needed to benefit from economic growth.We have to invest in creating opportunities, as well as investing in broadening access to opportunities.

Relative inequality refers to proportionate differences in incomes, while absolute inequality refers to actual rupee differences in incomes.

Wealth distribution in India is uneven, with the top 10% of income groups earning 33% of the income. The 2007 report by the National Commission for Enterprises in the Unorganised Sector (NCEUS) found that 25% of Indians, or 236 million people, lived on less than 20 rupees per day.

Inequality in China and Nepal with Gini Coefficients of 47 are the highest in Asia, while India has a Coefficient of 36.

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- disability etc.

In social insurance people receive benefits or services in recognition of 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
- Aam Admi Bima Yojana
- Rashtriya Swasthya Bima Yojana
- Unorganised Workers Social Security Act 2008

Major Anti Poverty, employment generation and basic services programmes

Pradhan Mantri Gram Sadak Yojana (PMGSY)

The PMGSY was launched in 2000 as a 100 per cent Centrally Sponsored Scheme with the primary objective of providing all- weather connectivity to the eligible unconnected habitations in the rural areas. The programme is funded mainly from the accruals of diesel cess in the Central Road Fund. In addition, support of the multilateral funding agencies and the domestic financial institutions is being obtained to meet the financial requirements of the programme. About 1,42,750 kilometre-long roadworks have been completed with a cumulative expenditure of Rs. 27,382.24 crore.

Indira Awaas Yojana (IAY)

This scheme aims at providing dwelling units, free of cost, to the poor families of the Scheduled Castes, Scheduled Tribes, freed bonded labourers and also the non-SC/ST persons below the poverty line in rural areas. The scheme is funded on a cost sharing basis of 75:25 between the Centre and the States. During the current financial year, Rs. 4,032.70 crore have been earmarked for release to DRDAs under Indira Awaas Yojana (IAY) for construction of 21.27 lakh houses. As per the information received from the State Governments, 9.39 lakh houses have been constructed up to November 2007.

Swarnjayanti Gram Swarozgar Yojana (SGSY)

The Swarnjayanti Gram Swarozgar Yojana (SGSY) was launched in April 1999 after restructuring the Integrated Rural Development Programme (IRDP) and allied programmes. It is the only Self Employment Programme currently being implemented for the rural poor. The objective of the SGSY is to bring the assisted swarozgaris above the poverty line by providing them income generating assets through bank credit and Government subsidy. The scheme is being implemented on cost sharing basis of 75:25 between the Centre and States. Up to December 2007, 27.37 lakh self-help groups (SHGs) have been formed and 93.21 lakh swarozgaris have been assisted with a total outlay of Rs. 19,340.32 crore.

Sampoorna Grameen Rozgar Yojana (SGRY)

The Sampoorna Grameen Rozgar Yojana (SGRY) was launched on September 25, 2001. The objective of the programme is to provide additional wage employment in the rural areas as also food security, alongside creation of durable community, social and economic infrastructure in the rural areas. In 2007-08 up to December 31, 2007, the number of person-days of employment generated under SGRY was 11.60 crore while the Centre's contributions in terms of cash and foodgrain component up to December 31, 2007, were Rs. 1,142.27 crore and 9.55 lakh tonnes, respectively. Under the special component, about 0.55 lakh tonnes of foodgrain have been released to calamity hit States in the current year up to December 2007. SGRY programme in 330 districts has already been subsumed in National Rural Employment Guarantee Scheme (NREGS) (200 districts in first phase during the year 2006-07 and 130 additional districts in second phase during 2007-08). SGRY programme will be entirely subsumed in NREGS with effect from April 1, 2008.

Swarna Jayanti Shahari Rozgar Yojana (SJSRY)

In December 1997, the Urban Self-Employment Programme (USEP) and the Urban Wage Employment Programme (UWEP), which are the two special components of the Swarna Jayanti Shahari Rozgar Yojana, were substituted for various programmes operated earlier for urban poverty alleviation. The fund allocation for the scheme was Rs. 344 crore during 2007-08 and Rs. 256.41 crore has been released up to December 4, 2007. During 2007-08, under USEP, 0.44 lakh urban poor were assisted to set up micro/group enterprise and 0.60 lakh urban poor were imparted skill training up to end of November 2007. Under UWEP, the mandays of employment generated was 6.77 lakh up to end of November 2007. Cumulative coverage of beneficiaries under the Community Structure Component was 358.13 lakh up to end of November 2007.

MPI – Multidimensional Poverty Index

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.

Why multidimensional approach?

- **Income alone can miss a lot.** For example, economic growth has been strong in India in recent years. In contrast, the prevalence of child malnutrition has remained at nearly 50 per cent, which is among the highest rates worldwide. HUNGaMA report 2012. Multidimensional measures can complement income.
- **Poor people** describe ill-being to include poor health, nutrition, lack of adequate sanitation and clean water, social exclusion, low education, bad housing conditions, violence, shame, disempowerment and much more.
- **The more policy-relevant information available on poverty, the better-equipped policy makers will be to reduce it.** For example, an area in which most people are deprived in education is going to require a different poverty reduction strategy to an area where most people are deprived in housing conditions.
- **Some methods for multidimensional measurement, such as the OPHI-developed Alkire Foster method, can be used for additional purposes.** In addition to measuring poverty and wellbeing, OPHI's method can be adapted to target services and conditional cash transfers or to monitor the performance of programmes.

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 multidimensionally poor (suffering deprivations in 33% of weighted indicators) and the number of deprivations with which poor households typically contend.

NSSO 68th Round

Rural incomes have grown at an accelerated pace from 2010 to 2012 according to the 68th round of the National Sample Survey Organisation (NSSO).This survey conducted from July 2011 to July 2012 shows that while the average monthly per capita consumption expenditure in real terms in rural India rose from 2005 to 2010 by just 5% that is to Rs 599 from Rs 558.8 in 2005, it grew by around 18% from 2010 and 2012 that is it rose to Rs 707 in 2012.

However urban incomes grew by 13.5% from 2005 to 2010, as well as from 2010 to 2012. Calculations show that therefore rural poverty is likely to have dropped to around 26% in 2011-12 from 33.8% estimated for 2009-10. In the case of urban areas the decline in the same period is marginal - from 20.9% to 19%.

Basically what happened was that 2009-10 was a drought year. When we look at 2009-10 versus 2004-05, we are understating the growth. Right comparison is 2011-12 against 2004-05, which will give you about a 4-4.5% growth.

Caveat: We are comparing from 2009-10 to 2011-12. So, 2009-10 obviously was a drought year, so the rural incomes were depressed. But also the urban areas, they were still under some kind of distress that was following the 2008 recession, which affected the manufacturing and the other sectors in the urban areas. There is some base effect.

Growth in rural consumption has been from 2004-2005 to 2011-2012; this was a period when growth also accelerated and government intervened with various flagship schemes in employment,health,education etc.Thus, there has to be some kind of an increase in rural consumption.

From 2004-2005 to 2011-2012, growth has been around 3.5% to 4%, which is an improvement over what we have seen in the earlier period, before 2004-2005 was close to 2-2.5% rate of growth of our rural consumption. So, there is an increase and the trend has continued, but looking at 2009-2010 as the base maybe misleading.

Short point: A part of the increase during 2010-12 can indeed be attributed to government interventions through NREGA and other programmes. Much of the explanation, however, lies in the fact that the base year of 2009-10 was a bad year as there was a crop failure.As a result, the per capita rural consumption expenditure grew by less than 2 per cent per annum in real terms during 200405 and 2009-10. In contrast, during 2010-12, it has grown by 9 per cent. Correspondingly, the growth rate in urban areas has risen from 3 per cent per year during 2005-10 to 6 per cent during 2010-12. The numbers indeed point towards an improvement in economic situation.

By the same token, worrying fact, however, is the growing rural-urban inequality which has not received due attention of the policy makers over the years.

In 2004-05, the per capita urban expenditure was 88 per cent higher than that in rural areas. In the latest round of NSS survey, this is more than 92 per cent.

The assessment which should send alarm bells among policy makers is that the modest economic growth in recent years has been characterised by significant rise in consumption inequality. The growth in consumption expenditure for the bottom deciles (data sorted into ten equal parts, so that each part represents one-tenth of the sample size) is reported to be much less than the growth in the higher expenditure groups, both in rural and urban areas. The implications are that inequality has gone up which would have serious implications for poverty.

Two facts stand out from the NSS 68th Round on Household Consumption Expenditure Survey. The first is that rural households continue to be worse off than their urban counterparts in terms of monthly per capita expenditure (MPCE) and the second is that the richest in rural areas fare relatively unfavourably compared with those in urban areas.

This suggests that the rural population remains disadvantaged vis-à-vis the urban folk in terms of employment, income and consumption.

It is also a reflection of the limited attention that has been paid to the development of our rural economy which has made migration to the urban areas more attractive.

The NSSO survey is a critical input for a host of government and private sector companies to decide on everything from anti-poverty programmes to sales of consumer goods.

The 68th round of the NSS, whose provisional findings were released on Wednesday, covered household consumer expenditure during 2011-12. It was based on a sample of 59,070 households in 7,391 villages and 41,602 households in 5,223 urban blocks. The final report is likely to be released next year.

The poorest 10 per cent lives on Rs 23.40 per day while their rural counterparts make do with even less at Rs 16.78.

The rate of growth of expenditure is lower in rural areas as the rural poor are known to depend more on non-traded items.

But when it came to all income groups, the average monthly consumption expenditure increased by 18 per cent in rural areas against 13.2 per cent in urban areas..

The NSS survey has pegged this average monthly spending by rural families in 2011-12 at Rs 1,281.45 and by urban households at Rs 2,401.68.

As expected, the difference between the richest 10 per cent of the population and the poorest 10 per cent was sharper in urban areas.

Inequality adjusted HDI

The HDI represents a national average of human development achievements in the three basic dimensions making up the HDI: health, education and income. Like all averages, it conceals disparities in human development across the population within the same country. Two countries with different distributions of achievements can have the same average HDI value. The IHDI takes into account not only the average achievements of a country on health, education and income, but also how those achievements are distributed among its citizens by "discounting" each dimension's average value according to its level of inequality.

The 2010 UNDP HDR focused on inequalities in human development attainments across countries. To quantify the potential loss because of such inequalities, the Report introduced three new indices, viz., Inequality-adjusted Human Development Index (IHDI), Gender Inequality Index and Multi-dimensional Poverty Index.

According to the report, the IHDI is a "measure of the average level of human development of people in a society once inequality is taken into account. Under perfect equality, the HDI and IHDI are equal; the greater the difference between the two, the greater the inequality." In that sense, "the IHDI is the actual level of human development (taking into account inequality), while the HDI can be viewed as an index of the potential human development that could be achieved if there is no inequality.".

The IHDI, estimated for 134 countries, captures the losses in human development due to inequality in health, education and income. Losses in the three dimensions vary across countries, ranging from 2.9% (Hong Kong) to 52.0% (Chad) in life expectancy, 1.3% (Czech Republic) to 49.7% (Yemen) in education and 4.5% (Azerbaijan) to 68.3% (Namibia) in income. Overall loss in all three dimensions ranges from 5.0% (Czech Republic) to 43.5% (Namibia).

GII

The **Gender Inequality Index (GII)** is a new 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 as an experimental measure 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.

There are three critical dimensions to the GII: reproductive health, empowerment, and labor market participation. The dimensions are captured in one single index.

Reproductive health

GII is a pioneering index, in that it is the first index to include reproductive health indicators as a measurement for gender inequality. The GII's dimension of reproductive health have two indicators: the Maternal Mortality Ratio (MMR),the data for which come from UNICEF's State of the World's Children, and the adolescent fertility rate (AFR), the data for which is obtained through the UN Department of Economic and Social Affairs, respectively. 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.

Empowerment

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%.

Labor market participation

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 exhibit high gender inequality also show inequality in distribution of development, and vice versa. The GII a composite index used to rank the loss of development through gender inequality within a country. (Condensed in the class)

Inequality is on various levels i.e. divides :-

⇒ Gender, Caste,