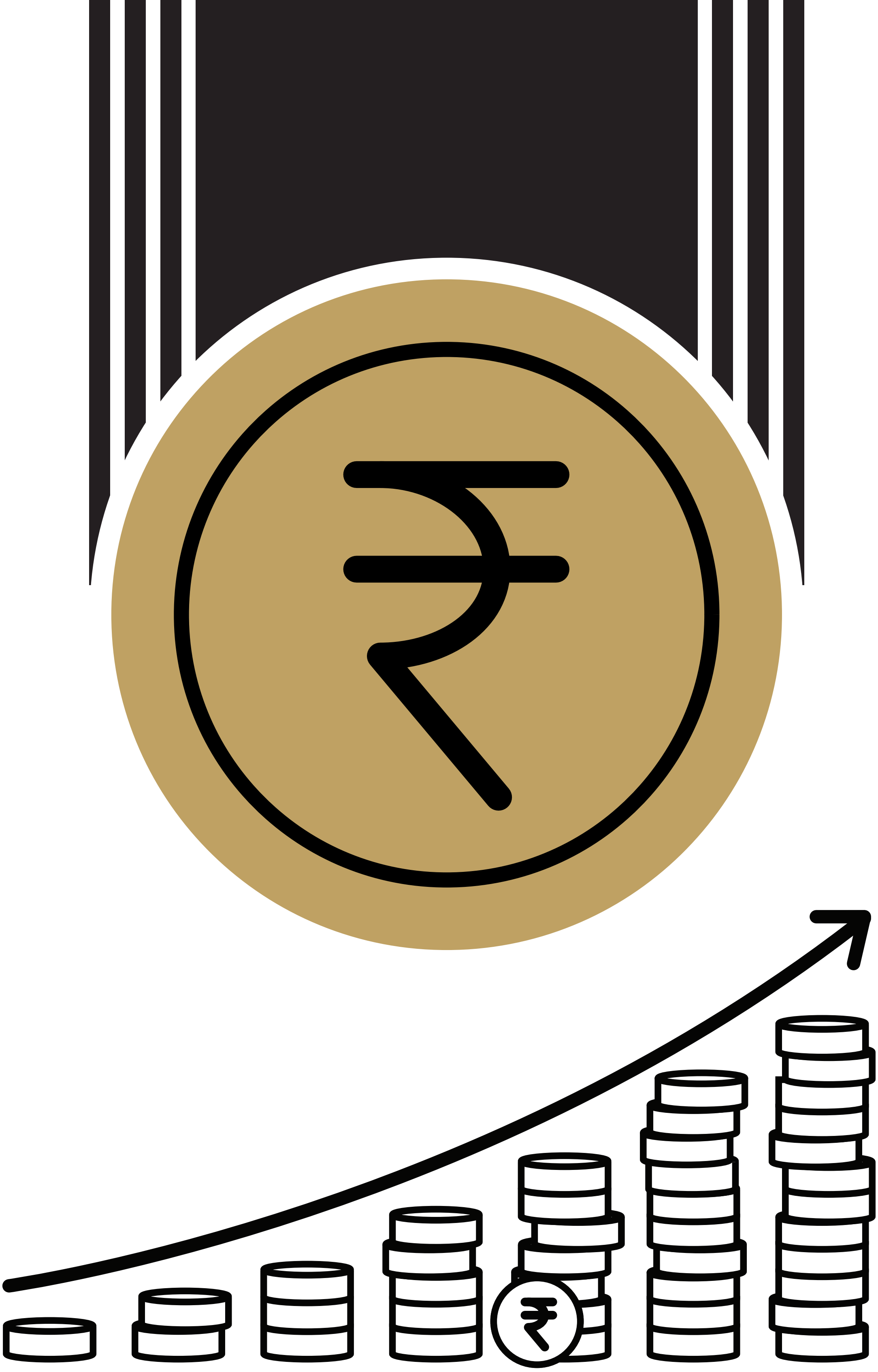
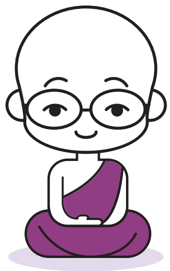


UPSC PATHSHALA

ECONOMY

CONTENTS



ABOUT THE BOOK

Indian Economy is one of the most important, essential and a core subject in all the three stages of the civil services examination. This particular subject gives you the knowledge required to understand the nature of the Indian Banking system, the different Economy related markets in India, the general Economic development and much more.

Understanding Economy becomes complex due to the technical nature of the subject and the presence of various concepts in it. To make things simpler, we have analysed the scope and weightage of Economy and designed the book to help the UPSC aspirants get the maximum output.

Each and every chapter of this book has been written exhaustively using simple language which would make it easy for an aspirant to understand the essence of the subject and provides conceptual clarity to its readers and to help you all answer different kinds and nature of questions in the Examination.

01

Banking in India

Introduction

The bank plays the role of a vital organ in the body of an economy. It effectively mobilises deposits and is responsible for disposal of credit to various sectors of the economy. A bank is a financial institution that is licensed to park consumers money in the form of deposits and lend money to individuals and businesses, look after disbursement of payments and invest in financial assets and securities. The bank generates profits from the difference in the interest rates charged and paid.

Banks act as a medium between people who have surplus of money and the ones who are in need of it. In addition to this, banks undertake the risk arising out of the possible default of the ultimate borrower. Thus it accepts deposits from people and advances loans by creating credit.

What are the functions of Banking?

The following functions of the bank explain the need of the bank and its importance.

1. To provide the security to the savings of customers.

2. To control the supply of money and credit.

3. To encourage public confidence in the working of the financial system, increase savings speedily and effectively.

4. To avoid focus of financial powers in the hands of a few individuals and institutions.

5. To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers.

Central Bank - RBI

RBI is an apex institution in the banking and financial structure of the country which plays a crucial role in organizing, running, supervising, regulating and developing the banking and financial structure of the economy. India's Central Bank is known as the Reserve Bank of India. According to Samuelson, a central bank is 'A Bank for Bankers.' It is the monetary authority of the economy entrusted with the task of managing money to promote and balance growth as well as maintain price stability.

What is the Historical Background of RBI?

1926

In 1926, the Royal Commission on Indian Currency and Finance which is also known as the Hilton- Young Commission recommended the creation of a central bank.

The idea was twofold. Firstly to separate the control of currency and credit from the government. Secondly, to augment banking facilities throughout the country.

1934

The Reserve Bank of India Act of 1934 established the Reserve Bank as the banker to the central government and set in motion a series of actions culminating in the start of operations on April 1, 1935.

1949

RBI was nationalized in 1949.

It has four Zonal offices at Delhi, Kolkata, Chennai and Mumbai for four regions: Northern, Eastern, Southern and Western regions respectively. RBI has 19 offices, which are located in state capitals and a few major cities in India. In addition, there are 9 sub-offices of RBI.

Zonal offices

Delhi	Kolkata	Chennai	Mumbai
Northern	Eastern	Southern	Western

What are the functions of RBI?

Bank of Issue:

It has a sole authority to issue currency notes and coins through the issue department, which is solely responsible for the issue of notes and coins. It imparts uniformity in the currency and adds the required prestige identified by every citizen of the country.

Banker to Banks and Government:

As the Banker's bank, RBI acts as the custodian of cash reserves of commercial and other Banks. The government too like the private sector is in need of the services of the bank. The important functions in this sector is to maintain accounts, act as a financial adviser, manage public debt as well as custodian of foreign exchange reserves. Since RBI is the apex bank, it has certain rights and responsibilities towards commercial banks as well.

- Commercial banks are under statutory obligation to keep a part of their deposits as reserves with the central bank.
- The central bank provides credit, mainly short-term credit, to the commercial banks. It provides them guidance and direction and regulates their activities.
- Commercial banks are required to shape their policy in accordance with these directions and guidance of the central bank.
- As the banker and financial adviser to the government, the central bank receives the deposit of cash, cheques, drafts etc. from the government.
- It provides cash to the government for paying salaries and wages and other cash disbursements. It makes payments on behalf of the government.
- It gives short-period loans to the government. It buys and sells foreign currencies on behalf of the government

Lender of Last Resort:

RBI helps commercial banks when they have exhausted their resources and are in financial need. In its capacity as the lender of the last resort, the central bank provides, directly or indirectly all reasonable financial assistance to commercial banks.

Controller of Credit:

RBI controls the credit creation by the commercial banks which are regarded as the most important function of Central Bank. At present, Credit Money or Bank Money is the dominant form of money and essentially requires the supply of credit to be regulated so as to ensure the smooth functioning of the economy. For this, the central bank adopts quantitative and qualitative methods of credit control. Quantitative methods aim at controlling the cost and availability of credit, while the qualitative method influences the use and direction of credit.

Bank of Central Clearance and Settlement:

It acts as a clearing house to settle mutual claims of commercial banks. Commercial banks meet at the clearing house to settle their mutual claims. Each commercial bank receives cheques deposited by their customers, to be claimed from other banks. Since central bank holds reserves of these banks, it can be settled through simple transfer entries in their accounts.

How is Central Bank different from Commercial Banks?

On the basis of Profit:

A central bank does not aim at making profits like a commercial bank and hence is not a profit making institution. It acts in the public interest so as to control and regulate the banking and financial system of the country.

On the basis of functions performed:

A central bank does not perform ordinary commercial banking functions such as accepting deposits from the general public of the country.

Ownership:

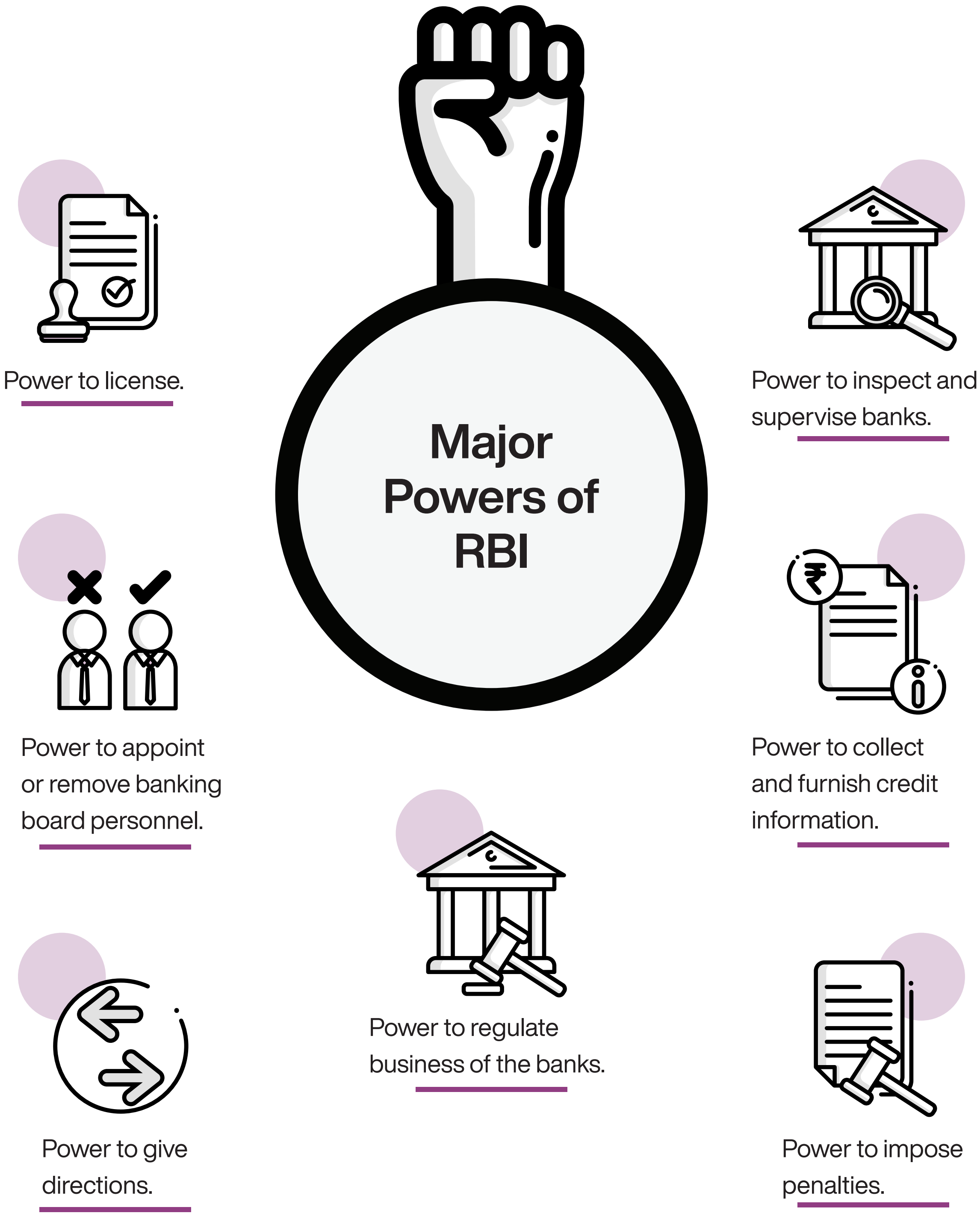
A central bank is an organ of the government and, therefore, is owned by the government and managed by the government officials. But a commercial bank is generally maybe owned by both private individuals as shareholders and by the government.

Issuer of Currency:

A central bank has sole monopoly of note issue, but commercial banks cannot issue notes.

Development Function:

The business of the central bank is to control the commercial banks in such a way which promotes the general monetary policy of the state. It is superior than the commercial banks since it is also responsible for expansion of the banking system, establishment of new financial institutions, development of money and capital market as well as promote investment.



Terms Associated with Banking

Monetary Policy

- Monetary policy is a policy undertaken by the monetary authority of the country. It has two major objectives to boost economic development and main price stability by keeping inflation within the estimated bandwidth.
- The RBI is the main agency for implementing the monetary policy. RBI has defined its monetary policy in terms of adequate financing of economic growth and at the same time ensuring reasonable price stability.

Bank Rate

- Rate at which the central bank lends to commercial banks. In other words, it is the rate at which RBI rediscounts the bill of exchange.
- It thus acts as a signal to the economy on the direction of the monetary policy. RBI uses changes in Bank Rate to regulate fluctuations in exchange rate and domestic inflation.
- Each bank is free to decide the Base Rate below which it will not lend to borrowers. Banks should declare the benchmark based on which such Base Rates are decided. One bank can have only one.
- At present it is 5.40%.

Cash Reserve Ratio (CRR)

- Every Commercial Bank is required to keep a certain percentage of its demand and time liabilities (deposits) with the RBI (either as cash or book balance).
- The RBI varies this ratio as and when it feels there is a need to increase or decrease the money supply.
- RBI is empowered to fix the CRR at a rate ranging between 3 percent and 15 percent.
- RBI uses this method (increase of CRR rate), to drain out the money to contract the money supply in the economy.
- At present the CRR is 4%.

Statutary Liquidity Ratio (SLR)

- Commercial Banks are also required to keep (in addition to CRR) a certain percentage of their net demand and time liabilities (NDTL) as liquid assets in the shape of cash, gold or approved securities.
- As most of the SLR money is kept in treasury bills, the government had, in the past, been using SLR as a means to mobilize low cost resources. This abuse of SLR leads to distortion in the interest rate and credit supply.
- In order to overcome this, Narasimhan Committee recommended that SLR should be brought down to 25 per cent, which is the current rate since 1993-94.
- At present the SLR is 21.50%.

Open Market Operation

- This refers to the RBI buying and selling eligible securities to regulate money supply.
- Traditionally, RBI was not resorting to this method. However, after the large inflow of foreign funds since 1991, RBI has had to step in to sterilize the flow to avoid excess liquidity.

Liquidity Adjustment Facility (LAF)

- Liquid Adjustment Facility is a monetary policy tool which allows banks to borrow money through repurchase agreements. LAF is used to aid banks in adjusting the day to day mismatches in liquidity. LAF consists of repo and reverse repo operations.

Repo Rate

- Repurchase Option (REPO) is the rate at which RBI lends to commercial banks. In other words, it is the rate at which our banks borrow rupees from RBI.
- When banks have any shortage of funds they can borrow it from RBI. A reduction in the Repo Rate will help banks to get money at a cheaper rate.
- When the Repo Rate increases, borrowing from RBI becomes more expensive.
- At present repo rate is 5.15%.

Reverse Repo Rate

- The rate at which The Reserve Bank of India (RBI) borrows money from banks and hence exact opposite of Repo Rate.
- RBI uses this tool when it feels there is too much money floating in the banking system. Banks are always happy to lend money to RBI since their money is in safe hands with a good interest.
- An increase in Reverse Repo Rate can cause the banks to transfer more funds to RBI due its attractive interest.
- RBI resorts to the Repo Route to fine tune the liquidity position, without resorting to major policy instruments such as changes in CRR and Bank Rate. However, markets are bound to react to frequent changes in the Repo Rates and this will be reflected in corresponding changes in the deposit and lending rates of commercial banks.
- At present the Reverse Repo Rate is 4.90%.

Prime Lending Rate

- It is the interest rate charged by banks to their most creditworthy customers (usually the most prominent and stable business customers).
- The rate is almost always the same amongst major banks.
- Some banks use the name “Reference Rate” or “Base Lending Rate” to refer to their Prime Lending Rate.

Marginal Standing Facility (MSF)

- Rates at which the Scheduled banks can borrow funds overnight from RBI against government securities.
- It is a short term borrowing scheme for scheduled commercial banks in case the banks are in severe cash shortage or acute shortage of liquidity.
- MSF has been introduced by RBI to reduce volatility in the overnight lending rates in the inter-bank market and to enable smooth monetary transmission in the financial system.
- At present the MSF rate is 5.65%.

Classification of Banks

Banks are classified into Organised and Unorganised banking:

Un-organized Banking	Organised Banking
The part of Indian Banking System which does not fall under the control of our central bank (i.e The Reserve Bank of India) is called as un-organized banking. For example: Indigenous banks.	The scheduled banks are those which are entered in the second schedule of RBI Act, 1939. Scheduled banks are those banks which have a paid up capital and reserves of aggregate value of not less than Rs 5 lakhs and which satisfy RBI guidelines.

The Organised (Scheduled) Banking Sector can be categorised into three major categories:

Central Bank of the Country (RBI)

Commercial Banks

Cooperative Banks

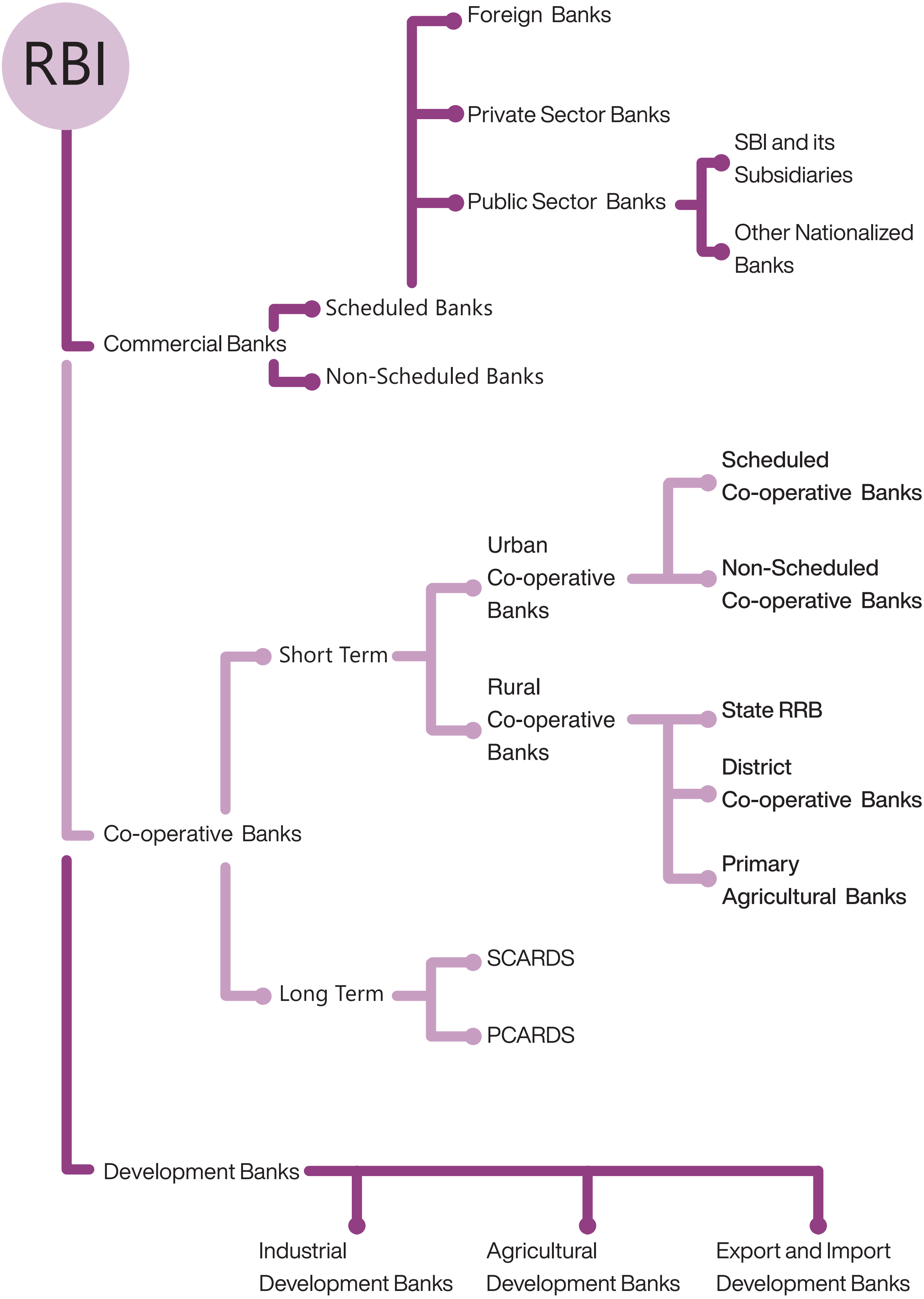
COMMERCIAL BANKS

Commercial banks are financial institutions which deal in money, with the main objective of profit maximising. A major chunk of the money that it deals with, comes from the public. It acts as an intermediary between the lenders and the borrowers. Scheduled Commercial Banks (SCBs) are grouped under following categories:

Nationalised Banks - State Bank of India and its associates along with the nationalised banks such as the IDBI Banks, Indian Bank, Dena Bank etc. are all public sector banks. Other scheduled commercial banks include private banks such as ICICI, Axis, HDFC bank etc. operating in the country.

Foreign Banks - Operating in the country include Deustche Bank, Bank of America, Citibank, HSBC, and Royal Bank of Scotland etc.

Regional Rural Banks - Regional rural banks came into being in the 1970s with the objective of providing deposit and credit facilities to the people in rural areas especially the small and marginal farmers, agricultural labourers, and small entrepreneurs. Even though these banks count as the scheduled commercial banks but their focus and reach is generally limited to a district or two. Some of the examples of Regional Rural Banks are Assam GraminVikash Bank, Allahabad UP Gramin Bank, Baroda Gujarat Gramin Bank etc. At present there are 91 RRBs functioning in India.


RBI
Foreign Banks
Private Sector Banks
Public Sector Banks
SBI and its Subsidiaries
Other Nationalized Banks
Scheduled Banks
Commercial Banks
Non-Scheduled Banks
Scheduled Co-operative Banks
Urban Co-operative Banks
Non-Scheduled Co-operative Banks
Short Term
Rural Co-operative Banks
State RRB
District Co-operative Banks
Primary Agricultural Banks
Co-operative Banks
SCARDS
Long Term
PCARDS
Development Banks
Industrial Development Banks
Agricultural Development Banks
Export and Import Development Banks

COOPERATIVE BANKS

It is an institution established on the basis of cooperative principles and dealing in ordinary banking business with 'No Profit No Loss Basis'. These banks are controlled, owned, managed and operated by cooperative societies and came into existence under the Cooperative Societies Act in 1912. These banks are located in the urban as well in the rural areas. Although these banks have the same functions as the commercial banks, but their rate of interest is low in comparison to other banks.

At present, there are 170 scheduled commercial banks in the country, which includes 91 Regional Rural Banks (RRBs), 19 Nationalised Banks, 8 Banks in State Bank of India Group and the Industrial Development Bank of India Limited (IDBI Ltd).

There are three types of cooperative banks in India, namely

Primary Credit Societies:	Central Cooperative Banks:	State Cooperative Banks:
These are formed in small locality like a small town or a village. The members using this bank usually know each other and the chances of committing fraud are minimal.	These banks have their members who belong to the same district. They function as other commercial banks and provide loans to their members. They act as a link between the state cooperative banks and the primary credit societies.	These banks have a presence in all the states of the country and have their presence throughout the state.

NON-SCHEDULED BANKS

Banks not under 2nd Schedule of the Reserve Bank of India Act, 1934. These are also known as Local Area Bank.Non-scheduled banks are also subject to the statutory cash reserve requirement. But they are not required to keep them with the RBI; they may keep these balances with themselves.

They are not entitled to borrow from the RBI for normal banking purposes, though they may approach the RBI for accommodation under abnormal circumstances.

What are the 5 Non-Scheduled Urban Cooperative Banks in India?

- Akhand Anand Co-Operative Bank Ltd.
- Alavi Co-Op Bank Ltd.
- Amarnath Co-operative Bank Ltd.
- Amod Nagrik Sahakari Bank Ltd.
- Amreli Nagrik Sahakari Bank Ltd.

Along with this 4 local area banks in India which, forms under non-scheduled list of Banking as per RBI.

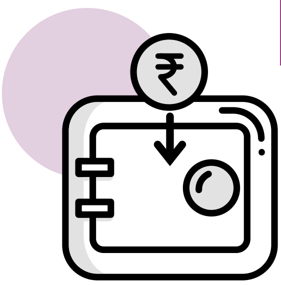
- Coastal Local Area Bank Ltd.
- Capital Local Area Bank Ltd.
- Krishna Bhima Samruddhi Local Area Bank Ltd.
- Subhadra Local Area Bank Ltd.

What are the functions of Commercial Banks?

The functions of a commercial bank can be divided into primary and secondary. The primary functions are the banking functions whereas the secondary functions are classified as non banking functions. We will be looking at a detailed understanding of both the types of functions.

BANKING FUNCTIONS

> Accepting deposits and advancing loans are two important parts under the purview of banking functions.



Deposits

Current Account Deposits: A current account deposit is also known as demand deposits. A current account deposit is usually operated by the business people. It makes business transactions possible with minimum liquidity pressure. No interest is paid on current account deposits. Banks can further charge a fee for providing this facility.

Savings Bank Deposits: These accounts are opened for salaried and low income individuals. It can be opened with a small amount of money as balance. Money can be withdrawn at will without much obligations. It earns interest though much less than fixed deposits.

Fixed Deposits: Money under this account is deposited for a fixed period of time. The time duration can vary from about 3 months to more than 3 years. These are the deposits to earn interest by the customers of a bank. Such deposits have high interest rate than the other types of deposits. In case the customer withdraws money before the end of the stipulated term of deposit, s/he has to pay the penalty.

Recurring Deposits: This type of deposits is to develop the habit of small savings among people. Under this, the depositters have to regularly deposit a certain amount in the stipulated amount of time. The deposit continues for a given period of time. The interest rate on it is very similar to that of the fixed deposits.

Loans and Advances

Commercial banks also play an important role in the economy by providing loans to industries, individuals, businesses, agriculture etc. They also provide loans for export and import trade.

Utility Services: Commercial banks perform various services useful to the customer.

Locker facility: Banks provide locker facility to customers to keep their valuables, such as securities, jewellery, documents etc. Draft facilities: Banks issue drafts to customers and enable them to transfer funds from place to place.

Letters of credit: Banks issue letters of credit to their customers. These are useful to traders to buy goods from foreign countries on credit. The credit issued by a bank in one place.
Agency services: Commercial banks also perform several activities on behalf of their customers.

Collections: Commercial banks take up collection of promissory notes, cheques, bills, dividends, subscriptions, rents, etc.,on behalf of their customers as agents. The bank charges ‘service charges’ for rendering these services to its customers.

Payments: Banks also accept the responsibility to pay insurance premium, rents, taxes, electricity bills, etc. periodically on behalf of its customers for whom they charge commission.

Sale and purchase of securities: Customers sometimes approach the bankers for sale and purchase of their securities. For these services the banks charge commission.

Types of Banks

UNIVERSAL BANK

- It is financial supermarket where all financial products are sold under one roof.
- It is a system of banking where bank undertake a blanket of financial services like investment banking, commercial banking, development banking, insurance and other financial services including functions of merchant banking, mutual funds, factoring, housing finance etc.
- As per the World Bank, the definition of the Universal Bank is as follows: In Universal banking, the large banks operate extensive network of branches, provide many different services, hold several claims on firms (including equity and debt) and participate directly in the Corporate Governance of firms that rely on banks for funding or as insurance underwriters.
- The second Narasimham committee of 1998 gave an introductory remark on the concept of the Universal banking, as a different concept than the Narrow Banking. Narsimham CommitteeII suggested that Development Financial Institutions (DFIs) should convert ultimately into either commercial banks or non-bank finance companies.
- However, the concept of Universal Banking conceptualized in India after the RH Khan Committee recommended it as a different concept. The Khan Working Group held the view that DFIs (Development Finance Institutions) should be allowed to become banks at the earliest.

What are the advantages of universal banking?

Increased diversions and increased profitability.

Better Resource Utilization.

Brand name leverage.

Existing clientele leverage.

Value added services.

One-stop shopping' saves a lot of transaction costs.

Easy Marketing

Profit Diversification

DEVELOPMENT BANK

- Development bank is essentially a multi-purpose financial institution with a broad development outlook.
- A development bank may, thus, be defined as a financial institution concerned with providing all types of financial assistance (medium as well as long term) to business units, in the form of loans, underwriting, investment and

guarantee operations, and promotional activities — economic development in general, and industrial development, in particular.

What are the different kinds of development bank?
Development banks in India are classified into following four groups:

Industrial Development Banks:
It includes, for example, Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), and Small Industries Development Bank of India (SIDBI).

Agricultural Development Banks:
It includes, for example, National Bank for Agriculture & Rural Development (NABARD).

Housing Development Banks:
It includes, for example, National Housing Bank (NHB).

Export-Import Development Banks:
It includes, for example, Export-Import Bank of India (EXIM Bank).

LEAD BANK

A lead bank is a bank that oversees the arrangement of loan management. The lead bank receives an additional fee for this service, which involves recruiting the syndicate members and negotiating the financing terms. Lead banks is the largest bank of that particular geographical area. They play a very important role in execution and achievement of key objective of district credit allocation policy.

The lead bank scheme was introduced in 1969, based on the recommendations of the Gadgil Study Group on the organisational framework for the implementation of social objectives. It assigns lead role to individual banks to manage the districts allotted to them. The bank which usually has the largest resource pool in terms of network is provided with additional resources of manpower and other finances to oversee the districts under them.

What are the objectives of the lead bank scheme?

- Eradication of unemployment and under employment.
- Appreciable rise in the standard of living for the poorest of the poor.
- Provision of some of the basic needs of the people who belong to poor sections of the society.
- The basic idea was to have an area approach for targeted and focused banking.
- The banker's committee, headed by S. Nariman, concluded that districts would be the units for area approach and each district could be allotted to a particular bank which will perform the role of a Lead Bank.

The Lead Bank Scheme was not fully able to achieve its targets due to shift in policies, complexities in operations, lack of cooperation among various financial institutions and issues shifting to the Financial Inclusion.There was a strong need felt to revitalize the scheme with clear guidelines on respecting the bankers' commercial judgements even as they fulfil their sectoral targets. The Government of India constituted a High-Power Committee headed by Mrs. UshaThorat, Deputy Governor of the RBI, to suggest reforms in the LBS. The task of this penal was to recommend how to revitalize the LBS, given the challenges facing the banking sector, especially in an era of increasing privatization and autonomy.

What were the recommendation of Usha Thorat Committee on Lead Banks?

The following were the recommendation of Usha Thorat Committee on Lead Banks

- LBS should be continued to accelerate financial inclusion in the unbanked areas of the country.
- Private sector banks should be given a greater role in LBS action plans, particularly in areas of their presence.
- Enhance the business correspondent model, making banking services available in all villages having a population of above 2,000 and relaxation in KYC (know your customer) norms for small value accounts.
- There is a strong need to revamp and revitalise the Lead Bank Scheme so as to make it an effective instrument for bringing about meaningful coordination among banks operating in various parts of the country.

Banking Reforms

What was the process of banking sector development in India?

1921

In 1921, all presidency banks were amalgamated to form the Imperial Bank of India which was run by European Shareholders.

1935

After that the Reserve Bank of India was established in April 1935. At the time of first phase the growth of banking sector was very slow.

1948

Between 1913 and 1948 there were approximately 1100 small banks in India. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No.23 of 1965).
The Reserve Bank of India was vested with extensive powers for the supervision of banking in India as a Central Banking Authority.

1955

After Independence, in 1955, the Imperial Bank of India was nationalized (under State Bank of India Act – 1955) and was given the name - State Bank of India, to act as the principal agent of RBI and to handle banking transactions all over the country.

1960

Seven banks forming subsidiary of State Bank of India was nationalized in 1960

1969

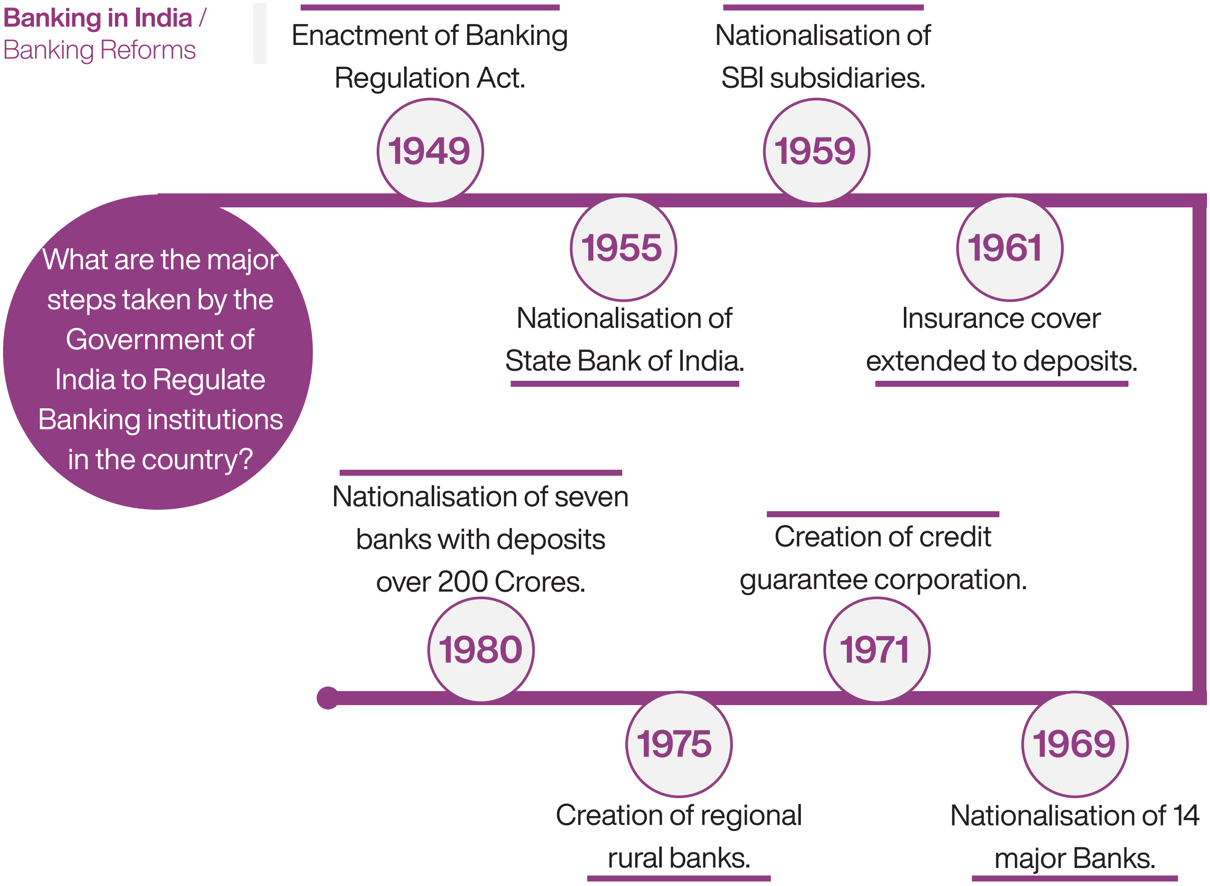
On 19th July, 1969, major process of nationalization was carried out. At the same time 14 major Indian commercial banks of the country were nationalized. In 1980, another six banks were nationalized, and thus raising the number of nationalized banks to 20.

1980

Seven more banks were nationalized with deposits over 200 Crores. Till the year 1980 approximately 80% of the banking segment in India was under government's ownership.

1993

On the suggestions of Narsimham Committee, the Banking Regulation Act was amended in 1993 and thus the gates for the new private sector banks were opened.



What was the motive behind nationalisation of banks?

- It was observed that certain sectors of the economy such as in agriculture, small-scale industries and weaker sections of the society were relatively ignored by the banking system of the country. For example, the agricultural sector only received 2.1% of the total credit as it stood in March 1967 compared to a huge 64% for the industry.
- It was though by Government of India that it should impose some control over banks with a view to preventing monopolistic trends, concentration of economic power and misuse of economic resources.
- National Credit Control Council was set up on December 22, 1967 to assess periodically the available resources of credit and to ensure its equitable and purposeful distribution among the several sectors.
- Such a mechanism didn't work out and eventually nationalisation was brought about through promulgation of an ordinance in 1969, which nationalised 14 leading commercial bank of the country. Some of them were the Punjab National Bank, IOB, Dena Bank, Syndicate Bank etc. In 1980 six more banks were nationalised.

What were the objectives behind nationalisation of banks?

- To mobilise savings of people to the maximum possible and to utilise them for productive purpose;
- To ensure that the banking operations are guided by a larger social purpose and are subject to close public regulations;
- To ensure that the legitimate credit ne eds of private sector industry and trade, big and small, are met;
- To ensure the needs of the productive sector and in particular, agriculture, small scale industry, self- employed professionals are met;
- To actively foster the growth of the new and progressive class of entrepreneurs and create fresh opportunities for hitherto neglected and backward areas in different parts of the country;
- To curb the use of bank credit for speculative and for other unproductive purposes.

Why was there a need of continuous reform?

- One of the sectors that has been subjected to reform as a part of the new economic policy since 1991 consistently is the banking sector.
- Commercial Banks and their weaknesses by 1991: The major factors that contributed to deteriorating bank performance 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.
- Lack of competition.

What problems did the reforms aim at solving?

- Floor and cap on SLR and CRR removed in 2006.
- Interest rates were deregulated to make banks respond dynamically to the market conditions. Even Scheduled Banks 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 up to 74% is permitted in private banks

Narisimhan Committee

Banking Sector reforms in India were conducted on the basis of Narasimham Committee reports I and II (1991 and 1998 respectively). This committee was appointed against the backdrop of the Balance of Payment Crisis. It was set up to analyse all factors related to financial system and give recommendations to improve its efficiency and productivity. This committee placed greater emphasis on structural measures and improvement in standards of disclosure and levels of transparency in order to align the Indian Banking Standards with International Best practices.

Again in 1998, the Finance Ministry of the GoI appointed a committee under the chairmanship of Mr. M Narasimham to review the progress of the implementation of the banking reforms since 1992 and further strengthening the financial institutions of India.

What were the recommendations by Narasimham Committee in 1991?	What were the recommendations by the committee in 1998?
▪ Creating a level playing field between the public sector, private sector and foreign sector banks. ▪ Selection of few banks like SBI for global operations. ▪ Reducing Statutory Liquidity Ratio (SLR) as that will leave more resources with banks for lending. ▪ Reducing Cash Reserve Ratio (CRR) to increase lendable resources of banks. ▪ Rationalizing and better targeting priority sector lending as sizeable portion of it is wasted and much of it is turning into non-performing assets. ▪ Introducing prudential norms for better risk management and transparency in operations. ▪ Deregulating 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.	▪ Need for stronger banking system by merging some banks which will have a multiplier effect on industry. ▪ Stricter norms for NPAs and the concept of narrow banking which allows the banks to place their funds only in the short term and risk free assets. ▪ Greater autonomy for the PSBs in order to make them function in accordance with their international counterparts. ▪ Government of India equity in nationalised banks be reduced to 33% for increased autonomy. ▪ Review of functions of banks boards with a view to make them responsible for enhancing shareholder value through formulation of corporate strategy and reduction of government equity. ▪ Increasing Capital Adequacy norms to improve the risk absorption capacity of banks. ▪ The committee targeted raising the capital adequacy ratio to 9% by 2000 and 10% by 2002. The Committee recommended penal provisions for banks that fail to meet these requirements.

Implementation of the recommendations by the committee

- In order to implement these (Narsimham Committee II) recommendations, The RBI in Oct 1998, initiated the second phase of Financial Sector Reforms raising capital adequacy ratio by 1% and tightened the prudential norms for provisioning and asset classification in a phased manner.
- It also targeted to bring the capital adequacy ratio to 9% by March 2001.
- In October 1999 criteria for autonomous status was identified by March 1999 and 17 banks were considered eligible for autonomy.

- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARAFESI Act 2002) was introduced to curb NPAs like problems.
- During the 2008 economic crisis, performance of Indian banking sector was far better than their international counterparts.
- This was credited to the successful implementation of the recommendations of the Narasimham Committee-II with particular reference to the capital adequacy norms and the recapitalisation of public sector banks.
- Impact of the two committees has been so significant that the financial-economic sector professionals have been applauding there positive contribution.

New Bank Licence Criteria

The Reserve Bank of India (RBI) granted two preliminary licences to set up new banks in a country where only one household in two has access to formal banking services.

The approval of licences for IDFC Ltd (IDFC.NS) and Bandhan Financial Services marks the start of a cautious experiment for a sector dominated by lethargic state lenders, many of which are reluctant to expand into rural areas or towns where banking penetration is low. No new Indian bank has been formed since Yes Bank (YESB.NS) in 2004.

What are the key features of the guidelines by RBI for issuing new bank license?

Eligible Promoters: Entities / groups in the private sector, entities in public sector and Non- Banking Financial Companies (NBFCs) shall be eligible to set up a bank through a wholly-owned Non-Operative Financial Holding Company (NOFHC).

'Fit and Proper' criteria: Entities / groups should have a past record of sound credentials and integrity, be financially sound with a successful track record of 10 years. For this purpose, RBI may seek feedback from other regulators and enforcement and investigative agencies.

Corporate structure of the NOFHC: The NOFHC shall be wholly owned by the Promoter.

Promoter Group: The NOFHC shall hold the bank as well as all the other financial services entities of the group.

Minimum voting equity capital requirements for banks and shareholding by NOFHC: The initial minimum paid-up voting equity capital for a bank shall be 5 billion. The NOFHC shall initially hold a minimum of 40 percent of the paid-up voting equity capital of the bank which shall be locked in for a period of five years and which shall be brought down to 15 per cent within 12 years. The bank shall get its shares listed on the stock exchanges within three years of the commencement of business by the bank.

Regulatory framework: The bank will be governed by the provisions of the relevant Acts, relevant Statutes and the Directives, Prudential regulations and other Guidelines/Instructions issued by RBI and other regulators. The NOFHC shall be registered as a non-banking finance company (NBFC) with the RBI and will be governed by a separate set of directions issued by RBI.

Foreign shareholding in the bank: The aggregate non-resident shareholding in the new bank shall not exceed 49% for the first 5 years after which it will be as per the extant policy.

Corporate governance of NOFHC: At least 50% of the Directors of the NOFHC should be independent directors. The corporate structure should not impede effective supervision of the bank and the NOFHC on a consolidated basis by RBI.

Prudential norms for the NOFHC: The prudential norms will be applied to NOFHC both on stand-alone as well as on a consolidated basis and the norms would be on similar lines as that of the bank.

Exposure norms: The NOFHC and the bank shall not have any exposure to the Promoter Group. The bank shall not invest in the equity / debt capital instruments of any financial entities held by the NOFHC.

Business Plan for the bank: The business plan should be realistic and viable and should address how the bank proposes to achieve financial inclusion.

Other conditions for the bank:

- The Board of the bank should have a majority of independent Directors.
- The bank shall open at least 25 percent of its branches in unbanked rural centres (population upto 9,999 as per the latest census).
- The bank shall comply with the priority sector lending targets and sub-targets as applicable to the existing domestic banks.
- Banks promoted by groups having 40 per cent or more assets/ income from non-financial business will require RBI's prior approval for raising paid-up voting equity capital beyond 10 billion for every block of 5 billion.
- Any non-compliance of terms and conditions will attract penal measures including cancellation of licence of the bank.

Additional conditions for NBFCs promoting / converting into a bank: Existing NBFCs, if considered eligible, may be permitted to promote a new bank or convert themselves into banks.

Other Recent Committees

NACHIKET MOR COMMITTEE

The Committee on Comprehensive Financial Services for Small Businesses and Low Income Households was set up by the RBI under the chairmanship of Nachiket Mor. In its final report, the Committee has outlined six vision statements for full financial inclusion and financial deepening in India.

What are the six vision statements outlined by the committee?

1

Universal Electronic Bank Account (UEBA):
Each Indian resident, above the age of eighteen years, would have an individual, full-service, safe, and secure electronic bank account.

2

Ubiquitous Access to Payment Services and Deposit Products at Reasonable Charges:
The Committee envisions that every resident in India would be within a fifteen minute walking distance of a payment access point.

3
Sufficient Access to Affordable Formal Credit:

Each low-income household and small-business would have access to a formally regulated lender that is capable of assessing and meeting their credit needs. Such a lender must also be able to offer them a full-range of suitable credit products at an affordable price.

4
Universal Access to a Range of Deposit and Investment Products at Reasonable Charges:

Each low-income household and small-business would have access to providers that can offer them suitable investment and deposit products. Such services must be available to them at reasonable charges.

5
Universal Access to a Range of Insurance and Risk Management Products at Reasonable Charges:

Each low-income household and small business would have access to providers that have the ability to offer them suitable insurance and risk management products. These products must at minimum allow them to manage risks related to:

a) commodity price movements;
b) longevity, disability, and death of human beings;
c) death of livestock;
d) rainfall; and
e) damage to property.

6
Right to Suitability:

Each low-income household and small-business would have a legally protected right to be offered only suitable financial services. She will have the right to seek legal redress if she feels that due process to establish Suitability was not followed or that there was gross negligence.

What are the key recommendations given by this committee?

- Providing a universal bank account to all Indians above the age of 18 years by January 1, 2016. To achieve this, a vertically differentiated banking system with payments banks for deposits and payments and wholesale banks for credit outreach. These banks need to have Rs.50 crore by way of capital, which is a tenth of what is applicable for new banks that are to be licensed.
- Aadhaar will be the prime driver towards rapid expansion in the number of bank accounts.
- Monitoring at the district level such as deposits and advances as a percentage of gross domestic product (GDP).
- Adjusted 50 per cent priority sector lending target with adjustments for sectors and regions based on difficulty in lending.

B. P. J. NAYAK COMMITTEE

It was constituted by the RBI for making recommendations regarding corporate governance in PSU banks.

What were the recommendations given by the Nayak committee?

- The scrapping of and removal of Bank Nationalisation Acts, SBI Act and SBI(Subsidiary Banks) Act.
- Conversion of PSBs into Companies as per the Companies Act.
- Formation of a Bank Investment Company/BIC under the Companies Act; transfer of shares by the central government in PSBs to the BIC.
- BIC in turn would have over the controlling power to boards of PSBs.
- Government will only control earning returns on investment.
- Fair return on investment to the Central government would be the responsibility of BIC.
- Appointments of CEOs, Inside Directors and top Executives of PSBs would be the responsibility of the Bank Boards Bureau constituting three serving or retired bank chairmans and the government would not be involved in this decision in any way.
- Nayak committee also recommends proportionate voting rights to all shareholders and reduction of governmental shareholding to 40%.

Basel Norms: Prudential Norms and Capital Adequacy

- Implementing the Narsimham Committee recommendations, RBI prescribed that banks should make 100 percent provision for all loss assets or non-performing assets (NPAs) over a period of 2 years, as prudential norms.
- Capital Adequacy Norms required the banks to achieve a capital to risk weighted asset ratio of 8 percent. A bank's real capital is assessed after taking into account the riskiness of its assets. Providing a cushion for the riskiness of the asset is necessary to guarantee against insolvency.

- The international norm for Capital Adequacy Ratio was set by the Basel Committee on Banking Supervision under the aegis of the Bank of International Settlements (BIS) Basle, Switzerland, after the failure of the German Bank Herstatt in 1974.
- It is a committee of Bank Supervisors consisting of members from each of the G10 countries. The committee is a forum for discussion of the handling of specific supervisory problems.
- It came up with the first set of recommendations which are called Basel I. These included a minimum capital adequacy of 8 percent of the total risk weighted assets of a bank.
- Many Indian Banks had to go in for public issues to satisfy capital adequacy norms. It was later realised that Basel I norms addressed only financial risk.

- Accordingly, a revised set of norms called Basel II was brought out in June 2004. These are more complex norms and are based on the three pillars of Capital Requirement, Supervisory Review and Market Discipline.
- Despite Basel II norms, the financial market crisis of 2008 revealed the need for further stringency.

- Basel III was proposed in Dec 2010 in order to improve the banking sector's ability to absorb shocks arising from financial and economic stress.
- RBI has issued instructions for the adoption of Basel III norms from Jan 2013 in a phased manner to be completed by March 31, 2018.
- This will require fresh infusion of capital for which dilution of PSU bank capital has been decided without diluting govt. Control.

Money

Money plays a very essential part in our day to day life. Money is anything that is generally acceptable as a means of exchange and which at the same time acts as a measure and store of value. It is also something that is widely accepted as a medium of exchange which is guaranteed by the government of the country.

What are the functions of money?

Money is a matter of four functions: A medium, a measure, a standard and a store. The first two are called primary functions of money, while the other two are called secondary functions or derived functions since it is derived from the primary function.

Primary Functions

Medium of Exchange:

Since money has general acceptability, it acts as a medium of exchange. It facilitates our daily transactions. On payment of money, purchase of various goods and services can be made.

Measure of value:

Money is used to measure units in economy. We measure the value of goods and services in terms of money, just as we measure weight in terms of kilos or distance in terms of meters. It helps us determine the rates of exchange between various goods and services.

Secondary Functions

Store of Value:

Money acts as a store of value. Since it comes with no expiry date, and it is comparatively stable in value, the value of other assets can be stored in the form of money. Moreover, money functions as a repository of purchasing power over time. This function of money is useful, because most of us do not want to spend our income immediately upon receiving it, but rather prefer to wait until we have the time or the desire to shop.

Standard or Deferred Payment:

Money facilitates not only the current transactions of goods and services but also their credit transactions. It facilitates credit transactions when present goods are exchanged against future payments. In the modem world, the bulk of deferred payments are stipulated in money terms only.

Transfer of value:

It involves the transferring of value of any asset to another or to any institution or to any place by transferring money. This transfer can take place irrespective of places, time and circumstances. Transfer of purchasing power, which is necessary in commerce and other transaction, has become available because of money.

Classification of Money

Actual Money

Money which actually circulates in the economy in terms of which all payments are made and general purchasing power is held as a medium of exchange. In Pakistan, notes and coins of all denominations are actual money.

Money of Account

In terms of which prices are expressed and accounts are maintained. Normally, actual money and money of account are the same but sometimes they are different. For example: Paisa is a money of account in Pakistan but it is not actual money. Now a day, it is no longer in circulation.

Metallic Money

It's made of metal such as gold and silver. Coins of all denominations circulating in economy are examples of metallic money.

Paper Money

Money made of paper is called paper money. It includes different denomination.

Legal Tender Money

Money which has a legal approval behind it and people are bound by law to accept it in all payments. Nobody can refuse to accept it.

Optional Money

That form of money which is used as a medium of exchange but it has no legal force behind it. It includes credit instruments like cheques, bills or exchange and CDRs etc. which are generally acceptable in payments.

Hot Money

Money that moves regularly and quickly between financial markets so that investors could ensure they are getting the highest short-term interest rates available. Hot money continuously shifts from countries with low interest rates to those with higher interest rates affecting the exchange rate (if there is a high sum) and also has the potential to impact a country's balance of payments.

Commodity Money

Its value is derived from the commodity out of which it is made. The commodity itself represents money, and the money is a commodity. For instance, commodities that have been used as a medium of exchange include gold, silver, copper, salt, peppercorns, rice, large stones etc.

Commercial Bank Money

These are the demand deposits, which are to be claimed against financial institutions which can be used for purchasing goods and services.

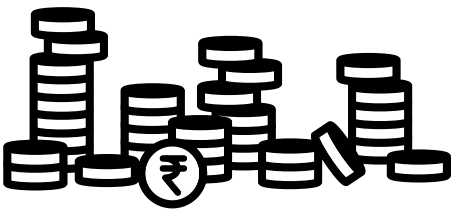
What are the two ways in which metallic money can be classified?

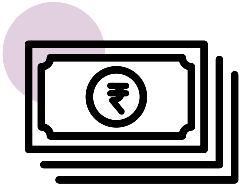
Full bodied money

If the face value of money is equal to its value as a commodity, it is called full bodied money. If a gold coin of face value Rs. 100/- contains gold worth of Rs. 100/- it will be called full bodied money or sometimes standard money.

Token Money

If the face value of money is more than its value as commodity or intrinsic value it is known as token money.





What are the ways in which paper money can be classified?

Representative Paper Money

If paper is issued by keeping hundred percent gold reserve of full bodied coins or gold bullion, it will be called representative money.

Convertible Paper Money

If paper money can be converted into gold coins or gold bullion on demand it is referred to as convertible money. This type of money is issued by keeping metallic reserve of equal amount behind it.

Fiat or In-convertible Paper Money

It cannot be converted into full bodied coins or gold bullion on demand. It is usually issued without keeping metallic reserve behind it.

What are the two ways in which legal tender money can be classified?

Limited Legal Tender

Which can be given in payments only upto a certain limit. The payee can refuse to accept it beyond that limit. In many Asians countries 25 paisa coins and coins of low denominations are limited legal tender. These coins can be given as payments up to 50 rupees only.

Unlimited Legal Tender

Unlimited legal tender means that money which can be given in payments up to any limit.

POSITION OF INDIAN RUPEE

The Indian Rupee is a mixture of the standard money and the token money. Like standard money, it is unlimited legal tender, and like the token money, its face value is greater than is intrinsic value. The Indian rupee is said to be a note printed on silver (now Nickel).

02

National Income

Introduction

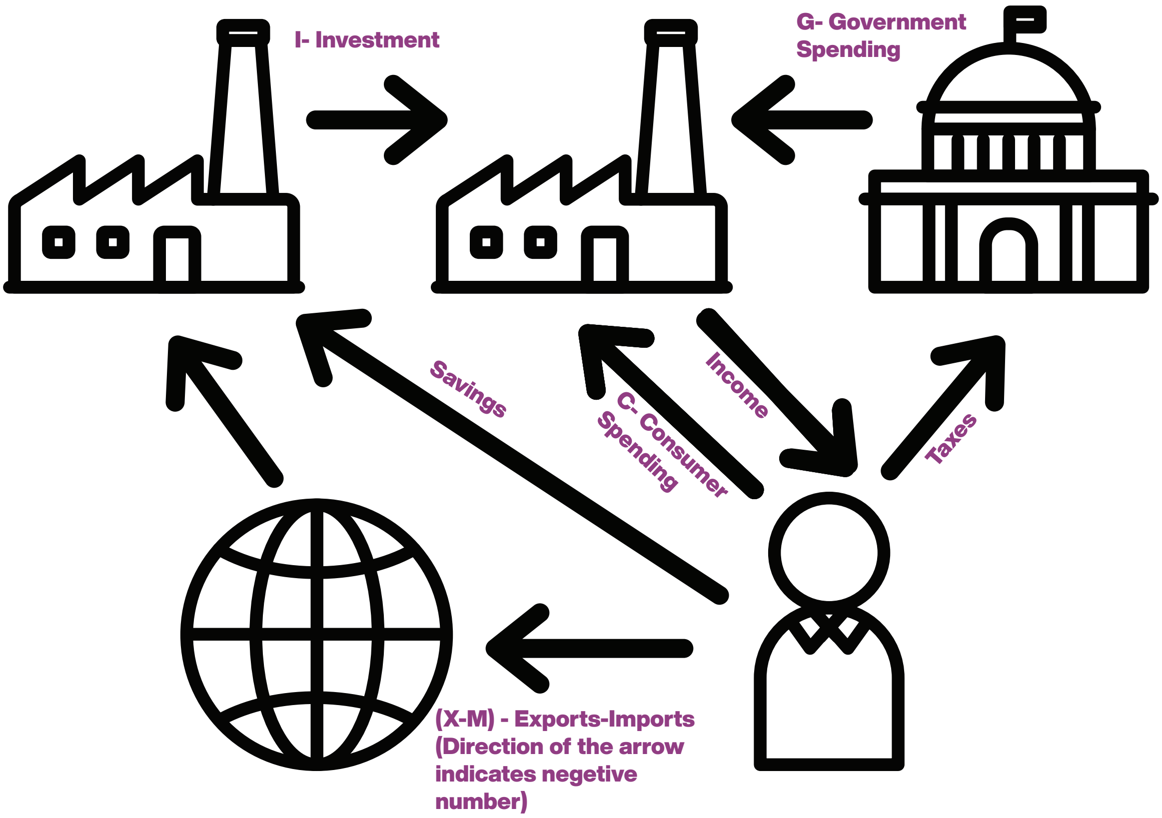
National Income Accounting is a macroeconomic concept. It assesses the level of economic activity which is crucial for any economy since it determines the number of goods and services produced in the country in a particular year. A country's level of production is a measure which determines the health and strength of the economy. National Income gives us an insight of the country's economic activity. These aggregates give a clear outlook of a country's fiscal health.

The concept of National Income is very similar to the concept of household budget. You must be familiar that in every household, there are three components namely sources of income, expenses incurred and total savings. These estimates guide the households to form a budget and take financial decisions. Similarly, national income estimates provide a clear picture of the expenses that the government can undertake given the revenue received in that particular year.

In this article, you should understand the different ways in which National Income is calculated, the scope of the terms GDP, GNP, NNP, NDP, their difference and their usage at both factor cost and market prices.

What is National Income?

National Income of a country is the total market value of all final goods and services produced in a fiscal year. It is the net output of all economic activities of a country during a given financial year and is valued in terms of money. Measuring National Income is not as easy as measuring household income. To measure it accurately, there should be no over counting. All goods and services produced in any given year must be counted only once. To avoid double counting, the estimates consider only the market value of final goods and services. It does not include the transactions involving intermediate goods.



National Income = C + I + G + (X - M)
Where, C = Total Consumption Expenditure
I = Total Investment Expenditure
G = Total Government Expenditure
X - M = Export - Import

National Income Accounting

National Income Accounting is a method or technique used to measure the economic activity of a country as a whole.

What is NIA is mainly done for?

Policy Formulation:

It helps in comparing the estimates of the past from the future and also forecast the growth rates in future. For example, if a country has a GDP of Rs. 103 Lakh which is 3 Lakh rupees higher than last year with a growth rate of 3 percent.

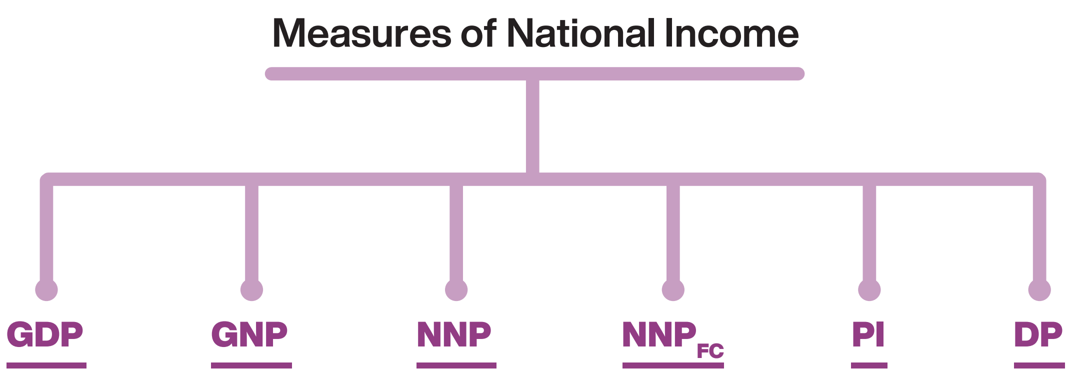
Effective Decision Making:

To estimate the contribution of each of the sectors of the economy. It helps the business to plan for production.

International Economic Comparison:

It helps in comparing the level of development of countries and provides useful insight into how well an economy is functioning, and where the money is being generated and spent. One can compare the standard of living of different nations and its growth rate.

What are the various terms associated with measuring of National Income?



GDP (GROSS DOMESTIC PRODUCT)

Here the catch word is Domestic which refers to Geographical Area.

> The total value of all final goods and services produced within the boundary of the country during a given period of time (generally one year) is called as GDP.

In this case, the final produce of resident citizens as well as foreign nationals who reside within that geographical boundary is considered.

GDP=Q-P

Q = total quantity of final goods and services produced in the country (both by Indians and foreigners residing within Indian borders)
P = final price of goods and services

Types of GDP: Real GDP and Nominal GDP

Real GDP:

Refers to the current year production of goods and services valued at base year prices. Such base year prices are Constant Prices.

Nominal GDP:

Refers to current year production of final goods and services valued at current year prices.

Which one is a better measure?

Real GDP is a better measure to calculate the GDP because in a particular year GDP may be inflated because of high rates of inflation in the economy.

Real GDP therefore allows us to determine if production increased or decreased, regardless of changes in the inflation and purchasing power of the currency.

Concept of Base Year:
It is the year used as the beginning or reference year for constructing an index, and which is usually assigned an arbitrary value of 100.

The base year is also known as Rebasing as by every 10 years there is change which will be minimum 4% rise in price of items which requires changing the base year.

Economists use a price index to find the real GNP/GDP to make the calculation of GNP/GDP easier. A Price index is a number showing the changes in the overall level of prices. It shows a change in general price level of an economy.

Recently the Indian Government changed the base year for calculating the GDP to 2011-12 from 2004-2005. Base Year selection is made on the basis of:

- **Stability** of macroeconomic parameters. It has to be a normal year without large fluctuations in production, trade and prices of goods and services.
- **Data availability:** Data available for the year should be reliable.
- **Comparability:** So that same parameters should be in use both the years. Therefore it should be a recent year and not go long back into history

GROSS NATIONAL PRODUCT (GNP)

Here the catch word is National which refers to all the citizens of a country.

> GNP is the total value of the total production or final goods and services produced by the nationals of a country during a given period of time (generally one year).

In this case, the income of all the resident and non-resident citizens (who resides abroad) of a country is included whereas, the income of foreigners who reside within India is excluded.

The GNP constitutes of the income earned by Indian Nationals (both in Indian Territory and Abroad) only.

GNP=GDP+(X-M)

X = Export

M = Import

X-M is called the Net Factor Income from Abroad (NFIA)

So, **GNP=GDP+ Net Factor Income from Abroad**

Market Price v/s Factor Cost

GDP and GNP are measured on the basis of Market Price and Factor Cost.

Market Price	Factor Cost
It refers to the actual transacted price which includes indirect taxes such as customs duty, excise duty, sales tax, service tax etc. (impending Goods and Services Tax). These taxes tend to raise the prices of the goods in an economy.	It is the cost of factors of production i.e. rent for land interest for capital, wages for labour and profit for entrepreneurship. This is equal to revenue price of the final goods and services sold by the producers.

Revenue Price (or Factor Cost) = Market Price – Net Indirect Taxes

Net Indirect Taxes = Indirect Taxes – Subsidies

Hence, Factor Cost = Market Price – Indirect Taxes + Subsidies

Concept of Depreciation

You must have come across the phrase " Buying a depreciating asset is a poor investment decision." Depreciation is fall in the value of goods over a period of time. Car, household furniture or electronics are examples of depreciating assets because their monetary value reduces over time. The resale value of a mobile phone, furniture or a car is less than the price at which it was bought by the consumer. The amount by which the value of the good is reduced is called the cost of depreciation.

In the process of production some capital such as equipment, machines get worn out over a period of time which leads to gradual decrease in its economic value. This is called capital depreciation.

Net National Product (NNP): NNP = GNP – Depreciation

- It is calculated by subtracting Depreciation from Gross National Product.
- Depreciation – Wear and Tear of goods produced.
- This deduction is done because a part of current produce goes to replace the depreciated parts of the products already produced. This part does not add value to current year's total produce. It is used to keep the products already produced intact and hence it is deducted.

Net Domestic Product (NDP): NDP = GDP – Depreciation

- It is the calculated GDP after adjusting the value of depreciation. This is basically, Net form of GDP, i.e. GDP – total value of wear and tear.
- NDP of an economy is always lower than its GDP, since their depreciation can never be reduced to zero. The concept of NDP and NNP are not used to compare different economies because the method of calculating depreciation varies from country to country.

National Income at Factor Cost (NIFC)

It is the sum of all factors of income earned by the residents of a country (Indian) both from within the country as well as abroad.

National Income at Factor Cost = NNP at Market Price – Indirect Taxes + Subsidies

In India, and many developing countries across the world, National Income is measured at factor cost instead of market prices.

Transfer Payments

A payment made by the government to individuals for whom there is no economic activity is produced in return. For example: Old Age Pensions, Scholarship etc.

Personal Income

- It refers to all of the income collectively received by all of the individuals or households in a country.
- It includes compensation from a number of sources including salaries, wages and bonuses received from employment or self employment; dividends and distributions received from investments; rental receipt from real estate investments and

profit sharing from businesses.

- In National Income Accounting, some income is attributed to individuals, which they do not actually receive. For Example: Undistributed Profits, Employees contribution for social security, corporate income taxes etc. which needs to be deducted from National Income to estimate the Personal Income.
- PI = NI + Transfer Payments – Corporate Retained Earnings, Income Taxes, Social Security Taxes.

Disposable Personal Income

- It is the amount left with the individuals after paying Personal Taxes such as Income Tax, Property Tax, and Professional Tax etc. to spend as they like.
- DPI = PI – Taxes (Income Tax i.e. Personal Taxes)
- DPI results into Savings and Expenditure i.e. (Spend and Save). This concept is very useful for studying and understanding the consumption and saving behaviour of the individuals.

Factors Affecting National Income

Several factors affect the national income of a country. Some of them have been listed below:

FACTORS OF PRODUCTION:

Normally, the more efficient and richer the resources, higher will be the level of National Income or GNP

Land:

Resources like coal, iron and timber are essential for heavy industries so that they must be available and accessible. In other words, the geographical location of these natural resources affects the level of GNP.

Capital:

Capital is generally determined by investment. Investment in turn depends on other factors like profitability, political stability etc.

Entrepreneur:

Labour:
The quality or productivity of human resources is more important than quantity. Manpower planning and education affect the productivity and production capacity of an economy.

Government:
Government can help to provide a favourable business environment for investment. It provides law and order, regulations.

Technology:
This factor is more important for Nations with fewer natural resources. The development in technology is affected by the level of invention and innovation in production.

Political Stability:
A stable economy and political system helps in appropriate allocation of resources. Wars, strikes and social unrests will discourage investment and business activities.

Methods of National Income Calculation

There are three approaches and methods of measuring National Income:

1 Income Method

By this National Income is calculated compiling income of factors of production viz., land, labour, capital and entrepreneur.

National Income = Total Wage + Total Rent + Total Interest + Total Profit

In Indian context, since 1993 as per the System of National Accounts (SNA), National Income is the total of the following:

GDP = Compensation of Employees + Consumption of Fixed Capital + (Other Taxes on Production – Subsidies of Production) + Gross Operating Surplus

- **Compensation of employees**: (Wage) salaries paid in cash and kind and other benefits provided to employees.
- **Consumption of Fixed Capital:** wear and tear of machinery which are replaced by new parts.
- **Other Taxes on Production minus Subsidies:** Net taxes on production.
- There is a difference between tax on products and tax on production. Taxes on products include taxes like sales tax and excise duty. Tax on production is tax imposed irrespective of production like license fees and land tax.
- **Gross Operating Surplus:** balance of value added after deducting the above three components. It goes to pay rent of land and interest of capital.

2 Product Method (or Value Added Method, Output Method)

- It is used by economists to calculate GDP at market prices, which are the total values of outputs produced at different stages of production.
- In order to avoid double counting, only the value of the final goods and services are considered.
- The monetary value of the intermediary goods are not taken into account.

Gross Value Added = Output of Final Goods and Services – Intermediate Consumption.

National Income = Gross Value Added + Indirect Taxes – Subsidies

What are the goods and services included in production?

- Goods and services actually sold in the market.
- Goods and services not sold but supplied free of cost. (No Charge/Complementary).

What are the goods and services not included in production?

- Second hand items and purchase and sale of the same. Sale and purchase of second cars, for example, are not a part of GDP calculation as no new production takes place in the economy.
- Production due to unwarranted/ illegal activities.
- Non-economic goods or natural goods such as air and water.
- Transfer Payments such as scholarships, pensions etc. are excluded as there is income received, but no good or service is produced in return.
- Imputed rental for owner-occupied housing is also excluded.
- Here the Gross Value of final goods and services produced in a country in certain year is calculated.
- GDP is a concept of value added; it is the sum of gross value added of all resident producer units (institutional sectors, or industries) plus that part of taxes (total) less subsidies, on products which is not included in the valuation of output.

3 Expenditure Method

- It measures all spending on currently-produced final goods and services only in an economy.
- In an economy, there are three main agencies which buy goods and services: Households, Firms and the Government.

What are the four major components of final expenditure?

Consumption (C)

Personal Consumption made by households, the payment of which is paid by households directly to the firms which produced the goods and services desired by the households.

Investment Expenditure (I)

Investment is an addition to capital stock of an economy in a given time period. This includes investments by firms as well as governments sectors.

Government Expenditure (G)

This category includes the value of goods and service purchased by Government. Government expenditure on pension schemes, scholarships, unemployment allowances etc. are not included in this as all of them come under transfer payments.

Net Exports (X-IM)

Expenditures on foreign made products (Imports) are expenditure that escapes the system, and must be subtracted from total expenditures. In turn, goods produced by domestic firms which are demanded by foreign economies involve expenditure by other economies on our production (Exports), and are included in total expenditure. The combination of the two gives us Net Exports.

National Income = Consumption (C) + Investment Expenditure (I) + Government Expenditure (G) + Net Exports (X-IM)

Calculating GDP (National Income) is extremely important as the performance of the economy is fixed by means of this method. The results would help the country to forecast the economic progress, determine the demand and supply, understand the buying power of the people, the per capita income, the position of the economy in the global arena. The Indian GDP is calculated by the expenditure method.

New Methodology for Calculation of GDP in India

Earlier domestic GDP was calculated at factor or basic cost, which took into account pieces of products received by producers.

The new formula takes into account market prices paid by consumers. It is calculated by adding GDP at factor price and indirect taxes (minus subsidies). It is in line with international practice and is expect4ed to better capture the changing structure of the Indian economy.

The government has also changed the base year for estimating the GDP from 2004-05 to 2011-12. This has been done to incorporate the changing structure of the economy, especially rural India.

Data for the new GDP series will now be collected from 5 lakh companies (against 2500 companies earlier. Under-represented and informal sectors as well as items such as smartphones and LED television sets will now be taken into account to calculate the gross domestic product.

The revision in GDP does not alter the size of India's economy ($1.8 trillion) nor will it alter key ratios such as fiscal deficit, CAD etc., (as percentage of GDP) for 2013-14.

The GDP at the aggregate and sector level has significantly changed. The average share of the industrial sector has moved up by 5.6 percentage points from 26.1 per cent in the old series to 31.7 per cent under the new series, for 2011-12 to 2013-14.

03

Fiscal Policy & Taxation

Introduction

Fiscal policy deals with government policy concerning changes in the taxation and expenditure overheads and components, while Monetary policy, deals with the changes in the factors and instruments that affect the supply of money in the economy and the rate of interest. These are routinely used by governments world over in various policy mix or combinations to have desired effects and to steer the broader aspects of the economy. In case of India as with most other economies, the government of India deals with fiscal policy (through Annual Budget and other timely interventions), while there is the central bank (Reserve bank of India), that is responsible for executing the monetary policy.

Fiscal policy is the result of several component policies or mix of policy instruments. These include, policy on taxation, subsidy, welfare expenditure, etc; investment or disinvestment strategies; and debt or surplus management. Fiscal policy is an important constituent of the overall economic framework of a country and is therefore intimately linked with its general economic policy strategy.

Fiscal Policy

What are the different types of fiscal policy?

Neutral Fiscal Policy:

This implies a balanced budget where (Government spending = Tax revenue). It further means that government spending is fully funded by tax revenue and overall the budget outcome has a neutral effect on the level of economic activity.

Contractionary (restrictive) Fiscal policy:

This policy involves raising taxes or cutting government spending, so that (Government spending < Tax revenue) it cuts up on the aggregate demand (thus, economic growth)and to reduce the inflationary pressures persisting in the economy.

Expansionary Fiscal Policy:

It is generally used for giving stimulus to the economy ,i.e., to speed up the rate of GDP growth or during a recession when growth in national income is not sufficient enough to maintain the present standards of living. A tax cut and/or an increase in government spending would be implemented to stimulate economic growth and lower unemployment rates. This is not a sustainable policy, as it leads to budget deficits and thus, should be used with caution.

What are the different types of fiscal policy combinations?

Reduction in Government Spending and no Change in Tax Rates (Contractionary fiscal policy):

This policy is useful in moderate inflation, which though is part of government's priority, is not the foremost objective. This would affect the growth little and sometimes even boost growth due to cut in inflation.

Reduction in Government Spending and Increase in Tax Rates (Contractionary fiscal policy):

This policy is useful in high inflation, when curbing inflation is the foremost objective, even above the economic growth in the short run.

Rigid Government Spending and Increasing Tax Rates (Contractionary fiscal policy):

This is used when the economy is overheated (When a prolonged period of good economic growth and activity causes high levels of inflation as producers overproduce and create excess production capacity in an attempt to capitalise on the high levels of wealth) due to too much excitement on the part of investors. Increase in taxes and interest rates (through monetary policy) would curb the investments in short-run and prevent the economy from going further into recession after overheating.

Reduction in Government Spending and an Equivalent Reduction in Taxes (Balanced Fiscal Policy):

This, is a balanced budget approach, when a government decides to reduce its size and level of its intervention in the economy, then this policy can be adopted. It simply means government is managing less money and hence less impact on markets and business.

Increase in government spending and tax rates (Balanced fiscal policy):

This would be opposite to the previous policy as it would increase the size of government. A government on the path of socialization would adopt such a policy.

Increase in government spending and decrease in tax rates (Expansionary fiscal policy):

This would be adopted to give economy a stimulus though injection of funds, first the government decreases taxes and leaves more income with people to spend and invest, then it also spends more to give further boost to demand through additional income generated through government work. This is only possible in short-run as this policy leads to massive deficits and thus, should be used when the situation is alarming.

Increase in government spending and no change in tax rates (Expansionary fiscal policy):

This is also a stimulus policy (through the public sector), but a more moderate one, which can be used for a bit longer compared to previous.

Rigid Government spending and decrease in tax rates (Expansionary fiscal policy):

This policy is usually adopted to give incentive to private sector to invest and boost growth. Again, a short-run stimulus policy like previous two.

What constitutes the government's expenditure?

Maintenance (including staff salaries):

This component can't be altered in short-run and hence is hardly a part of policy making, however, in the long-run, through VRS and reducing new jobs in the public sector or vice versa, this expenditure can be altered.

Loan payments:

This again is a component, which can't be touched in short-run, however, governments in the long-run can reduce these payments or eliminate them by running the budget surplus.

Subsidies:

This component is a major part of policy as it can be altered in short-run, but unfortunately, subsidies as policy instrument, have been abused in India. These are used by politicians as poll promise and political instruments to gain more popular support. Ideally only meritorious subsidies shall be in operation and all the wasteful subsidies must be phased out, for example, fertiliser subsidy and power subsidy benefits the large farm holder and capitalist farmers instead of the needy ones. Similarly, the recent example of Aam Aadmi Party manifesto is a good example, how subsidies should not be used. In place of these, subsidies for health programs, renewable energy, public transport shall be encouraged to ensure good health and sustainable growth.

Welfare schemes:

These are one of the policy options that once introduced can't be removed due to their populist nature. Similarly, in most of the cases these are necessary too, and important instrument of social welfare and economic growth. However, it is the implementation part, which is key, as these schemes generally suffer from poor implementation and massive corruption and loopholes. Thus, despite being meritorious expenditure in nature, these at time appears as waste.

Wasteful expenses:

Needless to say these are the expenditures that must be curbed with immediate effect; however, no government in world has neither shown the intention to curb them, though there are efforts to reduce them from time to time under public pressure. For example, full page government advertisements in newspapers to generate favourable public opinion.

What are the ways in which the government earns?

Tax: single:

Single most important source on the government revenue is also a very important policy measure as elaborated in the policy combinations above.

Borrowing:

Borrowing is a necessary source of funds, though not a desirable one. Particularly, in developing countries, as tax/GDP ratio is low due to less per capita income. However, it becomes an important part of monetary policy as well due to its impact on interest rates and credit creation and thus, overall money supply.

Proceeds from sale/lease of assets:

This is a both a one-time and regular source of income. For example, lending government buildings for private use, or other assets such as telecom spectrum or lease of a mine block for certain years, is a regular source of income, whereas sale of PSUs is a one time income. These however, are good sources of revenue, as they provide government more room to spend without increasing taxes.

Profits from PSU:

Profits from PSUs can also be a potential source of revenue, however, since most of PSUs are generating losses, Indian government usually ends up subsidising them. At times PSUs are deliberately kept in losses to keep prices low and ensure wider outreach for social welfare, for example, PSU banks in pre-reform era and post-offices. Similarly, at other times, they are in losses due to inefficiency and wasteful expenditure. Most striking case in India, is of ministerial corruption to keep PSUs in loss deliberately to benefit private sector, for example, CAG report says that, Indian Airlines was deliberately kept in losses by avoiding flights on profitable routes to benefit private airlines during UPA government's rule. Similarly, in previous NDA government, BSNL was deliberately pushed into loss, by increasing tariffs to provide competitive edge to a newly launched company by one of the biggest business conglomerates in India.

Fiscal Policy – Revenue Side

- The government fiscal policy is used to stabilize the level of output and employment through changes in its expenditure and taxes. The government attempts to increase output and income and seeks to stabilize the ups and downs in the economy.
- In the process, fiscal policy creates a surplus (when total receipts exceed expenditure) or a deficit budget (when total expenditure exceeds receipts) rather than a balanced budget (when expenditure equals receipts).
- Fiscal policy deals with the revenue and expenditure decisions of the government.
- As far as fiscal resources are concerned, taxes, user charges (power, water, transport charges etc); disinvestment proceeds; borrowings from internal and external sources are the main channels.
- 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 and Development of sound social and physical infrastructure etc.

Revenue and Its Classification

TAX REVENUES

India has a well-developed tax structure with clearly demarcated authority between Central and State Governments and local bodies.

What are the taxes central government levies taxes on?

Income Tax
(except tax on agricultural income, which the State Governments can levy) – Tax on income of a person

Customs Duties
Duties on import and export of goods.

Central Excise
Taxes on Manufacturing of dutiable goods.

Service Tax
Taxes on provision of services.

Corporate Tax
State Governments levies taxes on firms and corporations.

Value Added Tax (VAT)

This is tax on sale of goods. While intra-state sale of goods are covered by the VAT Law of that state, inter-state sale of goods is covered by the Central Sales Tax Act. Even the revenue collected under Central Sales Tax Act is done so by the State Governments themselves and actually the Central Government has no role to play in this.

Stamp duty

Since land is a matter on which only State Governments can govern, thus the Stamp duties on transfer of immovable properties are levied by State Governments.

Profession tax

Local bodies are empowered to levy tax on Properties, Octroi and for utilities like water supply, drainage etc.

Indian taxation system has undergone tremendous reforms during the last decade. The tax rates have been rationalised and tax laws have been simplified resulting in better compliance, ease of tax payment and better enforcement. The process of rationalisation of tax administration is still ongoing in India.

There are different types of taxes which is levied by the government. The following terms will make the classification of taxes easier for the students.

Direct Taxes

- In case of direct taxes (income tax, wealth tax, etc.), the burden directly falls on the taxpayer.
- Under the Income Tax Act, 1961, the Central Government levies direct taxes on the income of individuals and business entities as well as Non business entities also.
- The taxation level depends on the residential status of individuals.
- The thumb rule of residential status is that an individual becomes resident in India if he has remained in India for more than 182 days in a particular residential year.
- If he becomes resident in India, then his global income i.e.the income earned outside India is taxable in India.

Personal income tax

Personal income tax is levied by the Central Government and is administered by the Central Board of Direct taxes under Ministry of Finance in accordance with the provisions of the Income Tax Act.

How can income tax be categorised?
Income Tax can be categorised as Regressive, Proportional, or Progressive Taxation. Taxes can also be categorised as either regressive, proportional, or progressive, and the distinction has to do with the behaviour of the tax as the taxable base (such as a household's income or a business profit) changes.

Progressive tax

A tax that takes a larger percentage of income from high-income groups than from low-income groups.

Proportional tax

A tax that takes the same percentage of income from all income groups.

Regressive tax

A tax that takes a larger percentage of income from low-income groups than from high-income groups.

Corporate taxes

The taxability of a company's income depends on its domicile. Indian companies are taxable in India on their worldwide income. Foreign companies are taxable on income that arises out of their Indian operations, or, in certain cases, income that is deemed to arise in India. Royalty, interest, gains from sales of capital assets located in India (including gains from sale of shares in an Indian company), dividends from Indian companies and fees for technical services are all treated as income arising in India.

Minimum Alternate 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 had book profits as per their profit and loss account but were not paying any tax because income computed as per provisions of the income tax act was either nil or negative or insignificant.In such case, although the companies were showing book profits and declaring dividends to the shareholders, they were not paying any income tax. These companies are popularly known as Zero Tax companies. In order to bring such companies under the income tax act net, section 115JA was introduced in the year 1997-98.

Fringe Benefit Tax (FBT)

The Finance Act, 2005 introduced a new levy, namely Fringe Benefit Tax (FBT) contained in Chapter XIIH of the Income Tax Act, 1961.

Fringe Benefit Tax (FBT) is an additional income tax payable by the employers on the value of fringe benefits provided or deemed to have been provided to the employees. The FBT is payable by an employer who is a company; a firm; an association of persons excluding trusts/a body of individuals; a local authority; a sole trader, or an artificial juridical person. This tax is payable even where employer does not otherwise have taxable income. Fringe Benefits are defined as any privilege, service, facility or amenities directly or indirectly provided by an employer to his employees (including former employees) by reason of their employment and includes expenses or payments on certain specified heads.

Dividend Distribution Tax (DDT)

Under the Income Tax Act, any amount declared, distributed or paid by a domestic company by way of dividend shall be chargeable to dividend tax. Only a domestic company (not a foreign company) is liable for the tax.

Tax on distributed profit is in addition to income tax chargeable in respect of total income. It is applicable whether the dividend is interim or otherwise. Also, it is applicable whether such dividend is paid out of current profits or accumulated profits.

Wealth Tax

Wealth tax, in India, is levied under Wealth-tax Act, 1957. Wealth tax is a tax on the benefits derived from property ownership. The tax is to be paid year after year on the same property on its market value, whether or not such property yields any income.

Under the Act, the tax is charged in respect of the wealth held during the assessment year by the following persons: Individual, Hindu Undivided Family(HUF), Company.

Indirect Taxes

In India, indirect taxes is a vast ocean as there are a number of taxes to be paid on manufacture, import, sale and even purchase in certain cases. Further the law is governed less by the Acts and more by day to day notifications, circulars and orders by the Governing bodies. So an explicit understanding is very much essential.

Indirect taxes is based on the nature of Activity as follows: – Provision of services, Manufacture of Excisable Goods, Import of Goods and Sale of Goods.

Central Sales Tax(CST)

It is generally payable on the sale of all goods by a dealer in the course of inter-state trade or commerce or, outside a state or, in the course of import into or export from India.

Value Added Tax (VAT)

It is a multi-stage tax on goods that is levied across various stages of production and supply with credit given for tax paid at each stage of Value addition. Introduction of state level VAT is the most significant tax reform measure at state level.

The state level VAT has replaced the existing State Sales Tax. The decision to implement State level VAT was taken in the meeting of the Empowered Committee (EC) of State Finance Ministers held on June 18, 2004, where a broad consensus was arrived at to introduce VAT from April 1, 2005. Accordingly, all states/UT's have implemented VAT.

Excise Duty

Central Excise duty is an indirect tax levied on goods manufactured in India. Excisable goods have been defined as those, which have been specified in the Central Excise Tariff Act as being subjected to the duty of excise.

Customs Duty

Custom or import duties are levied by the Central Government of India on the goods imported into India. The rate at which customs duty is leviable on the goods depends on the classification of the goods determined under the Customs Tariff. The Customs Tariff is generally aligned with the Harmonised System of Nomenclature (HSL).

Service Tax

Service tax was introduced in India way back in 1994 and started with mere 3 basic services viz. general insurance, stock broking and telephone. Today the counter services subject to tax have reached over 100. There has been a steady increase in the rate of service tax. From a mere 5 per cent, service tax is now levied on specified taxable services at the rate of 12 percent of the gross value of taxable services. However, on account of the imposition of education cess of 3 per cent, the effective rate of service tax had reached upto 12.36 percent.

Goods and Services Tax (GST)

> GST is one indirect tax for the whole nation, which will make India one unified common market.

The GST intends to subsume most indirect taxes under a single taxation regime. GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages. This is expected to help broaden the tax base, increase tax compliance, and reduce economic distortions caused by inter-state variations in taxes.

Why GST has been proposed?

- Our Constitution empowers the Central Government to levy excise duty on manufacturing and service tax on the supply of services. Further, it empowers the State Governments to levy sales tax or value added tax (VAT) on the sale of goods. This exclusive division of fiscal powers has led to a multiplicity of indirect taxes in the country. In addition, central sales tax (CST) is levied on inter- State sale of goods by the Central Government, but collected and retained by the exporting States. Further, many States levy an entry tax on the entry of goods in local areas.
- This multiplicity of taxes at the State and Central levels has resulted in a complex indirect tax structure in the country that is ridden with hidden costs for the trade and industry.
- In order to simplify and rationalise indirect tax structures, Government of India attempted various tax policy reforms at different points of time. A system of VAT on services at the central government level was introduced in 2002. The states collect taxes through state sales tax VAT, introduced in 2005, levied on intrastate trade and the CST on interstate trade. Despite all the various changes the overall taxation system continues to be complex and has various exemptions.

- This led to the idea of One Nation, One Tax and introduction of GST in Indian financial system. This is simply very similar to VAT which is at present applicable in most of the states and can be termed as National level VAT on Goods and Services with only one difference that this system not only goods but also services are involved and the rate of tax on goods and services are generally the same.

How will GST be levied?

- The central government has the exclusive power to levy and collect GST in the course of interstate trade or commerce, or imports. This will be known as IGST (Integrated GST).
- A central law will prescribe the manner in which the IGST will be shared between the centre and states, based on the recommendations of the GST Council.
- Both, Parliament and state legislatures will have the power to make laws on the taxation of goods and services. A law made by Parliament in relation to GST will not override a state law on GST.

GST: Impact of Sector on the Economy

Impact of GST on three sub sectors namely Agriculture, Industries and Services

IMPACT ON AGRICULTURE

In the agriculture sector we shall look at how GST will impact cost of agriculture inputs, Supply chain of agriculture products and unification of agriculture in one national market.

Agricultural Inputs

Any input taxes placed on inputs used in the farm sector such as seeds, fertilisers, pesticides, tractors etc, contribute to the increase in cost of farm output. On the other hand, farm output prices are controlled by market forces on which farmer has little control. As the input price rises and output price remains stagnant, the farmer would have no option but to absorb the cost, thus increasing his burden. Indian farmer is already reeling under tremendous pressure from many ends and the increased burden of taxes will create a crater in his income. In this context, let us look at tax incidence on some major inputs.

Seeds

Seeds were exempted both under earlier tax structure and under new GST regime.

Tractors

The tax incidence on Tractor's inputs combined with VAT on final product takes the total tax incidence for the industry to levels of ~12-13%. The fixation of a GST rate of 12% on tractors and on tractor inputs@18% would allow the manufacturers to take credit of the cumulative input duties and taxes. Thus, the total tax incidence on tractors would remain at broadly similar levels and its implementation is neutral for the tractor industry.

Fertilisers

Fertilisers an important element of agriculture was previously taxed at 6% (1% Excise + 5% VAT). In the GST regime, the tax on fertilisers has been reduced to 5%. Thereby reducing cost for farmers Pesticides - Pesticides currently attract an excise duty of 12.5 per cent. But under GST regime, crop protection products like pesticides are taxable at 18%. So, this might increase tax burden on the farmer.

So, by and large either tax incidence under GST regime is similar to incidence under earlier tax structure.

Supply chain

One of the major issues faced by the agricultural sector is the transportation of agriculture products across state lines all over India. Agricultural commodities are perishable in nature in varying degrees therefore trade is influenced by the time required for transportation. The Economist reports that long distance trucks in India are parked for 60 percent of the time during transportation. Currently, trucks wait outside for hours to pay taxes on borders of states and cities. These taxes are State entry tax and Octroi. However, GST will subsume State entry tax and Octroi this means seamless movement of trucks. Thus, simple uniform tax regime is expected to improve the transportation time, and curtail wastage of precious food as well as it would ease interstate movement o of agricultural commodities which would improve marketing efficiency, facilitate the development of virtual markets through warehouses and reduce overhead marketing cost.

Agriculture Trade

The taxes applicable on agricultural trade vary from state to state. The degree of market distortions on account of variation in the levy of market taxes/cess applicable on different commodities in different states The implementation of GST is a move towards making One National Agricultural Market on account of subsuming all kinds of taxes/cess on marketing of agricultural produce.

IMPACT ON INDUSTRIES

Industrial sector mainly consist of Manufacturing, Construction, Mining and Utilities (electricity, gas, water etc.). Manufacturing is the main sub-sector among these and we shall analyse the impact of GST on Manufacturing. The share of Manufacturing in GDP is stagnant at 16%, however the share is 42% in China. Some of the reasons for such a low share are multiple indirect tax legislation which have led to significant compliance and administrative costs, classification and valuation disputes. So, tax reforms are critical and necessary to give a boost to an already flagging sector.

There will be reductions in tax burden on most of the manufactured goods post GST implementation. A look at important components of manufacturing like automobiles sector reveal that effective tax rate would reduce in Automobile sector the biggest benefit would go to SUV segment. Under FMCG, by and large tax burden would reduce. The biggest relief would be in Soap and Hair oil segment.

What are the aspects of GST that would lead to lead to competitiveness and ease of doing business in the manufacturing sector?

Correct Valuation of goods

Currently, various pre-packaged products for retail consumption are subject to excise duty not on the ex-factory transaction value but on a specified percentage of the maximum retail price (MRP) printed on the package. The MRP based value (which is usually between 30%-35% of the MRP) is in most cases, much higher than the ex- factory transaction value leading to a higher excise duty liability than would otherwise be the case. This increased excise duty itself, results in a higher MRP, ultimately leading to a higher cost burden for the consumers. Under the GST regime, GST is payable by the manufacturer at the transaction value, and is creditable for all subsequent resellers up to the final consumer. Accordingly, the unnecessary tax burden of the MRP regime will no longer be relevant.

Reduction of cascading taxes

Under the present indirect tax regime, Central taxes cannot be set-off against State taxes and vice versa. This often leads to a situation where manufacturers are unable to set off excess credit of central or state levies. Further, central sales tax paid on inter-state procurements is also not credit worthy and are costs for the company. Another issue is the cascading of taxes at the post manufacturing stage. Dealers, retailers etc. are subject to taxes on their input side which are not credit worthy (service tax on input services, excise duty on capital goods). This leads to an increase in the cost of goods, ultimately affecting the competitiveness of Indian manufactured goods vis-à-vis imports. All of the above issues are addressed under GST, which permits tax set offs across the production value-chain, both for goods and services. Thiswill result in a reduction of the cascading effect of taxes and bring down the overall cost of production of goods.

Formalisation of Manufacturing

Input credit is proposed to be allowed only if the details declared by a taxpayer matches with the details declared by vendors in their returns. This will incentivise vendors supplying to manufacturing firms to move from informal to formal sector, because if they are in the informal sector and do not furnish bill to their customers i.e. manufacturing units then these units will route supplies from those vendors which provide bills.

Reduction of classification disputes

Currently, due to varying rates of excise duty and VAT on different products, as well as several exemptions provided under excise and VAT legislations, classification disputes are a regular cause for litigation under both central excise and VAT, especially for the manufacturing sector. It is expected that the inception of GST which is based on the principles of a simplified rate structure and minimisation of exemptions will significantly reduce disputes regarding classification of products.

Supply chain restructuring based on economic factors

Current supply and distribution models are structured to optimise indirect tax impact arising at various levels of value addition. Transition to GST should hopefully result in such decisions being taken to optimise business efficiency (as opposed to indirect tax efficiency). For Example- currently warehousing choices are often based on arbitrage between VAT rates in different States/ between applicable VAT and CST rates. With the advent of GST, it is hoped that such warehousing and logistics decision would be based on economic efficiency such as costs and location advantages vis-a-vis key customers.

IMPACT ON SERVICES

Services sector accounts for 60% of GDP (2013-14) and contribute to 70% of overall yearly GDP growth since 2011-12. An adverse impact of new tax regime may subdue overall growth of Indian economy on the other hand gains from new tax regime shall boost overall growth. The assessment of Risks, Opportunities and challenges are as follows:

Risks

The government has unveiled a four-tier GST rate structure for the sector - 5 percent, 12 percent, 18 per cent and 28 per cent. The bulk of the services will, however, be taxed at 18 percent. The sector is currently taxed at 15 per cent, so the GST regime will likely increase tax incidence for this sector. Economic principles tell us final output sold might show slow growth due to increased prices. This may be a bad news given that the services sector is not doing well because exported oriented part of services like business process and IT industries are showing decelerated growth due to protectionist stance in Advance economies including the USA. But, services sector also include Public administration and defence which might see tremendous growth on account of increase in tax revenue, enhancement of tax base and ease in tax compliance.

Opportunity

Under GST input credit would be available for goods purchases as well as services which enter the production as services like transportation services. This treatment of service inputs shall have at least two distinct effects. First, as producers could get tax credit for service input it will automatically reduce prices of goods. Secondly, outsourcing of services will increase, as input tax credit will be available for services many services in the production process which are produced by producer themselves will now be outsourced to a third party. These third parties will provide services at a cheaper cost as compared to in-house production by producer due to economies of scale and division of labour. Thus, the price of final products shall reduce because of cheap service inputs.

Challenges

A four-tier tax slab and differential rate between the goods and services sectors may distort/influence business by providing arbitrage practice. For example, if a car is taxed at 10 per cent and leasing rates are at 18 per cent, we may have a situation where car sales could be replaced by car leasing. In the area of composite services, a contract may be specially designed to avail the lower rates on services. Therefore, there are implications in the area of dispute management.

GST Impact on Taxation system

Both the CENVAT and the State VAT have certain incompleteness. The incompleteness in CENVAT is that it has yet not been extended to include chain of value addition in the distributive trade below the stage of production. It has also not included several Central taxes, such as Additional Excise Duties, Additional Customs Duty, Surcharges etc. in the overall framework of CENVAT, and thus kept the benefits of comprehensive input tax and service tax set-off out of the reach of manufacturers/dealers. The introduction of GST will not only include comprehensively more indirect Central taxes and integrate goods and services taxes for set-off relief, but also capture certain value addition in the distributive trade.

Similarly, in the present State-level VAT scheme, CENVAT load on the goods has not yet been removed and the cascading effect of that part of tax burden has remained unrelieved. Moreover, there are several taxes in the States, such as, Luxury Tax, Entertainment Tax, etc. which have still not been subsumed in the VAT. Further, there has also not been any integration of VAT on goods with tax on services at the State level with removal of cascading effect of service tax. In addition, although the burden of Central Sales Tax (CST) on inter-State movement of goods has been lessened with reduction of CST rate from 4% to 2%, this burden has also not been fully phased out. With the introduction of GST at the State level, the additional burden of CENVAT and services tax would be comprehensively removed, and a continuous chain of set-off from the original producer's point and service provider's point upto the retailer's level would be established which would eliminate the burden of all cascading effects, including the burden of CENVAT and service tax. This is the essence of GST. Also, major Central and State taxes will get subsumed into GST which will reduce the multiplicity of taxes, and thus bring down the compliance cost. With GST, the burden of CST will also be phased out.

GST IMPACT ON COMMON CONSUMERS

With the introduction of GST, all the cascading effects of CENVAT and service tax will be more comprehensively removed with a continuous chain of set-off from the producer's point to the retailer's point than what was possible under the prevailing CENVAT and VAT regime. Certain major Central and State taxes will also be subsumed in GST and CST will be phased out. Other things remaining the same, the burden of tax on goods would, in general, fall under GST and that would benefit the consumers.

CONCLUSION

GST will not increase the tax burden drastically, and in many cases total tax burden will decline due to removal of cascading effect replacement of gamut of tax systems by one tax systems. The biggest gain shall be from the increase in competitiveness and ease of doing business which GST brings with it. The overall impact is expected to be positive on economy thereby increasing the overall economic growth.

GST Rate and its Implications

GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. The final consumer will thus bear only the GST charged by the last dealer in the supply chain, with set-off benefits at all the previous stages.

ANATOMY OF GST RATES

- At classification level around one-fifth of the items are in GST exempted category, around one- fifth under 28% rate category and one-sixth under 12% category.
- Most of the item shall come under 18% tax rate. Most of the food items have been exempted or fetch lowest rate of 5% which is important given high poor percentage in society.
- Within services category luxury services and services considered to be anti-social like gambling are under 28% category.
- Under the goods category, petroleum products, alcohol, electricity, real estate and several food subcomponents have been kept outside GST ambit.
- Under services, health and education, amongst some of the others, have been excluded.
- Four products luxury cars, aerated drinks, tobacco and related 'paan' products would also fetch additional Cess.
- The council has recently revised rates on 66 items such as pickles, sauces, fruit preserves, insulin, cashew nuts, insulin, school bags, colouring books, notebooks, printers, cutlery, agarbattis and cinema tickets, following representations from industry.
- Restaurants, manufacturers and traders having a turnover of up to Rs 75 lakh can avail of the composition scheme with lower rates of 5%, 2% and 1%, respectively, with lower compliance, against Rs 50 lakh previously. A GST rate of 5% will be applicable on outsourcing of manufacturing or job work in textiles and the gems and jewellery sector. Bleaching and cleaning of human hair, a big industry in Midnapore, will not face any tax.

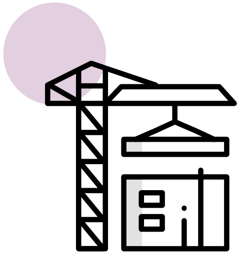
- Implications on various sectors of GST rates Estimates suggest that there is likely to be no upward impact on inflation. Rather, if tax cuts are passed on and the input tax credit mechanism runs with part efficiency, GST could help lower the inflation rate by 10-50bps. In terms of growth impact, the near-term could be messy, with adjustment costs for the private sector grappling with inter-sector implications. Service providers, in particular, are likely to face an increased (and more complex) tax burden. Over the medium-term, the impact on overall growth is unambiguously positive.
- The progressive tax structure would make sure that states do not face any revenue shortfall due to GST. It is likely that more comprehensive service
- tax coverage increases their revenues. Then, if any shortfall does remain, the Centre will take care of it.
- Moreover, with a view to keep inflation under check, essential items including food, which presently constitute roughly half of the consumer inflation basket, will be taxed at zero rate. The cess is expected to provide additional resources to the central government to compensate states for losses incurred. This will be based on the compensation formula.

Combined central and state taxes
Source: Govt, PwC

Products & Services	New GST Rate (%)	Old Rate (in %)
Pickles, Ketchup, Sauces, Preserves	12	18
Cashew nuts	5	12
Steel cutlery	12	18
School bags	18	28
Exercise books	12	18
Colouring books	Nil	12
Incense sticks	5	12
Insulin	5	12
Edible oil, Spices, Tea, Coffee	5	upto 9
Computers, Processed food	12	9-15
Soaps, Oil, Shaving Stickes	18	15-21
Most white goods such as LED TV sets	28	28

- Half the consumer price index basket, including food grains, to be zero-rated, enabling them to be part of GST chain but without burdening consumers.
- Cars may be in 28% bracket. While small cars may get a rebate, cess expected on luxury vehicles.
- Product details to be worked out by officers
- Cess to face annual review, to be out by phased out in 5 years
- No decision yet on service tax rates and GST on gold
- Movie tickets below ₹100 to face 18%
- Above ₹100 to face 28%
- GST rate on job work in textile, gems and jewellery cut to 5% from standard 18%

Impact on Important Sectors

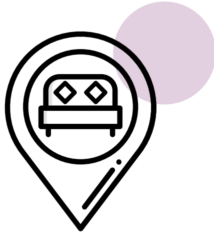


Construction and Infrastructure

The composite supply of works contract in this sector will fall under the 18% GST rate with full input tax credit (ITC). The GST rate may seem higher than the current tax rates as the effective tax incidence for an average construction contract in the pre-GST era is typically in the range of 11-18%, which is lower in comparison to the announced GST rate of 18%. The difference is more pronounced for the construction services which fall under the service tax exemption category.

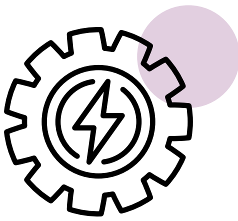
Despite higher rates, the sector is likely to benefit under GST regime from the availability of input tax credit. As under the current tax regime the benefit of input tax paid is not fully available, the benefits arising out of input tax credit on the raw-materials available under the GST regime would result in an overall neutral tax incidence for construction services.

Cement prices are expected to go up marginally, as the GST Council has announced a tax rate of 28 per cent on the product. The cement industry says the rate is above what was expected, and the increase will most likely be passed on to consumers.



Hospitality sector

Goods and Services Tax (GST) rate levy on the hospitality sector is within the range of 2 to 28 %. hoteliers have termed it as a “killer step” for the tourism and hospitality industry, which is already reeling under rising costs of basic commodities, labour and the recent liquor ban on highways. It will certainly have an adverse effect on the industry, particularly for the mid and high category hotels which will fall under the 18 and 28 % GST rate.



Engineering, Capital Goods & Power Equipment

Introduction of GST is expected to improve the prospects of engineering, capital goods and power equipment (ECPE) sector by simplifying the tax structure. The complexity in this sector is that companies are involved simultaneously in manufacturing of goods and rendering of services. A comprehensive tax like GST would combine the state and central taxes in a single structure and the tax credit would be available at each stage of production and final sale so that double taxation could be avoided. This would bring in more cost competitiveness to the domestic players.

Automobile sector

Currently taxes paid by car manufacturers are 27.6% to max 45.1% and the GST rates on automobile sector would be 28%. So rates seem to be revenue neutral though gains would occur from easy compliance and less cascading effect.

CRITICISM OF RATES ACCORDING TO SOME EXPERTS

It compromises on simplicity. The multiplicity of tax rates for services will add complexity to the compliance in the GST regime. Around 19% of services have been under the highest slab of 28% which caters to daily needs of middle class. Thus the middle class will now have to bear the brunt of higher prices.

CONCLUSION

A well-designed GST in India is expected to simplify and rationalise the current indirect tax regime, eliminate tax cascading and put the Indian economy on high-growth trajectory. The proposed GST levy may potentially impact both manufacturing and services sector for the entire value chain of operations, namely procurement, manufacturing, distribution, warehousing, sales, and pricing.

GST Council

As per Article 279A (1) of the amended Constitution, the GST Council has to be constituted by the President within 60 days of the commencement of Article 279A. As per Article 279A of the amended Constitution, the GST Council will be a joint forum of the Centre and the States.

As per Article 279A (4), the Council will make recommendations to the Union and the States on important issues related to GST, like the goods and services that may be subjected or exempted from GST, model GST Laws, principles that govern Place of Supply, threshold limits, GST rates including the floor rates with bands, special rates for raising additional resources during natural calamities/disasters, special provisions for certain States, etc. Central Government has inter alia, taken the following decisions for smooth functioning of GST Council -

a. Creation of the GST Council Secretariat, with its office at New Delhi;
b. Appointment of the Secretary (Revenue) as the Ex-officio Secretary to the GST Council;
c. Inclusion of the Chairperson, Central Board of Excise and Customs (CBEC), as a permanent invitee (non-voting) to all proceedings of the GST Council;
d. Create one post of Additional Secretary to the GST Council in the GST Council Secretariat (at the level of Additional Secretary to the Government of India), and four posts of Commissioner in the GST Council Secretariat (at the level of Joint Secretary to the Government of India).

The Cabinet has also decided to provide for adequate funds for meeting the recurring and non recurring expenses of the GST Council Secretariat, the entire cost for which shall be borne by the Central Government.The GST Council Secretariat shall be manned by officers taken on deputation from both the Central and State Governments. While discharging the functions conferred by this article, the Goods and Services Tax Council shall be guided by the need for a harmonised structure of goods and services tax and for the development of a harmonised national market for goods and services. The Goods and Services Tax Council shall determine the procedure in the performance of its functions.

Who are the members of GST council?
Union Finance Minister-Chairperson

The Union Minister of State, in-charge of Revenue of finance - Member

The Minister In-charge of finance or taxation or any other Minister nominated by each State Government - Members.

GSTN

The Goods and Service Tax Network (or GSTN) is a non-profit, non-government organisation. It will manage the entire IT system of the GST portal, which is the mother database for everything GST. This portal will be used by the government to track every financial transaction, and will provide taxpayers with all services – from registration to filing taxes and maintaining all tax details. The Government of India holds 24.5% equity in GSTN and all States of the Indian Union, including NCT of Delhi and Puducherry, and the Empowered Committee of State Finance Ministers (EC), together hold another 24.5%. Balance 51% equity is with non-Government financial institutions.

What are the Functions of GSTN?

- Facilitate registration.
- Computation of IGST and settlement.
- File tax returns and submit to central and state authorities.
- Integrate banking network with tax payment details.
- Analyse tax payer's profile.
- Manage computation engine of input tax credit.
- Submit MIS reports to governments.

What are the salient features of GSTN?

- The GSTN server, with an open Application Program Interface (API), will provide convenience and an all user interface by connecting seamlessly with third party applications used by taxpayers through their mobiles, tablets and desktops.
- Such a move will help taxpayers in automating invoice matching from their software itself without the need to log on to the portal, thereby ensuring simplicity of compliance and savings of time. Technology will also bring in efficiency in tax administration for returns filing, registration, data exchange and effectual auditing, monitoring, investigation and performance analysis with minimal or zero human intervention.

- For businesses too, technology will be key to survive and thrive in the post-GST era. Given that invoice matching is a crucial component of GST and is linked to stringent timelines, it would need a solution that is both agile and accurate.
- Companies would also have to deploy software that has the desired robustness to talk to the GSTN system, and also helps them in achieving reliable, accurate, and immediate compliance. Besides, they would have to move from manual to automated systems to ensure speedy and timely invoice matching. As a starting point, companies would have to understand the impact of GST and technology on their business. They would have to acknowledge the importance of compliance and decide on the right software solution to adhering to the compliance requirements.

GST: Macroeconomic Effects

GST is the biggest tax reform since 1991 when India opened its market first. Potentially one of the most dynamic economies in the developing world, India is hampered by a bewildering array of state-by-state tax codes that discourage doing business across state borders. The GST is widely viewed as a breakthrough that will allow the authorities to confront the problem, eventually creating a more unified economy that will allow businesses to expand nationwide far more easily.

Far from being only a tax reform, design of GST would have far reaching Macro-economic effects. It is expected that in the long run Tax to GDP ratio will improve both for centre and states.

As a consequence it will improve fiscal health of Centre and States and provide them with resources to improve state capacity in the delivery of basic services, augment infrastructure, etc. Another impact will be on ease of doing business which will improve many folds by this reform.

Last but not the least, Logistic sector will see far reaching changes which will reduce the cost of transportation and increase in competitiveness.

TAX TO GDP RATIO

A country's tax-GDP ratio is an important indicator that helps to understand how much tax revenue is being collected by the government as compared to the overall size of the economy. A higher tax-GDP ratio gives more room in a government's budget so that it can spend more without borrowing. However, despite many years of high growth, India's tax-GDP ratio continues to remain low. The cursory look at indirect tax-to GDP ratio shows that indirect tax to GDP ratio is around 5% and Direct tax to GDP ratio is at 5.5%. In this context, GST shall increase tax ratio.

It has also been noticed at times that businesses report a different data in their annual VAT return as compared to their Income Tax return. Many businesses deflate the value of profit to attract less income tax liability. Tax evaders who window dress their books at the year end to lessen their tax liability will find it harder to do so. Such actions were possible before, as the Income Tax Department did not have any access to the data which is filed under the state VAT laws. However, under the new regime, GSTN will be the single repository to all these transactions and the Income Tax Department will have access to such data thus having a clear picture of the total sales and purchases, and eventually the overall profitability of every business. In this way Direct tax to GDP ratio will improve.

Under the GST law, every sale invoice will get uploaded on the Goods and Services Tax Network's common GST portal. GSTN will ensure a 100% reconciliation of sale invoice of the supplier and the purchase invoice of the buyer. So far, returns filed under the VAT law or CST law do not require validation from the buyer, so we can expect more accurate value being reported under the new regime. This will increase the indirect tax to GDP ratio.

So, the new regime makes it tough to evade taxes. This likely to improve the overall compliance rate and would also reduce the size of black economy.

FISCAL HEALTH OF STATES

The successful implementation of GST will result in additional revenue through simpler and easier tax administration, supported by robust and user-friendly IT (information technology) systems and improvement in tax compliance.

Thus the GST is expected to reduce administrative costs for collection of tax revenue and improve revenue efficiency while uniformity in tax rates and procedures will lead to economy in compliance cost.

REVENUE EFFICIENCY

It is the amount spent by government to realise a rupee of tax.

Expenditure includes expenditure on tax compliance system like salary of revenue officials, establishment cost etc. As compliance under GST is through IT platform, cost of collecting revenue will decline thereby increasing revenue efficiency.

The GST regime will also increase the shareable pool of resources, resulting in transfer of large funds to the states for developmental works. Such an outcome will also ensure debt sustainability of states in the long term. This will be an important outcome because according to recent RBI report on State debt, two states have breached fiscal deficit threshold of 3% as mandated in State level FRBM.

Under GST central cess will be subsumed into the GST and in turn increase the divisible pool of resources which is to the advantage of states. This is because Cess is levied by the central government for a specific purpose like education cess to fund SSA. The proceeds go only to Central Government, but these cess are subsumed under GST and GST is collected by both the Centre and States hence state revenue shall increase. Similarly, revenue of States will increase as earlier Excise duty on production and Service Tax on services were assigned to Centre but now GST on production and Services will go to States too.

Another aspect of GST which is that GST is a destination based tax. This means that proceeds from tax collection are appropriated by state in which final sale is made irrespective of state in which the product is manufactured. This aspect of GST will improve the fiscal health of the poorest States - for example, Uttar Pradesh, Bihar, and Madhya Pradesh - who happen to be large consumers. These states are expected to generate resources to augment their state capacity in delivering basic services like law and order, Education and Health Services and improve physical infrastructure to attract manufacturing.

EASE OF DOING BUSINESS

Presently, the Central Government levies gamut of taxes like Central Excise duty, Service Tax, CST and states levy tax on retail sales (VAT), entry of goods in the State (Entry Tax), Luxury Tax, Purchase Tax, etc. Large number of taxes created high compliance cost for the taxpayers in the form of number of returns, payments, etc. In fact, it is said that our tax laws have created a situation where business decisions are based on tax considerations rather than logical economical factors. All these issues created a need for one tax that will be able to mitigate the number of these problems to a large extent and ease the way the business in which it is done.

GST IMPACT ON EASE OF DOING BUSINESS RANKING

The Ease of Doing Business Index is an index created by the World Bank Group. Higher rankings (a low numerical value) indicate better, usually simpler, regulations for businesses and stronger protections of property rights. A nation's ranking on the index is based on the average of 10 sub-indices, which among other includes "Paying Taxes" Index. New GST regime would improve India's rank under this sub-index and consequently ranking in overall Index would improve. India is currently placed at 130 out of 189 countries. The Prime Minister hopes to bring India amongst the top 50 countries on the rankings and GST is a step in this direction.

What are the ways in which GST would facilitate ease of doing business?

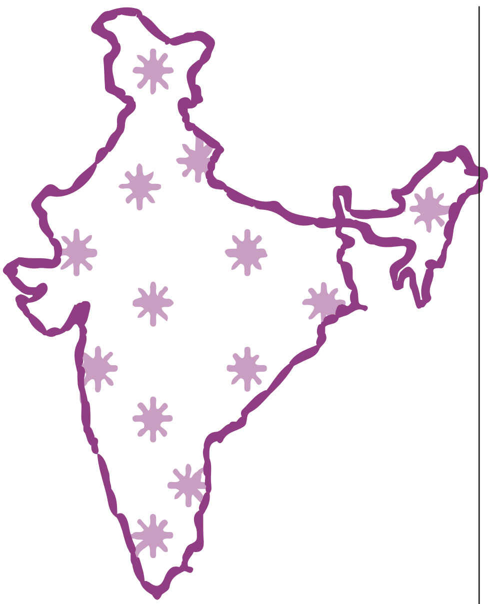
- Simpler tax regime with fewer exemptions.
- Reductions in the multiplicity of taxes that are at present, governing our indirect tax system leading to simplification and uniformity.
- Reduction in compliance costs.
- No multiple records keeping for a variety of taxes - so less investment of resources and manpower in maintaining records.
- More efficient neutralisation of taxes especially for exports thereby making our products.
- More competitive in the international market and gives a boost to the Indian exports.
- Simplified and automated procedures for various processes such as registration, returns, refunds, tax payments, etc.

- Tax authorities and tax payer
- Timelines to be provided for important activities like obtaining registration, refunds, etc.

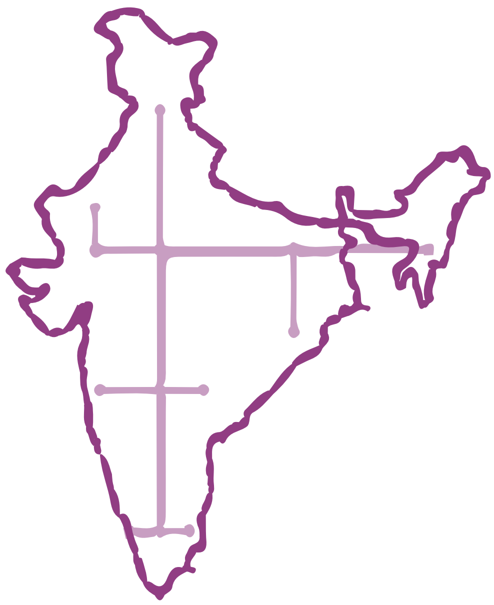
LOGISTICS

Logistics is considered to be the backbone of manufacturing and trading activities in the economy. It has a critical role to play for developing countries like India. It can be fairly assumed that a well organised and mature logistics industry has the potential to leapfrog the “Make In India” initiative to its desired position.

Warehousing under the current tax regime and upcoming GST regime



Warehouses under the current tax regime



Warehouses under the GST regime

So far, logistics players in India have been maintaining multiple warehouses across states to avoid CST levy and state entry taxes. Most of these warehouses are operating below their capacity and thus adding to their operational inefficiencies. On the other hand movements of truck carrying goods take a lot of time mainly due to stoppage at state check- posts for payment of taxes. India has approximately 600 check posts.

According to a Ministry of Road Transport and Highways (MORTH) study, a typical truck spends nearly 16% of the time at check posts. A truck in India covers an average annual distance of only 85,000 km as compared to 150,000 to 200,000 km in advanced countries. Goods carriage vehicles in India barely travel 280 km per day against a world average of 400 km per day. However, under GST, most of the current challenges of this industry will be a story of the past asIndia will become one single market wherein the goods can move freely inter-state without any levy.

Many companies are expected to migrate from a current strategy of 'multiple warehousing' to the 'hub and spoke' model as tax treatment across India will be the same. GST will further bring warehouse consolidation across the country and we can witness mega logistics hubs and high investments in infrastructure wherein 100% FDI has already been allowed. As an outcome of GST, warehouse operators and e-commerce players have already shown interest in setting up their warehouses at strategic locations such as Nagpur, which is the zero mile city of India and is well connected throughout. Another favourable outcome would be seamless movement of Truck across India thus cutting delivery time and cost.

BOOST TO MAKE IN INDIA

GST will give a major boost to the Government of India's 'Make in India' initiative by making goods or services produced or provided in India competitive in the national and international markets. The currently prevalent Counter-veiling Duty (CVD) on imported goods will be replaced under GST regime by the integrated tax (IGST) which is simply the sum total of Central GST +State GST. This will bring parity in taxation on domestic and imported products, and thereby provide protection to domestic industry.

Under the GST regime, exports will be entirely zero rated, unlike the present system where refund of some taxes is not allowed due to the fragmented nature of indirect taxes between the Centre and the States. This means that input tax credit of tax paid on input supplies would be available to the exporter even though no tax is required to be paid on final export supplies. The exporters also have an option to pay IGST on export supplies and claim their fund for the same for which a fast track mechanism has been provided. This will boost Indian exports thereby improving the balance of payments position.

CONCLUSION

It is clear that GST is not only a tax reform but a structural reform which will change the trajectory of growth. It will improve the fiscal capacity of states which would ensure that they do not have to fall back on borrowings to fill the fiscal deficit and for businesses it will make doing business relatively easy which along with changes in logistic sector will improve export competitiveness of Indian products and may put India on the path of 'Export led Growth'.

04

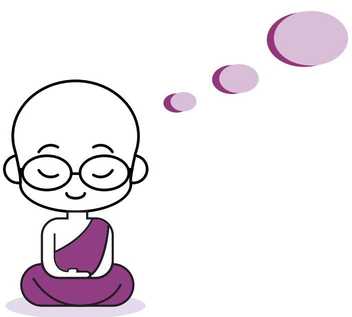
Public Finance & Union Budget 2020-21

Introduction

Budget is an Annual Financial Statement of yearly estimated receipts and expenditures of the government in respect of every financial year.

Budgeting is the process of estimating the availability of resources and then allocating them to various activities as per pre determined priority.

Budgets act as instruments of control and act as a benchmark to evaluate the progress of various departments.



Types of Budgeting

Performance Budgeting

- A performance budget reflects the goal/objectives of the organisation and spells out its performance targets.
- These targets are sought to be achieved through a strategy. Unit costs are associated with the strategy and allocations are accordingly made for achievement of the objectives.
- A Performance Budget gives an indication of how the funds spent are expected to give outputs and ultimately the outcomes.

> However, performance budgeting has limitation – it is not easy to arrive at standard unit costs especially in social programmes, which require a multi-pronged approach.

Zero-based Budgeting

- The basic purpose of ZBB is phasing out of programmes/ activities, which do not have relevance anymore. ZBB is done 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. Therefore, Zero Based Budgeting is followed for rationalisation of expenditure.
- The concept of zero-based budgeting was introduced in the 1970s. As the name suggests, in the process every budgeting cycle starts from scratch.
- Unlike the earlier systems, where only incremental changes were made in the allocation, under zero-based budgeting every activity is evaluated each time a budget is made and only if it is established that the activity is necessary, funds are allocated to it.

- 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.

Programme Budgeting

- Programme budgeting aimed at a system in which expenditure would be planned and controlled by the objective. The basic building block of the system was classification of expenditure into programmes, which meant objective-oriented classification so that programmes with common objectives are considered together.

Programme & Performance Budgeting System (PPBS)

- PPBS went much beyond the core elements of programme budgeting and was much more than the budgeting system. It aimed at an integrated expenditure management system, in which systematic policy and expenditure planning would be developed and closely integrated with the budget. Thus, it was too ambitious in scope.
- Neither was adequate preparation time given nor was a stage-by-stage approach adopted. Therefore, this attempt to introduce PPBS in the federal government in the USA did not succeed, although the concept of performance budgeting and programme budgeting endured.
- Many governments today use the - programme budgeting label for their performance budgeting system. As pointed out by Marc Robertson, the contemporary influence of the basic programme budgeting idea is much wider than the continuing use of the label. It is defined in terms of its core elements as mentioned above. Programme budgeting is an element of many contemporary budgeting systems which aim at linking funding and results.

Outcome Budget

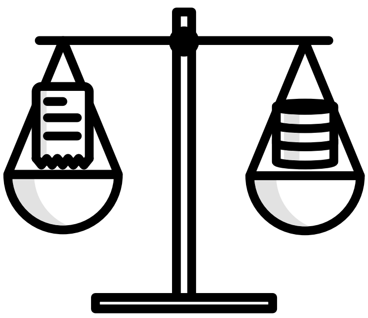
- The Outcome Budget is a progress card on what various ministries and departments have done with the outlay announced in the annual budget.
- It is a performance measurement tool that helps in better service delivery; decision-making; evaluating programme performance and results; communicating programme goals; and improving programme effectiveness.
- The Outcome Budget is likely to comprise scheme- or project-wise outlays for all central ministries, departments and organisations during 2005-06 listed against corresponding outcomes (measurable physical targets) to be achieved during the year.
- It measures the development outcomes of all government programmes. The Outcome Budget, however, will not necessarily include information of targets already achieved.
- This method of monitoring flow of funds, implementation of schemes and the actual results of the usage of the money is followed by many countries.

Gender Budgeting

- The 2005-06 Budget introduced a statement highlighting the gender sensitivities of the budgetary allocations.
- Gender budgeting is an exercise to translate the stated gender commitments of the government into budgetary commitments, involving special initiatives for empowering women and examination of the utilisation of resources allocated for women and the impact of public expenditure and policies of the government on women.

Balanced and Unbalanced Budgets

Balanced Budgeting



A Balanced Budget is that budget in which Government receipts are equal to Government expenditure.

Merits of the Balanced Budget

- The Government does not indulge in wasteful expenditure.
- Interference in economic functioning of the system is totally avoided by the government generally.
- Financial stability is ensured with balanced budget.

Limitation

However, balanced budget is not an achievement of the government when the economy is in a state of depression for at that time, the government is expected to increase its expenditure with a view to increasing aggregate demand.

Demerits of a Balanced Budget

Balanced budget does not offer any solution to the problem of unemployment during the depression.
Balanced budget is not helpful to the growth and development programmes of the less developed countries.

Unbalanced Budgeting

An unbalanced budget is that budget in which receipts and expenditure of the government are not equal.

In this, two cases concerning surplus Budget and Deficit Budget arise.

In Surplus Budget - Government receipts > Government expenditures.

In Deficit Budget, Government expenditures > Government receipts.

Merits of a Deficit Budget

It helps in addressing the problem of unemployment during depressions.
It is conducive for growth and development in less developed countries
It works towards social welfare of the people.

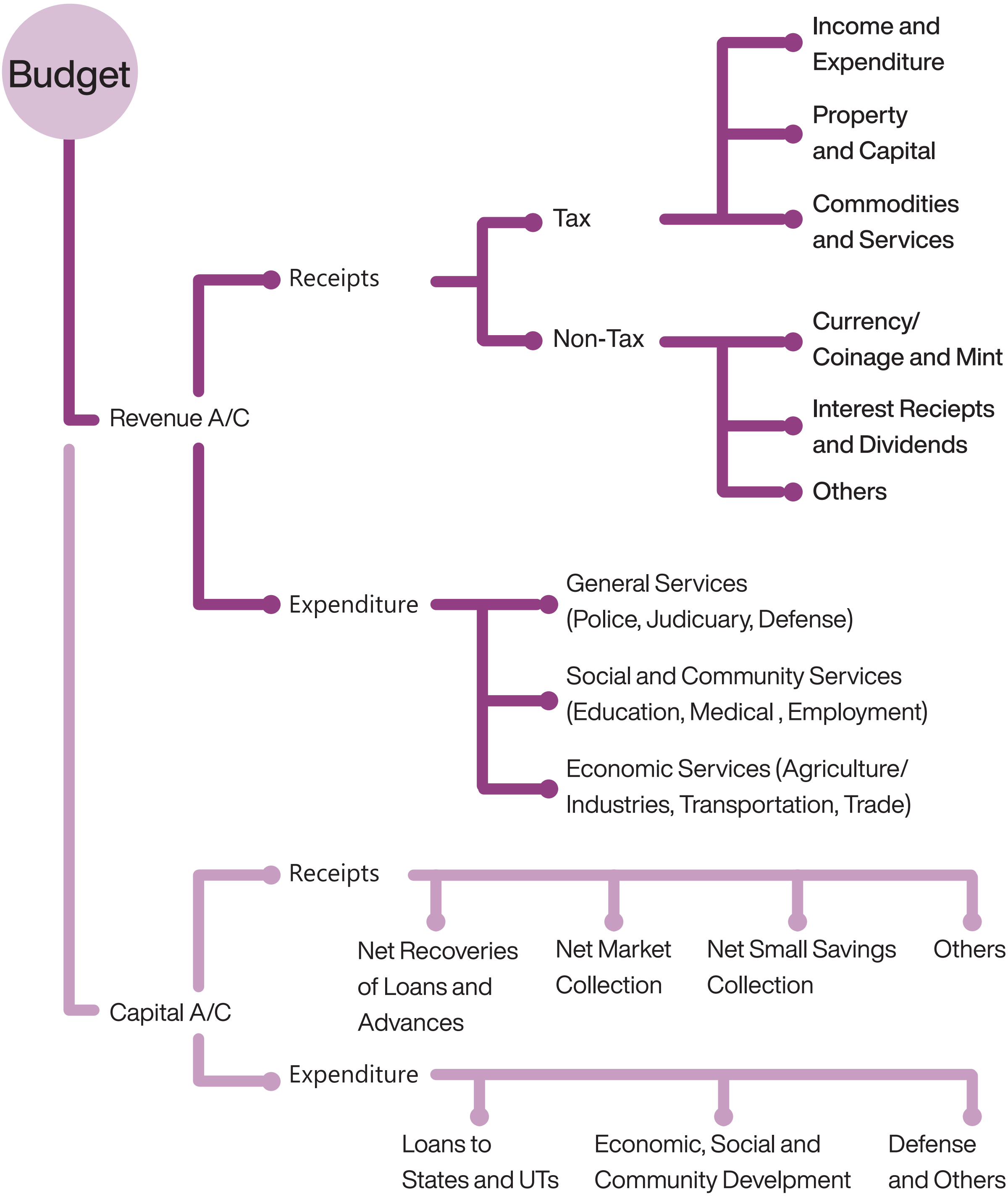
Demerits of Deficit Budget

It shows wasteful expenditure by the government.
It shows less revenue realisation in comparison with the expenditure.
It increases debt burden of the government.

Components of Government Budget

Theory and Concept of Budget

There is a constitutional requirement in India (Article 112) to present before the Parliament a statement of estimated receipts and expenditures of the government in respect of every financial year which runs from 1 April to 31 March. This Annual Financial Statement constitutes the main budget document. Further, the budget must distinguish expenditure on revenue account from other expenditure. Therefore, the budget comprises of the Revenue Budget and the Capital Budget.



Revenue Budget

The Revenue Budget shows the current receipts of the government and the expenditure that can be met from these receipts.

REVENUE RECEIPTS

These are divided into tax and non-tax revenues.
Tax revenues consist of the proceeds of taxes and other duties levied by the central government.

Tax revenues

Direct taxes
Which fall directly on individuals (personal income tax) and firms (corporation tax).

Indirect taxes
Like excise taxes (duties levied on goods produced within the country), customs duties (taxes imposed on goods imported into and exported out of India) and service tax.

Non-tax revenue

Interest receipts (on account of loans by the central government which constitutes the single largest item of non-tax revenue)

Cash grants-in-aid from foreign countries and international organisations are also included.

Dividends and profits on investments made by the government – Fees and other receipts for services rendered by the government.

The estimates of revenue receipts take into account the effects of tax proposals made in the Finance Bill. A Finance Bill, presented along with the Annual Financial Statement, provides details of the imposition, abolition, remission, alteration or regulation of taxes proposed in the Budget.

REVENUE EXPENDITURE

Revenue expenditure consists of all those expenditures of the government which do not result in the creation of physical or financial assets.

It relates to those expenses incurred for the normal functioning of the government departments and various services, interest payments on debt incurred by the government, and grants given to state governments and other parties (even though some of the grants may be meant for creation of assets).

Budget documents classify total revenue expenditure into Plan and Non-plan expenditure.

Plan Revenue Expenditure	Non-Plan Expenditure
Plan revenue expenditure relates to central Plans (the Five-Year Plans) and central assistance for State and Union Territory Plans.	Non-plan expenditure, the more important component of revenue expenditure, covers a vast range of general, economic and social services of the government. The main items of non-plan expenditure are interest payments, defence services, subsidies, salaries and pensions. Interest payments on market loans, external loans and from various reserve funds constitute the single largest component of non- plan revenue expenditure. They used up 41.5 percent of revenue receipts in 2004-05. Defence expenditure, the second largest component of non-plan expenditure, is the committed expenditure in the sense that given the national security concerns, there exists a little scope for drastic reduction.

Subsidies are an important policy instrument which aim at increasing welfare. Apart from providing implicit subsidies through under-pricing of public goods and services like education and health, the government also extends subsidies explicitly on items such as exports, interest on loans, food and fertilisers.

The Capital Account

The Capital Budget is an account of the assets as well as liabilities of the central government, which takes into consideration changes in capital. It consists of capital receipts and capital expenditure of the government. This shows the capital requirements of the government and the pattern of their financing.

CAPITAL RECEIPTS

The main items of capital receipts are loans raised by the government from the public which are called market borrowings, borrowing by the government from the Reserve Bank and commercial banks and other financial institutions through the sale of treasury bills, loans received from foreign governments and international organisations, and recoveries of loans granted by the central government.

Other items include small savings (Post-Office Savings Accounts, National Savings Certificates, etc), provident funds and net receipts obtained from the sale of shares in Public Sector Undertakings (PSUs).

CAPITAL EXPENDITURE

This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties.

Capital expenditure is also categorised as plan and non-plan in the budget documents.

Plan capital expenditure, like its revenue counterpart, relates to central plan and central assistance for state and union territory plans.

Non-plan capital expenditure covers various general, social and economic services provided by the government.

Summary

- The budget is not merely a statement of receipts and expenditures. Since Independence, with the launching of the Five-Year Plans, it has also become a significant national policy statement.
- The budget, it has been argued, reflects and shapes, and is, in turn, shaped by the country's economic life.
- Along with the budget, three policy statements are mandated by the Fiscal Responsibility and Budget Management Act, 2003 (FRBMA).
- The Medium-term Fiscal Policy Statement sets a three-year rolling target for specific fiscal indicators and examines whether revenue expenditure can be financed through revenue receipts on a sustainable basis and how productively capital receipts including market borrowings are being utilised.
- The Fiscal Policy Strategy Statement sets the priorities of the government in the fiscal area, examining current policies and justifying any deviation in important fiscal measures. The Macroeconomic Framework Statement assesses the prospects of the economy with respect to the GDP growth rate, fiscal balance of the central government and external balance.

Deficits

When a government spends more than it collects by way of revenue, it incurs a budget deficit. There are various measures that capture government deficit and they have their own implications for the economy.

Types of Deficits

Revenue Deficit

- The revenue deficit refers to the excess of government's revenue expenditure over revenue receipts.
- Revenue deficit = Revenue expenditure – Revenue receipts.
- The revenue deficit includes only such transactions that affect the current income and expenditure of the government.

- When the government incurs a revenue deficit, it implies that the government is dissaving and is using up the savings of the other sectors of the economy to finance a part of its consumption expenditure.
- This will lead to a buildup of stock of debt and interest liabilities and force the government, eventually, to cut expenditure. Since a major part of revenue expenditure is committed expenditure, it cannot be reduced. Often the government reduces productive capital expenditure or welfare expenditure. This would mean lower growth and adverse welfare implications.

Fiscal Deficit

- Fiscal deficit is the difference between the government's total expenditure and its total receipts excluding borrowing.
- Gross fiscal deficit = Total expenditure – (Revenue receipts + Non-debt creating capital receipts)
- Non-debt creating capital receipts are those receipts which are not borrowings and, therefore, do not give rise to debt. Examples are recovery of loans and the proceeds from the sale of PSUs.
- The fiscal deficit will have to be financed through borrowings.
- Thus, it indicates the total borrowing requirements of the government from all sources. From the financing side.
- Gross fiscal deficit = Net borrowing at home + Borrowing from RBI + Borrowing from abroad
- Net borrowing at home includes that directly borrowed from the public through debt instruments (for example, the various small savings schemes) and indirectly from commercial banks through Statutory Liquidity Ratio (SLR).

Primary Deficit

- Primary deficit is simply the fiscal deficit minus the interest payments
- Gross primary deficit = Gross fiscal deficit – net interest liabilities
- Net interest liabilities consist of interest payments minus interest receipts by the government on net domestic lending.

Deficit Financing

- Deficit Financing is the phrase used to describe -the financing of a deliberately created gap between public revenue and public expenditure or a budgetary deficit, the method of financing resorted to borrowing from the RBI.
- When the Government has to spend more than what it can raise through taxes, non-tax and other sources, it borrows from the market.
- It cannot borrow above a certain amount from the market as it may push up interest rates and crowd out private investment.
- Then it borrows from the RBI. In other words, when the resources from taxes, user charges, public sector enterprises, public borrowings, small scale borrowings and others are not enough, RBI is approached for loans. It is called deficit financing.

Managing Fiscal Deficit

First, fiscal deficits may cause macroeconomic instability by inflating the economy as money supply rises.

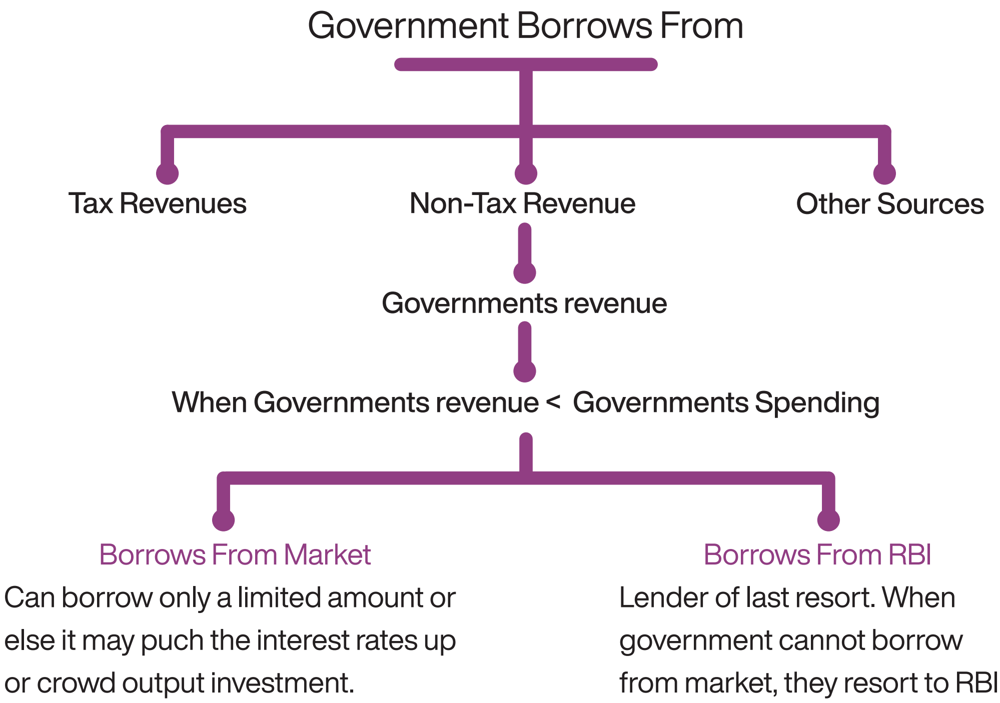
Second, they negatively impact on savings rates, reducing investment and jeopardising the sustainability of high growth.

Thirdly, private investment may be crowded out. Interest rates go up to make cost of credit high for investment thus pulling down growth.

Fourthly, the continuing 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.

High tax rates will place India at a significant disadvantage to other fast-growing countries. Also, 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 repays the debt.

However, the extent of reduction and the manner of reduction matter. More resources should be raised on the revenue side (taxes etc). Expenditure control should not involve cuts on the social sector expenditure as it hurts the poor and demographic dividend cannot be reaped.



How should the level of FD be determined?

- Whether the debt can be put to productive deployment.
- The rate of return on the borrowed funds used.
- The impact on private sector investment; interest rates etc.
- Even more important is not to cut social spending in a move to reduce deficit. In other words, while FD reduction is needed for macroeconomic stability and inter-generational parity, what is even more important is to make sure that social sector items are taken care of fully while reduction of expenditure is affected.

Debt

Budgetary deficits must be financed by taxation, borrowing or printing money.

Governments have mostly relied on borrowing, giving rise to what is called government debt. The concepts of deficits and debt are closely related. Deficits can be thought of as a flow which adds to the stock of debt. If the government continues to borrow year after year, it leads to the accumulation of debt and the government has to pay more and more by way of interest. These interest payments themselves contribute to the debt.

1

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, etc.

Public debt is justified as the government does not have adequate resources and taxation cannot 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.

2

External Debt

External debt includes Long-term external debt which is the bulk part, NRI deposits and multilateral loans, Commercial borrowings, Bilateral loans, Negligible amount from export credit and external debt-to-GDP ratio has been on the decline since 1991.

Government has been able to check the external debt through measures like raising funds from least expensive sources, accelerating growth in export, prepaying high-cost debts, maintaining vigil on build up of short-term debt and encouraging foreign direct investments.

3

Internal Debt

It includes loans raised by the government in the open market through treasury bills and government securities, special securities issued to the RBI, rupee securities (non-interest bearing) issued to international institutions such as the IMF and the World Bank and, various bonds like oil bonds,-fertiliser bonds etc.

The money sucked in by the Market Stabilisation Scheme (MSS) is shown in the government's statement of liabilities. Introduced in April 2004, the scheme envisages the issue of treasury bills and/or dated securities to absorb excess liquidity arising out of the excessive foreign exchange inflows.

4

Other Liabilities

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

Fiscal Consolidation

- Fiscal consolidation means improving government finances and maintaining the same.
- Fiscal consolidation is critical as it enables 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.

Fiscal consolidation in India

Revenue reforms include tax reforms on both direct and indirect tax front; r Reduction/ elimination of tax exemptions and treating the revenue forgone as tax expenditure, improving efficiency of tax collection, including the arrears and stable medium term tax rates avoiding annual changes.

Expenditure reforms which include Reforms targeted to cut out non-essential and unproductive activities, schemes and projects; Allocation of resources to priority areas; Reducing cost of services; rationalising subsidies; reduction of time and cost overruns on projects and getting proper outcome‘ from output.

Measures to be taken to ensure greater transparency in fiscal operations.

- The central government to lay before both Houses of Parliament three statements – Medium-term Fiscal Policy Statement, the Fiscal Policy Strategy Statement and The Macroeconomic Framework Statement along with the Annual Financial Statement.
- Quarterly review of the trends in receipts and expenditure in relation to the budget be placed before both Houses of Parliament.
- The Act applies only to the central government. States like Karnataka, Kerala, Punjab, Tamil Nadu and Uttar Pradesh have enacted fiscal responsibility legislations, the objective of fiscal consolidation, growth and macroeconomic stability will not be achieved if all the states do not participate.
- Effort by the government to widen the tax net and ensure better compliance, there have been fears that welfare

expenditure may be reduced to meet the targets mandated by the Act.

Terms Associated with Deficits and Fiscal Management

Pump-priming

- Deficit financing and spending by the government on public works in an attempt to revive the economy during recession is known as pump-priming.
- It is a countercyclical measure.
- It can raise the purchasing power of the people and thus stimulate and revive economic activity to the extent that deficit spending will no longer be necessary.

Fiscal neutrality

- When the net effect of taxation and public spending is neutral neither stimulating nor dampening demand, it is called fiscal neutrality. It is neutral, as total tax revenue equals total public spending.

Fiscal Drag

- It is a situation where inflation pushes income into higher tax brackets.
- Leads to an 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.

Crowding Out

- Excessive government borrowing can lead to shrinkage of the liquidity in the market and force the interest rates to go up.
- Private investment is crowded out, because liquidity availability is less and the interest rates are high.
- Investment suffers and growth decelerates.
- The government 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.

FRBM Act 2003

The FRBM Act 2003 is to bring fiscal discipline and to implement a prudent fiscal policy. High fiscal deficit was the one major macroeconomic problem faced by Indian economy around 2000. It was argued that high deficits lead to inflation, reduces consumption, result in a crowding out of the private sector investment, rising unemployment and falling living standards of the people. Thus arose a need to institutionalise a new fiscal discipline framework.

Features of FRBM Act:

- Phase out fiscal stimulus
- Eliminate inefficient subsidies that affect private incentives
- Increase effectiveness of productivity-enhancing spending

- Eliminate inefficient tax expenditures
- Improve equality of the tax system
- Strengthen tax administration

Public Spending

Non-oil Revenue

Cut Non-Oil Deficit

Oil Revenue Consumption

Net Borrowing

- Facilitate budget financing at prudent cost-risk levels.
- Strengthen fiscal risk management
- Improve results-based planning

- Stick to the adopted guaranteed-transfer rule
- Avoid discretionary use of funds during good times
- Maintain prohibition for off-budget allocations

- The revenue deficit should be reduced to an amount equivalent by 0.5% or more of GDP every year, beginning with the financial year 2004-05 and eliminate revenue deficit by March, 2009.
- Reduce fiscal deficit by 0.3% or more of the GDP every year, beginning with the financial year 2004-05and bringing it down to 3% of GDP by March 2009.

- The Central Government should not provide guarantees in excess of 0.5% of GDP in any financial year, beginning with 2004-05
- The Central Government should not assume additional liabilities in excess of 9% of GDP for financial year 2004-05 and progressive reduction of this limit by at least 1 % point of GDP in each subsequent year
- The RBI should not subscribe to primary issues of Central Government securities from the year 2006-07.
- The Finance Minister to make a quarterly review of trends in receipts and expenditure in relation to budget and place the outcome of such reviews before both the Houses of Parliament.
- The Central Government should specify four fiscal indicators- Fiscal deficit as a percentage of GDP; Revenue deficit as a percentage of GDP; Tax revenue as a percentage of GDP; Total outstanding liabilities as a percentage of GDP.
- The Central Government should place in each financial year before houses of Parliament three statements-Medium Term Fiscal Policy Statement; Fiscal policy strategy statement; Macroeconomic Framework statement along with Annual Financial Statement and Demands for grants.
- The FRBM Act States that the Central Government shall not borrow from RBI except by way of means and advances to meet temporary excess of cash disbursements over cash receipts.
- The revenue and fiscal deficit may exceed the targets specified in Rules only on grounds of national security or national calamity or such other exceptional grounds as the Central Government may specify.

FRBM- The Impact and Limitations

IMPACT ON DEFICITS

- FRBM act has been violated more than adhered to since its enactment.
- Since its enactment, the act has been paused for four times including a reset of the fiscal deficit target in 2008-09 following the global financial crisis.
- In 2010-11, Government replaced revenue deficit with the concept of Effective Revenue Deficit in the budget documents.

- In Budget 2012-13, the finance act changed the FRBM act. The amended rules extended tthe time for elimination of Effective revenue deficit by March 2015 and bringing down fiscal deficit to 3% by March 2017.
- The Act has helped on the issues relating to fiscal consolidation due to the mandatory medium- term and strategy statements which are required to be presented annually before Parliament.
- Implementing the Act, the government had managed to cut the fiscal deficit to 2.7% of GDP and revenue deficit to 1.1% of GDP in 2007–08.

IMPACT ON DEVELOPMENT

- Reductions in critical sectors of the economy has led to fall in deficits. The Union Government's development expenditure as a proportion of GDP declined in the post FRBM era from 7.49% in 2002-03 to 6.42 % in 2005-06.
- In almost all the sectors, there has been a decline in the post FRBM era. In case of education, it declined from around 2.5 % of GDP in 2002-03 to less than 2.2 % of GDP in 2005-06. In Health sector, the decline has been from 0.6% to 0.49 % and in agriculture, from 0.67 % to 0.58 %. In overall Social sectors, it declined from 4.5 %of GDP to 4.16 % of GDP during the period.
- The act impacts the social sector expenditure necessary to create productive assets and general upliftment of rural poor of India.

IMPACT ON CREDIT GROWTH

- FRBM Act ignores the possible inverse link between fiscal deficit (fiscal expansion) and bank credit (monetary expansion). If credit growth falls, fiscal deficit may need to rise and if credit rises, fiscal deficit ought to fall — to ensure adequate money supply to the economy.
- Data on money supply growth, bank credit and GDP establishes that, in the last six years, both money supply growth and credit expansion have halved absolutely and in relation to GDP growth. Combined fiscal deficit (fiscal expansion) and credit growth (monetary expansion) as a percentage of GDP has halved from 17.4 percent in 2009-10 to 8.8 per cent, which is less than nominal GDP growth. Thus the FRBM Act has not only reduced fiscal deficit but also starved the growing economy from much needed investment.

FRBM- The Impact and Limitations

The 3 per cent fiscal deficit limit from the famous Maastricht Treaty to form the European Union (EU) in 1992 was applied to Indian context without any modifications.

Fiscal deficit is the quantum amount a nation borrows to meet expenditure. The investment needs are independently determined by the structural developments in the economy, its stock of capital and its planned growth profile. Borrowing to meet investment needs capped at 3% of the GDP is not so logical.

It is in this context the Finance Minister's Budget proposal to have a committee to review the implementation of the FRBM Act is the right step to ask the question whether the law has served the purposes for which it was envisaged.

THE WAY FORWARD

The FRBM Act has the potential of ensuring macro-economic stability provided it is revised to needs of Indian economy. Further, there are some other approaches which can help:

Adopt a target range rather than a specific number, it gives the necessary policy space to deal with dynamic and volatile situations like that of India.

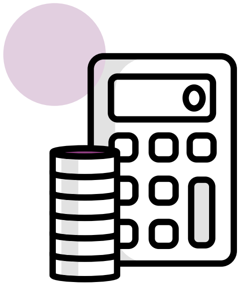
Aligning the monetary and fiscal economies so that if bank credit growth falls, fiscal deficit may need to go up.

An autonomous Fiscal Management Review Committee (FMRC) which would conduct an annual independent and public review of FRBM compliance.

Move the annual numerical targets from FRBM rules (which are framed and amended by central Government at whim by gazette notification) to the FRBM act itself.

Do away with the concept of the Effective Revenue Deficit just rewrites revenue expenditure as capital expenditure.
Resources gained from this fiscal reset should be utilised for creation of long-term public assets and putting the country back on her growth tracks.

Union Budget 2020-21 Highlights



Expenditure

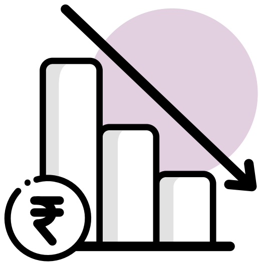
The government proposes to spend Rs 30,42,230 crore in 2020-21, which is 12.7% higher than the revised estimate of 2019-20.

Receipts

The receipts (other than net borrowings) are expected to increase by 16.3% to Rs 22,45,893 crore, owing to higher estimated revenue from disinvestments.

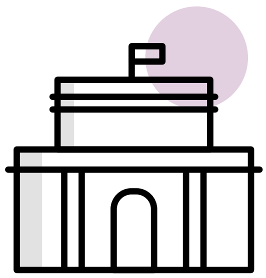
GDP growth

The government has assumed a nominal GDP growth rate of 10% (i.e., real growth plus inflation) in 2020-21. The nominal growth estimate for 2019-20 was 12%.



Deficits

Revenue deficit is targeted at 2.7% of GDP, which is higher than the revised estimate of 2.4% in 2019-20. Fiscal deficit is targeted at 3.5% of GDP, lower than the revised estimate of 3.8% in 2019-20. Note that the government is estimated to breach its budgeted target for fiscal deficit (3.3%) in 2019-20 and the medium term fiscal target of 3% in 2020-21. This does not include off-budget borrowings (0.9% of GDP in 2020-21).



Ministry allocations

Among the top 13 ministries with the highest allocations, the highest percentage increase is observed in the Ministry of Communications (129%), followed by the Ministry of Agriculture and Farmers' Welfare (30%) and the Ministry of Home Affairs (20%).

Tax proposals in the Finance Bill

In addition to changes in tax laws, the Finance Bill, 2020 also proposes certain non-tax changes to the Prohibition of Benami Properties Transactions Act, 1988.

Change in income tax rates

The income tax rates have been changed. Table 1 below compares the current tax rates with the proposed tax rates. Note that the new personal tax rates are optional and may only be availed if the person satisfies certain conditions, such as if they do not claim certain exemptions or deductions. These include standard deductions, leave travel allowance, house rent allowance, interest payment on housing loan, and deductions under Chapter VI-A (investments in provident fund, insurance premium, donations to charities, etc.). Once the option is exercised, it will be applicable for all subsequent years.

Income	Current Tax Rate	Proposed Tax Rate
Upto Rs 5 lakh	Nil	Nil
Between Rs 5 lakh and Rs 7.5 lakh	20%	10%
Between Rs 7.5 lakh and Rs 10 lakh		15%
Between Rs 10 lakh and Rs 12.5 lakh	30%	20%
Between Rs 12.5 lakh and Rs 15 lakh		25%
Above Rs 15 lakh		30%

Option for lower tax rates

The Income Tax Act was recently amended to give an option to domestic companies to avail of 22% tax rate if they did not claim certain deductions. The list has been expanded to include other deductions, such as those under Section 80G (donations to charities). Also, a similar facility has been provided to co-operatives.

Benefits to corporate

Currently, domestic manufacturing companies have an option to pay income tax at the rate of 15% if they do not claim certain deductions under the Act. This benefit has been extended to domestic companies engaged in electricity generation.

Dividend Distribution Tax

Currently, companies have to pay a tax of 15% on dividends distributed by it to shareholders. This has been removed and the dividend income will now be taxable in the hands of the recipient.

Limit on deductions for social security contributions

Currently, there is no combined limit for the purpose of deductions on the amount of contribution made by an employer towards a recognised provident fund, an approved superannuation fund and the National Pension Scheme. A combined ceiling of Rs 7.5 lakh is being introduced on deductions which may be claimed towards such contributions.

Residence in India

The Income Tax Act, 1961 specifies various conditions for determining the resident status of an Indian citizen or a person of Indian origin. A person will be considered a resident, i.e. their global income is taxable in India, if they are in India for more than 182 days. This has been reduced to 120 days. In addition, any Indian citizen who is not liable to tax in any other country or territory by reason of domicile or residence shall be deemed to be a resident of India.

TDS on E-Commerce Transactions

TDS of 1% will be levied on e-commerce transactions.

Housing Incentives

Currently, an exemption is provided on profits or gains arising out of building affordable houses if the project was approved by March

31, 2020. Further, an additional tax deduction of up to Rs 1,50,000 is provided on interest paid on loans for self-occupied house owners if the loan was sanctioned by March 31, 2020. The deadline in both cases has been extended to March 31, 2021.

Tax changes for start-ups

Start-ups are allowed to get a full tax waiver on profits for any three consecutive years out of their first seven years, if they are incorporated between April 1, 2016 and March 31, 2021, and their turnover does not exceed Rs 25 crore. The waiver has been extended to start-ups for any three years out of their first ten years. In addition, the turnover threshold has been increased from Rs 25 crore to Rs 100 crore.

Further, the tax on ESOPs (stock options) held by employees of start-ups will be payable only on the earliest of the following events:
(i) expiry of 4 years from the end of the assessment year,
(ii) sale of the options, or
(iii) till the employee leaves the company.

Excise

The rate of central excise duty on certain tobacco products such as cigarettes, chewing tobacco, and tobacco extracts has been increased. For example, the rate of duty on chewing tobacco has been increased from 10% to 25% per kg. Further, crude petroleum has been included at a rate of duty of Rs 50 per tonne.

Customs

Customs duty has been raised on some items such as tableware and kitchenware, footwear, fans, and toys.

Health cess on customs

A health cess will be levied (in addition to customs duty) on certain medical devices, such as X-ray machines, imported into India. This cess may be utilised for the financing of health infrastructure and services.

Obligations on charities

Charitable organisations get an exemption from taxation under Section 12AA, and donations to them get exemptions under Sections 10(23C), 35, and 80G. From now, the approvals under these sections will be valid for a maximum of five years. Any entity having these approvals has to get them re-issued.

Commodities Transaction Tax

Currently, the commodities transaction tax on commodity derivatives is 0.01%. The Bill creates three tax rates: (i) 0.01% payable by the seller on sale of commodity derivatives based on its price or price index, (ii) 0.0001% payable by the buyer on the sale of an option in goods resulting in the delivery of the goods, and (iii) 0.125% payable by the buyer on the sale of an option in goods resulting in cash payment.

Indian Stamp Act, 1899

Stamp duty will not be charged in the case of transactions in stock exchanges and depositories established in international financial centers set up under the Special Economic Zones Act, 2005.

Sovereign wealth funds

Income arising out of investments made by the Abu Dhabi Investment Authority and other notified sovereign wealth funds in certain infrastructure facilities will be exempt from tax. This exemption is available if the investment was made before March 31, 2024, and with a minimum lock-in period of three years.

The Prohibition of Benami Property Transactions Act, 1988

The Act constitutes an adjudicating authority on issues related to benami properties. The qualifications for the chairperson and members of the authority are that they must have been:

(i) a member of the Indian Revenue Service as Commissioner of Income-tax or equivalent, or

(ii) a member of the Indian Legal Service as Joint Secretary or equivalent.

The Bill states that an individual qualified for the position of District Judge may also be the chairperson or a member of the authority.

Removal of tax exemptions on certain allowances

Certain exemptions on facilities to current and former members of the Union Public Service Commission and the Election Commission such as rent-free residence, conveyance allowance, and medical facilities are exempt from tax. This exemption has been removed.

Policy Highlights

Legislative Changes

The Banking Regulation Act, 1949 will be amended for better governance of cooperative banks. The limit for NBFCs to be eligible for debt recovery under the SARFAESI Act, 2002 will be reduced. The asset size will be reduced from Rs 500 crore to Rs 100 crore, and loan size will be reduced from one crore rupees to Rs 50 lakh. The Deposit Insurance and Credit Guarantee Corporation has been permitted to increase deposit insurance coverage for a depositor, which will now be one lakh to five lakh rupees, per depositor. The Factor Regulation Act, 2011 will be amended to enable NBFCs to extend invoice financing to MSMEs. The PFRDA Act will be amended to separate NPS trust for government employees for PFRDAI. Laws where there is criminal liability for acts that are civil in nature will be examined and amended. Contracts Act, 1872 will be strengthened to ensure that contracts are honoured.

GST Compensation

GST compensation balances for 2016-17 and 2017-18 will be paid in two instalments. From now, transfer to GST Compensation Fund will be only through the compensation cess.

Disinvestment

The government will sell a part of its holding in LIC through an Initial Public Offer. The government also plans to sell the balance of its holding in IDBI Bank.

Investment

Certain specified categories of government securities will be opened fully for non-resident investors. The limit for Foreign Portfolio Investment in corporate bonds will be increased from 9% to 15% of the outstanding stock of corporate bonds. It has been proposed to set up an Investment Clearance Cell which will provide "end to end" facilitation and support, such as pre-investment advisory at the central and state level.

Commerce and Industry

A scheme focused on encouraging manufacturing of mobile phones, electronic equipment, and semi-conductor packaging has been proposed. The National Technical Textiles Mission will be implemented from 2020-21 to 2023-24 with an outlay of Rs 1,480 crore. A scheme will be launched for the refund of duties and taxes on exported products, which are not getting exempted under any other existing mechanism.

Infrastructure and Urban Development

The government will build 6,500 projects under the National Infrastructure Pipeline. These projects will include housing, safe drinking water, and healthcare, among others. A National Logistics Policy will be released which will clarify the roles of the central government, state governments, and key regulators. Further, it will create a single window e-logistics market. Five new smart cities will be developed in collaboration with states in public-private partnership mode.

Transport and Energy

Four railway station re-development projects and operation of 150 passenger trains will be done through public-private partnership mode. The government will encourage states to replace conventional energy meters with prepaid smart meters by 2023. It has been proposed to expand the national gas grid from 16,200 km to 27,000 km.

Agriculture and allied activities

The government will expand the Pradhan Mantri Kisan Urja Suraksha evam Utthan Mahabhiyan scheme to help 20 lakh farmers in setting up stand-alone solar pumps. Viability gap funding will be provided for setting up warehouses at the block level. All eligible beneficiaries of Pradhan Mantri Kisan Samman Nidhi will be covered under the Kisan Credit Card scheme. The government will propose comprehensive measures for 100 water stressed districts.

Technology

A policy will be introduced to enable private sector to build data centre parks. Fibre to the Home connections through Bharatnet will link one lakh gram panchayats in 2020. A new National Policy on Official Statistics has been proposed which will use latest technology including Artificial Intelligence. An outlay of Rs 8,000 crore has been proposed for the National Mission on Quantum Technologies and Applications, over a period of five years.

Education

The new National Education Policy will be announced. Steps will be taken to enable sourcing of External Commercial Borrowings and Foreign Direct Investment for education. Degree level online education programme will be started by institutions who rank within top 100 in the National Institutional Ranking framework.

Health

Jan Aushadhi Kendra scheme will be expanded to all districts and 2,000 medicines and 300 surgicals will be offered by 2024. Viability gap funding window has been proposed for setting up hospitals in the public-private partnership mode.

Social Justice

Legislative and institutional changes will be made to ensure that there is no manual cleaning of sewer systems or septic tanks. Rs 28,600 crore has been allocated for programs specific to women.

National Recruitment Agency

National Recruitment Agency will be set up for recruitment of non-gazetted posts in government and public sector banks.

Total Expenditure

The government is estimated to spend Rs 30,42,230 crore during 2020-21. This is 12.7% more than the revised estimate of 2019-20. Out of the total expenditure, revenue expenditure is estimated to be Rs 26,30,145 crore (11.9% growth) and capital expenditure is estimated to be Rs 4,12,085 crore (18.1% growth).

Transfer to states

The central government will transfer Rs 13,90,666 crore to states and union territories in 2020-21. This is an increase of 17.1% over the revised estimates of 2019-20 and includes devolution of
(i) Rs 7,84,181 crore to states, out of the centre's share of taxes, and
(ii) Rs 6,06,485 crore in the form of grants and loans.

Total Receipts

The government receipts (excluding borrowings) are estimated to be Rs 22,45,893 crore, an increase of 16.3% over the revised estimates of 2019-20. The gap between these receipts and the expenditure will be plugged by borrowings, budgeted to be Rs 7,96,337 crore, an increase of 3.8% over the revised estimate of 2019-20.

Deficits

Revenue deficit is targeted at 2.7% of GDP, and fiscal deficit is targeted at 3.5% of GDP in 2020-21. The target for primary deficit (which is fiscal deficit excluding interest payments) is 0.4% of GDP.

GDP growth estimate

The nominal GDP is estimated to grow at a rate of 10% in 2020-21. The estimated nominal GDP growth rate for 2019-20 was 12%.

Budget estimates of 2020-21 as compared to revised estimates of 2019-20

	2018-19 (Actuals)	**2019-20** (Budget Estimates)	**2018-19** (Revised Estimates)	**2020-21** (Budget Estimates)
Revenue Receipts	15,52,916	19,62,761	18,50,101	20,20,926
Capital Receipts	7,62,197	8,23,588	8,48,451	10,21,304
Total Receipts	23,15,113	27,86,349	26,98,552	30,42,230
Total Expenditure	23,15,113	27,86,349	26,98,552	30,42,230
Revenue Deficit	4,54,483	4,85,019	4,99,544	6,09,219
Effective Revenue Deficit	2,62,702	2,77,686	3,07,807	4,02,719
Fiscal Deficit	6,49,418	7,03,760	7,66,846	7,96,337
Primary Deficit	66,770	43,289	1,41,741	88,134

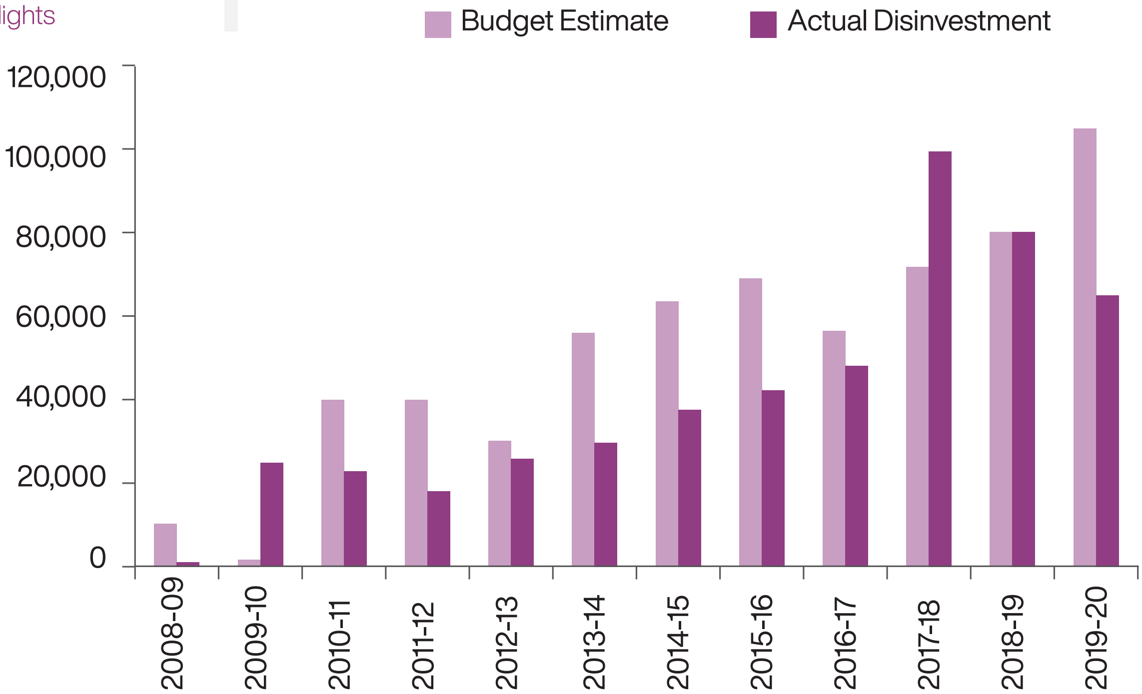
Expenses which bring a change to the government's assets or liabilities (such as construction of roads or recovery of loans) are capital expenses, and all other expenses are revenue expenses (such as payment of salaries or interest payments).

In 2020-21, capit al expenditure is expected to increase by 18.1 % over the revised estimates of 2019-20, to Rs 4,12,085 crore. On the other hand, revenue expenditure is expected to increase by 11.9% over the revised estimates of 2019-20 to Rs 26,30,145 crore.

From 2010-11 to 2020-21, capital expenditure had an annual average growth of 10.2%, while revenue expenditure had an annual average growth of 9.7%.

Disinvestment is the government selling its stakes in Public Sector Undertakings (PSUs). In 2019-20, the government is estimated to meet 62% of its disinvestment target. The disinvestment target for 2020-21 has been set at Rs 2,10,000 crore.

Budgeted vs Actual Disinvestments (Rs crore)



Note: Figures for 2019-20 are revised estimates.
Sources: Receipts Budget, Union Budget Documents 2020-21; PRS

Receipts Highlights for 2020-21

Total receipts (including borrowings) in 2020-21 are estimated to be Rs 30,42,230 crore and net receipts (excluding borrowings) to be Rs 22,45,893 crore. Receipts (without borrowings) are estimated to increase by 16.3% over the revised estimates of 2019-20.

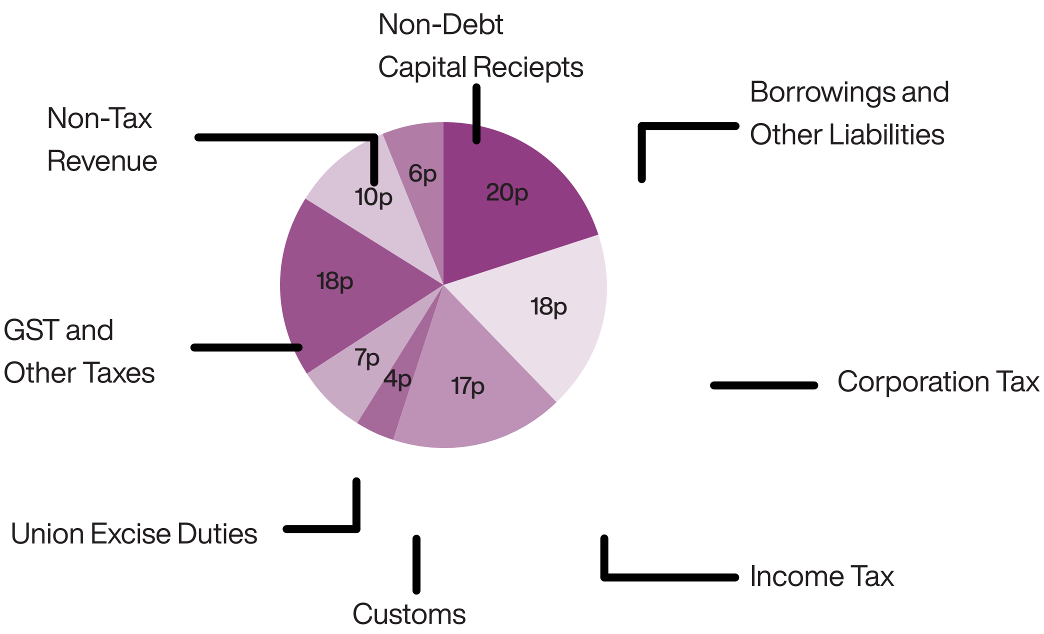
Gross tax revenue is budgeted to increase by 12% over the revised estimates of 2019-20, which is higher than the estimated nominal GDP growth of 10% in 2020-21. The net tax revenue of the central government (excluding states' share in taxes) is estimated to be Rs 16,35,909 crore in 2020-21.

Devolution to states from centre's tax revenue is estimated to be Rs 7,84,181 crore in 2020-21. In 2019-20, the devolution to states reduced by 19% from an estimate of Rs 8,09,133 crore at the budgeted stage to Rs 6,56,046 crore at the revised stage.

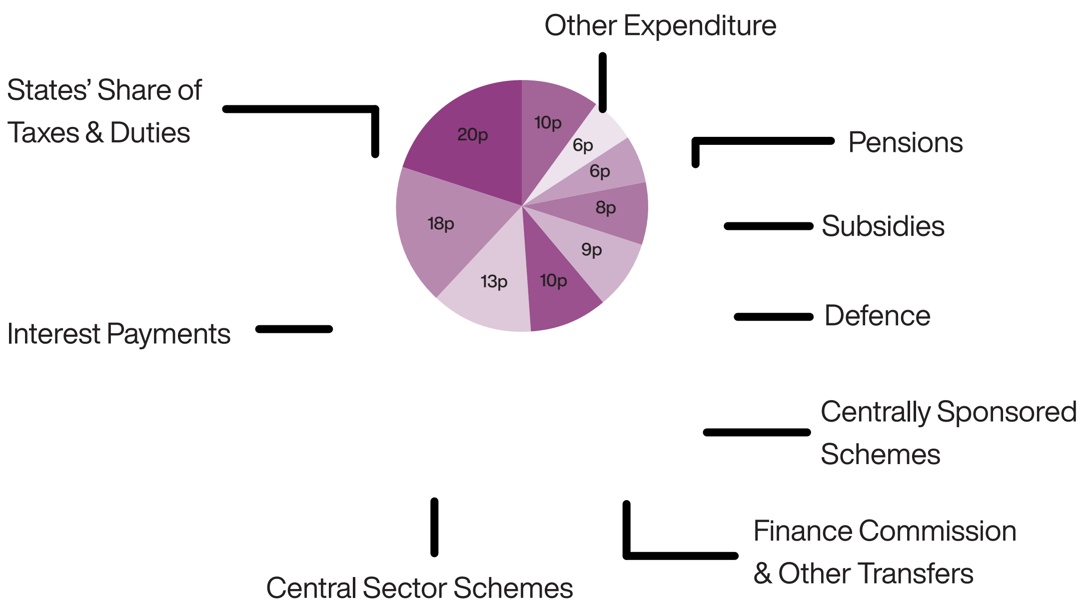
Non-tax revenue is expected to be Rs 3,85,017 crore in 2020-21. This is 11.4% higher than the revised estimate of 2019-20.

Capital receipts (without borrowings) are budgeted to increase by 175.7% over the revised estimates of 2019-20. This is on account of disinvestments, which are expected to be Rs 2,10,000 crore in 2020-21, as compared to Rs 65,000 crore as per the revised estimates of 2019-20.

Rupee Comes From



Rupee Comes To



Indirect taxes

The total indirect tax collections are estimated to be Rs 10,96,520 crore in 2020-21. Of this, the government has estimated to raise Rs 6,90,500 crore from GST. Out of the total tax collections under GST, 84% is expected to come from central GST (Rs 5,80,000 crore), and 16% (Rs 1,10,500 crore) from the GST compensation cess.

Corporation tax

The collections from taxes on companies are expected to increase by 11.5% in 2020-21 to Rs 6,81,000 crore. The revised estimates of 2019-20 indicate a 20.3% shortfall in collections from corporation tax over the budget estimates of 2019-20. This shortfall may be due to a cut in the corporate tax rates made earlier during the financial year.

Income tax

The collections from income tax are expected to increase by 14% in 2020-21 to Rs 6,38,000 crore. The 14% growth is despite a reduction in tax rates. That is, income tax is estimated to grow at 21%, if not for the Rs 40,000 crore revenue foregone due to the reduction in tax rates.

Non-tax receipts

Non-tax revenue consists of interest receipts on loans given by the centre, dividends and profits, external grants, and receipts from general, economic, and social services, among others. Non-tax revenue is expected to increase by 11.4% over the revised estimates of 2019-20 to Rs 3,85,017 crore.

Disinvestment target

The disinvestment target for 2020-21 is Rs 2,10,000 crore. This target is 223.1% higher than the revised estimate of 2019-20 (Rs 65,000 crore).

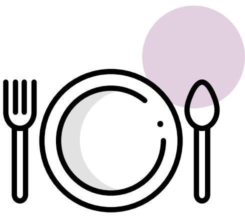
Expenditure Highlights for 2020-21

Total expenditure in 2020-21 is expected to be Rs 30,42,230 crore, which is 12.7% higher than the revised estimate of 2019-20. Out of this, (i) Rs 8,31,825 crore is proposed to be spent on central sector schemes (7.6% increase over the revised estimate of 2019-20), and (ii) Rs 3,39,894 crore is proposed to be spent on centrally sponsored schemes (7.3% increase over the revised estimate of 2019-20).

The government is expected to spend Rs 2,10,682 crore on pensions in 2020-21, which is 14.4% higher than the revised estimate of 2019-20. In addition, expenditure on interest payments in 2020-21 is expected to be Rs 7,08,203 crore, which is 23% of the government's expenditure.

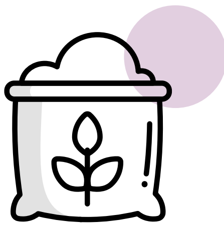
EXPENDITURE ON SUBSIDIES

In 2020-21, the total expenditure on subsidies is estimated to be Rs 2,62,109 crore, a decrease of 0.5% from the revised estimate of 2019-20. This is largely due to a decrease in expenditure on fertiliser subsidy. Details are given below:



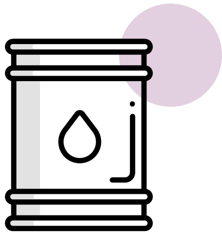
Food Subsidy

Allocation to food subsidy is estimated at Rs 1,15,570 crore in 2020-21, a 6.3% increase as compared to the revised estimate of 2019-20. In 2019-20 budget, Rs 1,84,220 crore was allocated to food subsidy. However, the revised estimate is much lower than the budgeted estimate at Rs 1,08,688 crore. This is due to a 41% cut (Rs 75,532 crore in amount) in the allocation to food subsidy for 2019-20 from the budgeted stage to the revised stage.



Fertiliser Subsidy

Expenditure on fertiliser subsidy is estimated at Rs 71,309 crore in 2020-21. This is a decrease of Rs 8,689 crore (10.9%) from the revised estimate of 2019-20.



Petroleum Subsidy

Expenditure on petroleum subsidy is estimated to increase by 6.1% to Rs 40,915 crore in 2020-21. Petroleum subsidy consists of subsidy on LPG (Rs 37,256 crore) and kerosene subsidy (Rs 3,659 crore). In 2020-21, while the LPG subsidy is estimated to increase by Rs 3,170 crore over the previous year, kerosene subsidy is estimated to decrease by Rs 824 crore.

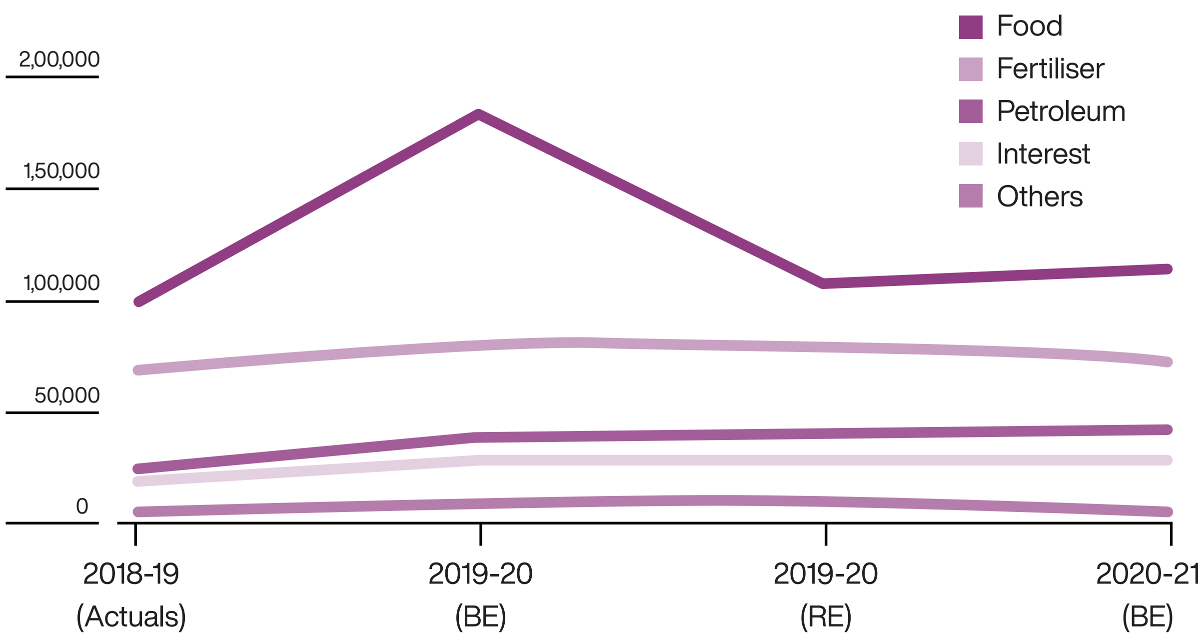
Other Subsidies

Expenditure on other subsidies includes interest subsidies for various government schemes, subsidies for the price support scheme for agricultural produce, and assistance to state agencies for procurement, among others. In 2020-21, the expenditure on these other subsidies has decreased by Rs 1,987 crore (5.5%) over the revised estimate of 2019-20. Table 4 provides details of subsidies in 2020-21.

Subdidies (in crore)

Grand Total

2018-19 (Actuals)	2019-20 (BE)	2019-20 (RE)	2020-21 (BE)
2,22,953.75	**3,38,153.67**	**2,63, 557.33**	**2,62,108.76**



EXPENDITURE BY MINISTRIES

The ministries with the 13 highest allocations account for 53% of the estimated total expenditure in 2020-21. Of these, the Ministry of Defence has the highest allocation in 2020-21, at Rs 4,71,378 crore. It accounts for 15% of the total budgeted expenditure of the central government. Other Ministries with high allocation include: (i) Home Affairs, (ii) Agriculture and Farmers' Welfare, (iii) Consumer Affairs, Food and Public Distribution, and (iv) Rural Development. Table 5 shows the expenditure on Ministries with the 13 highest allocations for 2020-21 and the changes in allocation as compared to the revised estimate of 2019-20.

Note: Expenditure is net of recoveries such as fines, and ticket sales.
Sources: Expenditure Budget, Union Budget 2020-21; PRS.

Table 5: Ministry-wise expenditure in 2020-21 (Rs crore)

	Actuals 2018-19	Budgeted 2019-20	Revised 2019-20	Budgeted 2020-21	% change (RE 2019-20 to BE 2020-21)
Defence	4,03,457	4,31,011	4,48,820	4,71,378	5.0%
Home Affairs	1,12,189	1,19,025	1,39,108	1,67,250	20.2%
Agriculture and Farmers' Welfare	53,620	1,38,564	1,09,750	1,42,762	30.1%
Consumer Affairs, Food and Public Distribution	1,08,848	1,94,513	1,17,290	1,24,535	6.2%
Rural Development	1,13,706	1,19,874	1,24,549	1,22,398	-1.7%
Human Resource Development	80,345	94,854	94,854	99,312	4.7%
Road Transport and Highways	77,301	83,016	83,016	91,823	10.6%
Communications	35,395	38,637	35,749	81,957	129.3%
Railways	54,913	68,019	69,967	72,216	3.2%
Chemicals and Fertilisers	71,414	80,534	80,968	71,897	-11.2%
Health and Family Welfare	54,682	64,559	64,609	67,112	3.9%
Housing and Urban Affairs	40,612	48,032	2,267	50,040	18.4%
Petroleum and Natural Gas	32,371	42,901	42,901	42,901	0.0%
Other Ministries	10,76,261	12,62,809	12,44,703	4,36,648	13.8%
Total Expenditure	**23,15,113**	**27,86,349**	**26,98,552**	**30,42,230**	**12.7%**

Ministry of Communications

Allocation to the Ministry of Communications increased by Rs 46,208 crore (129.3%) in 2020-21, over the revised estimate of 2019-20. This is mainly on account of capital infusion of Rs 20,410 crore in BSNL and MTNL for 4G spectrum, and Rs 13,184 crore of grants provided to them for Voluntary Retirement Scheme.

Ministry of Consumer Affairs, Food and Public Distribution

Allocation to the Ministry increased by Rs 7,245 crore (6.2%) over the previous year. In 2019-20, the Ministry was expected to spend Rs 1,94,513 crore, which has been revised down by 40% to Rs 1,17,290 crore (due to Rs 75,532 crore cut in allocation to the food subsidy).

Ministry of Home Affairs

Allocation to the Ministry of Home Affairs increased by Rs 28,142 crore (20.2%) in 2020-21, over the revised estimate of 2019-20. This is mainly on account of grants provided by the Ministry to the newly formed union territories of Jammu and Kashmir (Rs 30,757 crore), and Ladakh (Rs 5,958 crore).

Ministry of Agriculture and Farmers' Welfare

Allocation to the Ministry of Agriculture and Farmers' Welfare increased by 30.1% to Rs 1,42,762 crore in 2020-21 over the previous year. This is primarily due to an increase of Rs 20,630 crore in allocation to the PM-KISAN scheme. In 2019-20, the Ministry was allocated Rs 1,38,564 crore, which has been revised down by 21% to Rs 1,09,750 crore (due to Rs 20,630 crore of estimated underspending in PM-KISAN).

EXPENDITURE ON MAJOR SCHEMES

Sources: Expenditure Profile, Union Budget 2020-21; PRS.

Table 6: Scheme wise allocation in 2020-21 (Rs crore)

	Actuals 2018-19	Budgeted 2019-20	Revised 2019-20	Budgeted 2020-21	% change (RE 2019-20 to BE 2020-21)
PM-KISAN	1,241	75,000	54,370	75,000	37.9%
MGNREGS	61,815	60,000	71,002	61,500	-13.4%

	Actuals 2018-19	Budgeted 2019-20	Revised 2019-20	Budgeted 2020-21	% change (RE 2019-20 to BE 2020-21)
National Education Mission	30,830	38,547	37,672	39,161	4.0%
National Health Mission	31,502	33,651	34,290	34,115	-0.5%
Integrated Child Development Services	21,642	27,584	24,955	28,557	14.4%
Pradhan Mantri Awas Yojana	25,443	25,853	25,328	27,500	8.6%
Pradhan Mantri Gram Sadak Yojana	15,414	19,000	14,070	19,500	38.6%
Pradhan Mantri Fasal Bima Yojanat	11,937	14,000	13,641	15,695	15.1%
AMRUT and Smart Cities Mission	12,085	13,750	9,842	13,750	39.7%
Green Revolution	11,758	12,561	9,965	13,320	33.7%
Swachh Bharat Mission	15,374	12,644	9,638	12,294	27.6%
National Rural Drinking Water Mission	5,484	10,001	10,001	11,500	15.0%
Pradhan Mantri Krishi Sinchai Yojana	8,143	9,682	7,896	11,127	40.9%
Mid-Day Meal Programme	9,514	11,000	9,912	11,000	11.0%
National Livelihood Mission	6,282	9,774	9,774	10,005	2.4%

Among schemes, the PM-KISAN scheme (income support to farmers) has the highest allocation in 2020-21 at Rs 75,000 crore. Allocation to the scheme has increased by 37.9% from the revised estimate of 2019-20. However, in 2019-20, allocation to the scheme has been cut by Rs 20,630 crore (28%) from the budgeted stage to the revised stage. In 2018-19, expenditure on the scheme saw a 94% cut, from an estimate of Rs 20,000 crore at the revised stage to an actual expenditure of Rs 1,241 crore.

The Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) has the second highest allocation in 2020-21 at Rs 61,500 crore. This is a decrease of Rs 9,502 crore (13.4%)

from the revised estimate of 2019-20. In 2019-20, allocation to the scheme has increased by 18% from Rs 60,000 crore at the budgeted stage to Rs 71,002 crore at the revised stage.

Allocation to the Pradhan Mantri Gram Sadak Yojana has increased by 38.6% over the revised estimate of 2019-20 to Rs 19,500 crore. In 2019-20, allocation to the scheme has been cut by Rs 4,930 crore (26%) from the budgeted stage to the revised stage.

Expenditure on Scheduled Caste and Scheduled Tribe sub-plans and schemes for welfare of women, children and NER

Programmes for the welfare of women and children have been allocated Rs 2,39,504 crore in 2020-21, an increase of 3.9% over the revised estimate of 2020-21. These allocations include programmes under all the ministries.

The sub-plans for Scheduled Castes and Scheduled Tribes have been allocated a total of Rs 1,36,909 crore in 2020-21, a 12% increase over the revised estimate of 2019-20.

Sources: Expenditure Profile, Union Budget 2020-21; PRS.

Table 7: Allocations for women, children, SCs, STs and NER (Rs crore)

	Budgeted 2019-20	Revised 2019-20	Budgeted 2020-21	% change (RE 2019-20 to BE 2020-21)
Welfare of Women	1,36,934	1,42,813	1,43,462	0.5%
Welfare of Children	91,644	87,642	96,042	9.6%
Scheduled Castes	81,341	72,936	83,257	14.1%
Scheduled Tribes	52,884	49,268	53,653	8.9%
North Eastern Region (NER)	59,370	53,374	60,112	12.6%

Fiscal Responsibility and Budget Management targets

The Fiscal Responsibility and Budget Management (FRBM) Act, 2003 requires the central government to progressively reduce its outstanding debt, revenue deficit and fiscal deficit. The central government gives three year rolling targets for these indicators when it presents the Union Budget each year. Table 8 shows the targets for revenue deficit and fiscal deficit as given in the Medium Term Fiscal Policy Statement.

Table 8: FRBM targets for deficits (as % of GDP)

Sources: Medium Term Fiscal Policy Statement, Union Budget 2020-21; PRS.

	Actuals 2018-19	Revised 2019-20	Budgeted 2020-21	Target 2021-22	Target 2022-23
Fiscal Deficit	3.4%	3.8%	3.5%	3.3%	3.1%
Revenue Deficit	2.4%	2.4%	2.7%	2.3%	1.9%

Fiscal deficit is an indicator of borrowings by the government for financing its expenditure. The estimated fiscal deficit for 2020-21 is 3.5% of GDP.

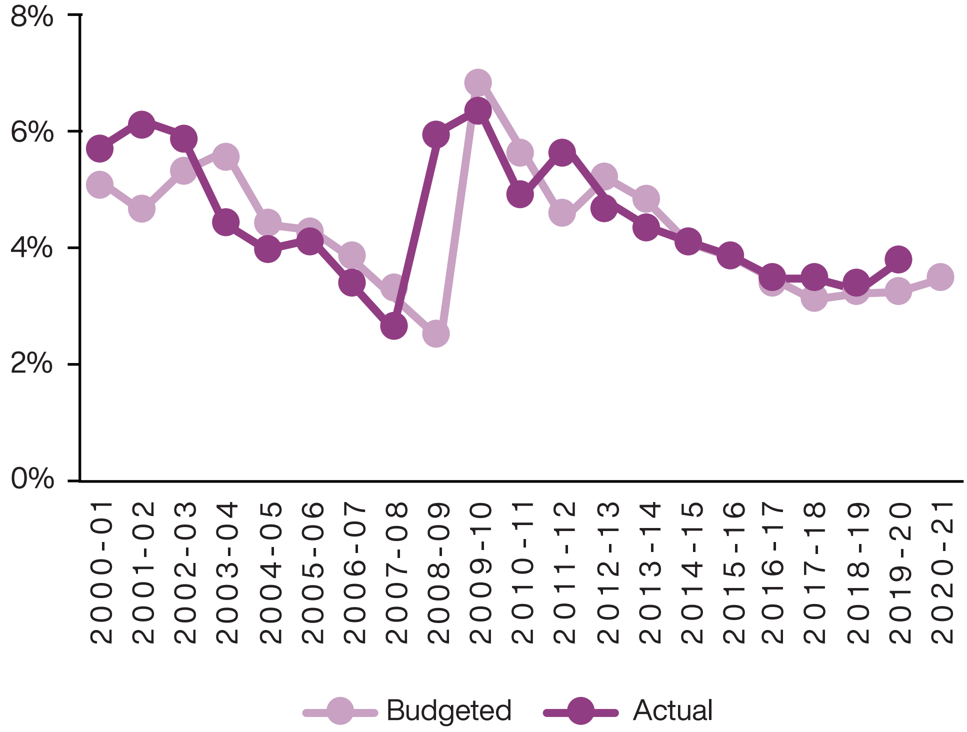
Revenue deficit is the excess of revenue expenditure over revenue receipts. Such a deficit implies the government's need to borrow funds to meet expenses which may not provide future returns. The estimated revenue deficit for 2020-21 is 2.7% of GDP.

Primary deficit is the difference between fiscal deficit and interest payments. It is estimated to be 0.4% of GDP in 2020-21.

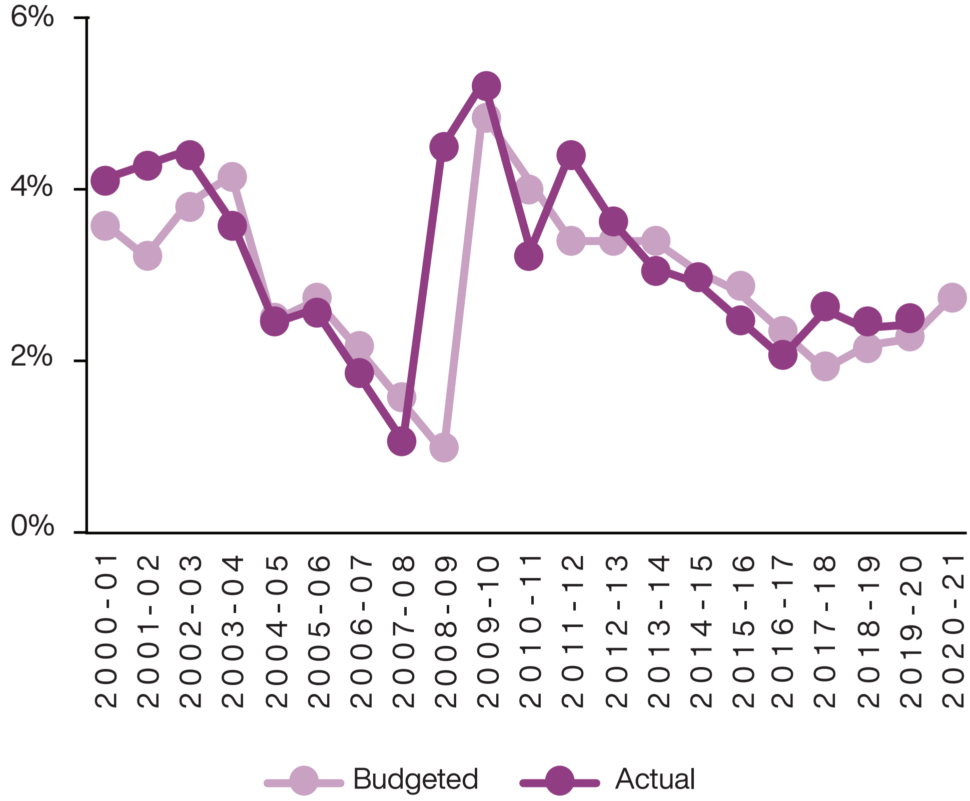
Extra-Budgetary Resources:
In addition to the expenditure shown in the budget, the government also spends through ext ra-budgetary resources. These resources are raised by issuing bonds and through loans from the National Small Savings Fund (NSSF). In 2020-21, the government estimates an expenditure of Rs 1,86,100 crore through such extra-budgetary resources. This includes an expenditure of Rs 1,36,600 crore by the Food Corporation of India financed through loans from NSSF.

Since funds borrowed for such expenditure remain outside the budget, they do not get factored in the deficit and debt figures. If borrowings made in the form of extra-budgetary resources are also taken into account, the fiscal deficit estimated for the year 2020-21 would increase from 3.5% of GDP to 4.4% of GDP. Similarly, the fiscal deficit for the year 2019-20 would increase from 3.8% of GDP to 4.6% of GDP due to extra-budgetary borrowings of Rs 1,72,699 crore.

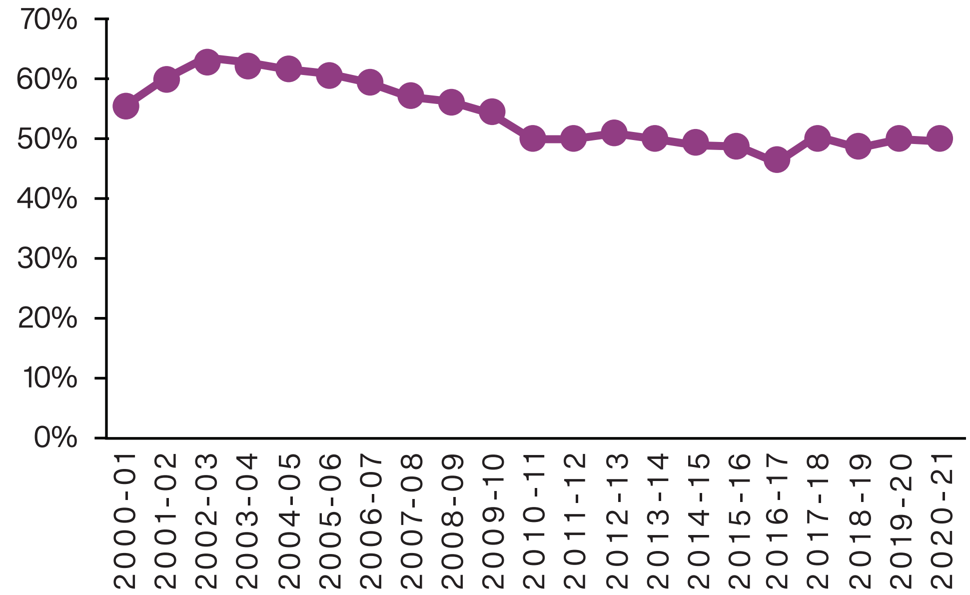
Fiscal Deficit: Budgeted vs Actual (% of GDP)



Revenue Deficit: Budgeted vs Actual (% of GDP)



Total Outstanding Debt (% of GDP)



- Over the past 15 years, the government has largely been able to keep the deficits below budgeted levels. In 2018-19, the government exceeded its budgeted target of fiscal deficit of 3.3% of GDP, as the actual deficit was at 3.4% of GDP.
- In 2019-20, the government had set a budget estimate of 3.3% of GDP for fiscal deficit, and 2.3% of GDP for revenue deficit. As per the revised estimates, both the deficits have exceeded the 2019-20 budget target.
- Outstanding debt is the accumulation of borrowings over the years. A higher debt implies that the government has a higher loan repayment obligation over the years.
- Total outstanding debt of the government has decreased from 55.5% of GDP in 2000-01 to 50.1% of GDP in 2020-21 (estimate). The FRBM Act sets a target of 40% of GDP for outstanding debt to be met by 2024-25.

05

Inflation

Introduction

It refers to the gradual rise in the general price level in the economy.

Purchasing power of the money reduces over time.

It is a rise in average price level of all goods and services in an economy.

Inflation occurs when too much money chases a few goods. In other words, the increase in money supply increases the supply of good just disproportionately.

Types of Inflation

On the basis of rate of Inflation, it is categorised into four types.

1 Creeping Inflation

less than 3%

- When the rise in prices is very slow (less than 3% Per annum) like that of snail or creeper.
- Such inflation is safe and necessary for economic growth.

2 Walking or Trotting Inflation

3 – 10%

- When prices rise moderately and the annual inflation rate is of a single digit (3 – 10%).
- Such inflation is a warning signal for the government to control it before it turns into running inflation.

3 Running Inflation

10 – 20%

- When prices rise rapidly like the running of a horse at a rate of speed of 10 – 20% per annum.
- Such inflation requires strong monetary and fiscal measures to control otherwise will lead to Hyper-inflation.

4 Galloping or Hyper-Inflation

20 – 100%

- When price rise is in between 20 – 100% per annum or even more.
- Such inflation brings total collapse of the monetary system because of the continuous fall in the purchasing power of money.

On the basis of Cause-Based Inflation

it is of Five Types

1 Demand Pull Inflation

- When demand is rising but the supply of goods is restricted.
- Can be defined as too much money chasing very few goods.
- One of the reasons for demand pull inflation can be the increase in money supply.

2 Cost Push Inflation

- Also known as supply shock inflation.
- Occurs due to reduced supplies due to increased prices of inputs.
- For example, an increase in price of international crude oil adversely affects the inputs of almost all the items in a country like India, which neither has alternatives to oil for energy needs nor has significant amount of domestic oil production.

On the basis of Cause-Based Inflation

it is of Five Types

3

Comprehensive and Sporadic Inflation

- When the prices of all the commodities rises its known as Comprehensive Inflation.
- It is also referred as Bottleneck Inflation.
- Sporadic Inflation is a sectoral inflation in which the prices of a few commodities rise. It arises because of physical bottlenecks which impedes growth in production.

4

Open and Suppressed Inflation

- It is said to be open when the Government takes no steps to control the rise in the price level. It is caused due to uninterrupted operation of the market mechanism.
- Suppressed Inflation when the Government actively intervenes to check the rise in the price level.

5

Mark-up Inflation

- It arises when a peculiar method of pricing adopted by the big business organisations.
- This is a scenario in which big business houses calculate their production costs first and then add a mark up to meet their desired profit expectations.

Causes of Inflation

Inflation can arise from internal as well as external events.

- Some inflationary pressures direct from the domestic economy, especially the ones that increase the production cost.
- Inflation can also come from external sources. Factors like rise in the international crude oil prices, fluctuations in the exchange rate or depreciation of the rupee can contribute to domestic inflation.

Due to Demand Pull Factors Inflation can occur such as

- Increase in Government Expenditure increases the money supply in the economy leaving lot of liquidity in the hands of the public. This increases the demand but due to restricted supply of good, it leads to excessive demand and thereby a rise in prices.

- Rising Population pushes up prices because of increased demand especially when the supply is unable to meet the demand.
- A large part of the black money is used in buying and selling of real estate in urban areas, extensive hoarding and black marketing in essential wage goods, such as cereals, pulses, etc. Black money, therefore, fuels demands and leads to rise in prices.
- Changing Consumption Patterns drive up prices in the economy by increasing the demand for goods consumed in larger quantities during periods of boom.

Due to Cost Push Factors Inflation can occur such as

- **Rise in wages:** Rise in wages, if greater than the rise in productivity, increases the costs therefore increasing the prices too.
- **Tax increase:** Increase in indirect taxes also leads to cost side inflation. Taxes such as custom and excise duty raise the cost of production as these taxes are levied on commodities.
- **Increase in administered prices:** such as the MSP (Minimum Support Price) for the food grains, petroleum products etc. also leads to inflation as they have a huge share in budget of common citizens.
- **Infrastructural bottlenecks:** Infrastructural bottlenecks such as the lack of proper roads, electricity, water etc. raises per unit cost of production. This is one of the prime reasons for inflation in the context of Indian economy.
- **Fluctuation due to seasonal and cyclical reasons:** Owing to events such as failed monsoons there is a drop in agricultural productivity, which inevitably results in inflation at times.

Measuring Inflation

- There are several ways to measure inflation among which India uses Wholesale Price Index and Consumer Price Index.
- Based on the Population Coverage the inflation indices are developed to understand the levels of inflation for certain sets of population such as Consumer Price Index (CPI), Producer Price Index (PPI), and the Wholesale Price Index (WPI) etc.

- On the basis of items, the inflation indices are developed to understand the levels of inflation for certain sets/basket of items.
- One feature common to all the price indices is the use of 'Base Year' which is a particular year used as a reference to calculate the price rise in a particular year.
- For Example: 2011-2012 is the base year for CPI and 2004-05 for WPI.
- In India, Consumer Price Index (CPI) and the Wholesale Price Index (WPI) are two major indices for measuring inflation in comparison to USA where CPI and PPI (Producer Price Index) are used to measure inflation.
- The Wholesale Price Index (WPI) was the main index for measurement of inflation in India till April 2014 when RBI adopted new Consumer Price Index (CPI) (combined) as the key measure of inflation.

Different measures of Inflation

WHOLESALE PRICE INDEX: (Headline Inflation)

- Calculated and released on a weekly basis for primary articles and Fuel Group, by the Office of the Economic Adviser in the Ministry of Commerce and Industry, Government of India. However, this has been discontinued since 2012 and now it is released on a monthly basis.
- The new WPI index is based on the recommendation of a working group set up under the guidance of Abhijit Sen.
- WPI is an important statistical indicator, as various policy decisions of the Government like inflation management, monitoring of prices of essential commodities etc. are based on it.
- Due to two base year for WPI (2004-05) and CPI (2012), the difference in rate occurs for WPI and CPI.
- There are a total of 676 items in the WPI and inflation is computed taking 5482 Price Quotations. These items are divided into three broad categories:
    -Primary Articles
    -Fuel and Power
    -Manufactured Products

Limitations of WPI

It does not include services such as health, IT, Education, transport etc. Also it does not account for the products of the unorganised sector in India, which constitutes about 35% of the manufactured output of the Indian economy. WPI does not take into consideration the retail prices or prices of the services.

CONSUMER PRICE INDEX

- India also measures inflation at the consumer level by the means of CPI.
- It is the measure of change in retail prices of goods and services consumed by defined population group in a given area with reference to a base year.
- Due to wide disparities in consumption basket for different segment of consumers, India has not been able to evolve a single and comprehensive consumer price index.

Types of Consumer Price Indices

Consumer Price Index for Industrial Workers (CPI-IW)

- Compiled by Labour Bureau, an attached office under the Ministry of Labour & Employment.
- It measures a change over time in prices of a fixed basket of goods and services consumed by Industrial Workers.
- The target group is an average working class family belonging to any of the seven sectors of the economy- factories, mines, plantations, motor transport, port, railways and electricity generation and distribution.
- CPI (IW) is currently calculated at base 2001=100 for 78 centres and prices are collected from 289 markets across these 78 centres.
- It contains 120–160 commodities in its basket. Basically, this index specifies the government employees (other than banks and embassies personnel).
- The index has a time lag of one month and is released on the last working day of the month.
- It is used for wage indexation and fixation of dearness allowance for government employees which is announced twice a year.
- When the Pay Commissions recommend pay revisions, the base is the CPI (IW).

Consumer Price Index for Urban Non Manual Employees (CPI-UNME)

- 1984-85 is the base year and there are 146-365 commodities in the basket for which data is collected monthly with two weeks time lag.
- It is used for determining dearness allowances (DA's) of employees and some foreign companies operating in India (i.e. Airlines, Communications, Banking, Insurance, embassies" , and other financial services).
- 5.5.3.3 Consumer Price Index for Agricultural Labors (CPI AL)
- Having 1986-87 as its base year with 260 commodities in its basket. The Data is collected in 600 villages with a monthly frequency and has three weeks time lag.
- The Index is used for revising minimum wages for agricultural labourers in different states.

Consumer Price Index for Rural Labourers/workers: (CPI RL)

- Having 1983 as the base year with 260 commodities in its basket for which data is collected from 600 villages on monthly frequency with three weeks time lag.
- In 2011, the CSO brought a revised CPI, having CPI (Urban), CPI (Rural) and CPI (Urban + Rural) with 2010 as the base price. The combined one would take into account the data from both the indices taking appropriate weights.
- CPI has much larger weightage in comparison to WPI in primary articles which is 57%
- 5.5.4 Producer Price Indexes (PPI)
- These are indices that measure the average change over time in selling prices by producers of goods and services.
- They measure price change from the point of view of the seller.
- Majority of OECD countries measure inflation based on Producer Price Index (PPI) while only some uses WPI. Countries like Japan, Greece, Norway and Turkey use WPI.

Services Price Index (SPI)

- The contribution of the tertiary sector in India's GDP has been strengthening for the past 6 to 7 years and today it stands at approximately 54 per cent. The need for a service price index (SPI) in India is warranted by the growing dominance of the sector in the economy.
- There is no index, so far, to measure the price changes in the service sector.

- The present inflation (at the WPI) only shows the price movements of the commodity-producing sector i.e. it includes only the primary and the secondary sectors-the tertiary sector is not represented by it.
- At present, efforts are being made to develop service price indices for selected services initially on an experimental basis (covering road transport, railways, airways, business, trade, port, postal telecommunications, banking and insurance services only).

Core Inflation

- Food and energy prices are not included in estimating core inflation.
- It does not include volatile items, which may distort the true picture of inflation in the economy.
- In mid 2012, RBI Governor threw up the conundrum posed by this “Core” inflation by saying “In our economy, where food constitutes nearly 50% of consumption basket and fuel has a weight of 15%, can a measure of inflation that excludes them be called “Core”.

Effects of Inflation

- Increase in the prices of goods and services makes consumption expensive. Inflation causes slow down in the economy.
- Due to budget constraints, consumers reduce their consumption for such products or they switch to inferior substitutes. Leads to fewer production of goods.
- Banks increase interest rates during inflation. This increases the borrowing cost for both consumers and corporates alike. It further leads to reduced consumer demand and low investor demand.

- Higher interest rates lead to slowdown in the economy. This leads to increase in unemployment because companies start focusing on cost cutting and reduces hiring. Remember Jet Airways lay off over 1000 employees to save cost.
- Rising inflation can prompt trade unions to demand higher wages, to keep up with consumer prices. Rising wages in turn can help fuel inflation.
- Inflation affects the productivity of companies. They add inefficiencies in the market, and make it difficult for companies to budget or plan long-term.
- Inflation can act as a drag on productivity as companies are forced to shift resources away from products and services in order to focus on profit and losses from currency inflation.

Demonetisation and its Impact On Inflation

- The Demonetization impacted the inflation negatively.
- Consumer spending activity fell to a near halt. Consumers refrained from making any purchases except essential items from the consumer staples, healthcare, and energy segments.
- The real estate sector, which includes a lot of cash and undocumented transactions, slowed down significantly as well as Metropolitan and Tier 1 cities reported a fall in house prices up to a 30%.
- Food item inflation, measured by changes in the Consumer Food Price Index, accounts for 47.3% of the overall CPI. Due to 86.4% of the value of the currency notes in circulation leaving the financial system and re-monetization being slow, the supply and demand of food items fell. It exerted more downward pressure on inflation.
- Major chunk of the Indian workforce lies in the informal sector. Most of their transactions are cash based and demonetisation has resulted in many of them losing their jobs. According to CMIE's Consumer Pyramids Household Surveys (CPHS), approximately 1.5 million jobs were lost during the final quarter of the financial year 2016-17. Further increases downside risk to inflation.

Other Relevent Terms Related To Inflation

Deflation

- Contraction in the supply of circulated money within an economy, and therefore the opposite of inflation.
- Reduction in money supply or credit availability is the reason for deflation in most cases.
- Reduced investment spending by government or individuals may also lead to this situation.
- Deflation leads to a problem of increased unemployment due to slack in demand.
- Deflation is different from disinflation as the latter implies the decrease in the level of inflation whereas deflation implies negative inflation.

Recession

- A situation which is characterized by negative growth rate of GDP into successive quarters.
- Some of the indicators of a recession include slowdown in the economy, fall in investments, fall in the output of the economy etc.

Depression

- It is an extreme form of recession and characterizes a situation in which the recession may have gone on for too long resulting in depression of the economy.
- A common rule of thumb for recession is two quarters of negative GDP growth. The corresponding rule of thumb for a depression is a 10 percent decline in gross domestic product (GDP).

Inflation Spiral

- It is also known as the wage-price spiral.
- It is a result of a process of wage and price interaction 'when wages press prices up and prices pull wages up', is known as the inflationary spiral.
- This wage-price interaction was seen as a plausible cause of inflation in the year 1935 in the US economy, for the first time.

Reflation

- Initiatives taken by the government to reduce unemployment and increase demand by going for higher levels of economic growth either through fiscal or monetary policy.
- Governments go for higher public expenditures, tax cuts, interest rate cuts, etc. Fiscal deficit rises, extra money is generally printed at higher level of growth, wages increase and there is almost no improvement in unemployment.
- It is a situation where the economy is crossing a cycle of recession (low inflation, high unemployment, low demand, etc.) and government takes some economic policy decisions to revive the economy from recession, certain goods see sudden and temporary increase in their prices, such price rise is also known as reflation.

Stagflation

- It is a condition of slow economic growth and relatively high unemployment (economic stagnation) accompanied by rising prices, or inflation and decline in GDP.
- It's an economic problem defined in equal parts by its rarity and by the lack of consensus among academics on how exactly it comes to pass.
- Usually, when unemployment is high, spending declines and prices of goods, both decline. Stagflation occurs when the prices of goods rise while unemployment increases and spending declines.
- Stagflation can prove to be a particularly tough problem for governments to deal with due to the fact that most policies designed to lower inflation tends to make it tougher for the unemployed, and policies designed to ease unemployment raise inflation.

Skewflation

- It brings sustained price rise in some particular commodities only, while at the same time other commodities can show deflation (lowering of price).
- For Example: In the beginning of year 2010-11 India had inflation in certain food commodities such as food grains, pulses, and sugar. Later in the year prices of these commodities stabilized but there was price spike in commodities such as onions, milk etc. that is a condition of skewflation prevailed at that time.

Base Effect

- The base effect refers to the impact of the rise in the price level (i.e. last year's inflation) in the previous year over the corresponding rise in price levels in the current year (i.e., current inflation).
- Inflation is calculated from a base year in which a price index is assigned the number 100. For example, if the price index in 2010 was 100 and the price index in 2011 rose to 110, the inflation rate would be 10%. If the price index rose to 115 in 2012, what would be the best way to assess inflation?

Distortion due to base effect

If the price index had risen at a high rate in the corresponding period of the previous year leading to a high inflation rate, some of the potential rise is already factored in, therefore a similar absolute increase in the Price index in the current year will lead to relatively lower inflation rates.On the other hand, if the inflation rate was too low in the corresponding period of the previous year, even a relatively smaller rise in the Price Index will arithmetically give a high rate of current inflation. This distortion is the base effect.

NEW INDEX FOR MEASURING INFLATION

The Reserve Bank of India (RBI) had adopted the new Consumer Price Index (CPI) (combined) as the key measure of inflation. The national CPI is meant to measure retail inflation. This index will combine urban and rural CPIs, both under preparation and to be released simultaneously.

Inflation Targeting & Monetary Policy Framework

a. It has been signed between Union Government and the Reserve Bank of India (RBI).

b. The Reserve Bank of India will aim to bring retail inflation below 6% by January 2016. The target of financial year 2016-17 and all subsequent years shall be four per cent with a band of (+/-) 2 per cent.

c. The agreement also requires the RBI to give the government a report in case the target is missed for a specified period.

d. The RBI is also required to make public every six months a document explaining the sources of inflation and the inflation forecast for the period between six and eight months. In case of any dispute arising out of interpretation of the agreement, it would be resolved through a meeting between the RBI governor and the government.

e. The new monetary policy committee, which will set the inflation target.

f. **The Monetary Policy Committee will comprise :**

- the Reserve Bank Chairperson as its chairperson;
- one executive member of the Reserve Bank Board nominated by the Reserve Bank Board;
- one employee of the Reserve Bank nominated by the Reserve Bank Chairperson;
- our persons appointed by the Central Government.

The objective of monetary policy is to achieve price stability while striking a balance with the objective of the Central government to achieve growth.

CRITICISM OF MECHANISM

a. The Indian economy is inflation prone and fiscal populism, is its biggest contributor. From loan waivers to corporate give-aways, fiscal policy primes the pump needlessly on many occasions for non-economic considerations.

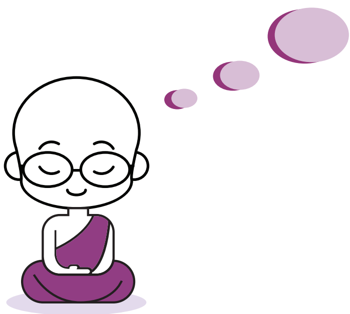
b. The government works on short term basis as Political considerations like re-election make the central government more than willing to consistently spend more than it earns despite the risks of higher future inflation and increased interest rates. This begs the question as to how the central government can be entrusted with conducting monetary policy when such a task requires a long term perspective.

06

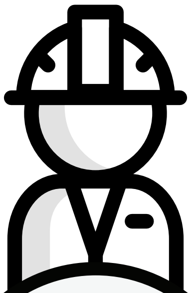
Industry

Introduction

Industry implies the transformation of existent materials into something new, into goods that are used as end-products themselves, or are utilised to manufacture more goods. Industries can be classified into several groups. A brief account is given below-



Classification of Industries

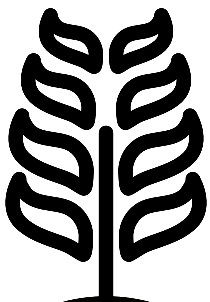


On the basis of strength of Labour

Large-scale Industries

Medium-scale Industries

Small-scale Industries



On the basis of Raw Material and Finished Goods

Heavy Industries

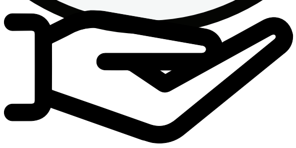
Industries, which use heavy and bulky raw materials and produce products of the same category, are called heavy industries. Iron and steel industry presents a good example of heavy industries.

Light Industries

The light industries use light raw materials and produce similar finished products. Textile industry, electronics, fans, sewing machines are light industries.

On the basis of Ownership

Since the beginning of the planned development of Indian economy in 1951, industries are divided into the following three classes:



Private Sector Industries

Industries owned by individuals or firms such as Bajaj Auto or TISCO situated at Jamshedpur are called private sector industries.

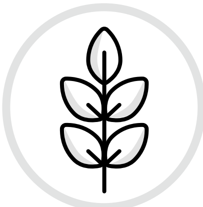
Public Sector Industries

Industries owned by the state and its agencies, like Bharat heavy Electricals Ltd. or Bhilai Steel Plant or Durgapur Steel Plant and Integral Coach Factory at Kapurthala are public sector industries.

Joint Sector Industries

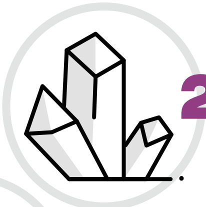
Industries owned jointly by the private firms and the state or its agencies, such as Gujarat alkalies Ltd. or Oil India Ltd., fall in the group of joint sector industries.

On the basis of source of Raw Material



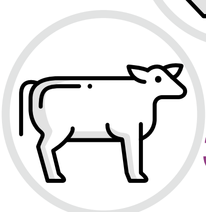
1 Agro-based Industries

Agro-based industries are those industries which obtain raw material from agriculture. Cotton textile, jute textile, silk, sugar, vegetable oil and paper industry are representative industries of agro-based group of industries.



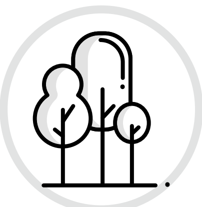
2 Mineral-based Industries

The industries that receive raw material primarily from minerals such as iron and steel, aluminium and cement industries fall in this category.



3 Pastoral-based Industries

These industries depend upon animals for their raw material. Hide, skin, bone, horn, shoes, dairy, etc., are some of the pastoral-based industries.

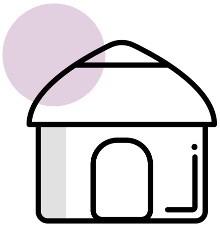


4 Forest-based Industries

The industries which use forest products as their raw materials are known as forest-based industries. Paper, card-board, lac, rayon, resin, basket, etc. are examples of forest based industries.

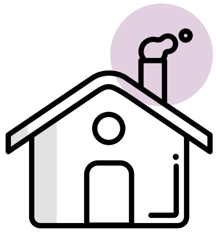
Miscellaneous Industries

Industries can also be classified into the following categories:



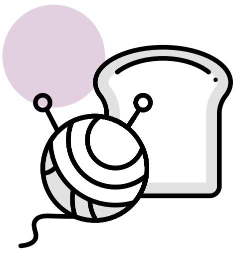
Village industries

Village industries are located in villages and primarily cater to the needs of the rural people. They usually employ local machinery such as oil extractor, flour-grinding and agricultural implements.



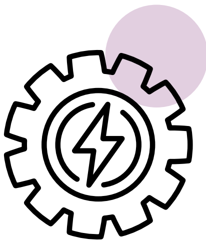
Cottage Industries

Industries which artisans set up in their own houses, work with wood, cane, brass, stone, etc., are called cottage industries. Handloom Khadi and leather work at the artisans‘ house fall in this category.



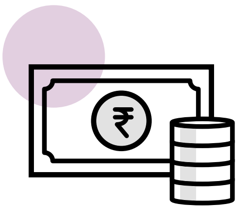
Consumer Industries

Consumer industries convert raw materials or primary products into commodities directly used by the people. Textile industry, bakeries, etc., are some of the consumer industries.



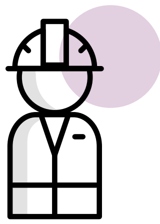
Basic Industries

Industries, on which depend many other industries for their manufacturing processes, are called basic industries. Iron and steel industry and power generating industry are included in this category.



Capital-intensive Industries

Industries requiring huge investments are called capital-intensive industries. Iron and steel, cement and aluminium are capital-intensive industries.



Labour-intensive Industries

Such industries which require huge labour force for running them are called labour-intensive industries. In these industries, labour is more important than capital. Shoe- manufacturing and bidi making, etc. are included in these industries.

Industrial Policies

MEANING

Government action to influence the ownership & structure of the industry and its performance. It takes the form of paying subsidies or providing finance in other ways, or of regulation.
It includes procedures, principles (i.e., the philosophy of a given economy), policies, rules and regulations, incentives and punishments, the tariff policy, the labour policy, government's attitude towards foreign capital, etc.

Objectives

The main objectives of the Industrial Policy of the Government in India are:

- to maintain a sustained growth in productivity;
- to enhance gainful employment;
- to achieve optimal utilisation of human resources;
- to attain international competitiveness; and
- to transform India into a major partner and player in the global arena.

Industrial Policies in India since Independence

INDUSTRIAL POLICY RESOLUTION OF 1948

- It defined the broad contours of the policy delineating the role of the State in industrial development both as an entrepreneur and authority.
- It made clear that India is going to have a Mixed Economic Model.

It classified industries into four broad areas:

Strategic Industries (Public Sector)
It included three industries in which Central Government had monopoly. These included Arms and ammunition, Atomic energy and Rail transport.

Other Industries (Private and Cooperative Sector)
All other industries which were not included in the above mentioned three categories were left open for the private sector.
The Industries (Development and Regulation) Act was passed in 1951 to implement the Industrial Policy Resolution, 1948.

Basic/Key Industries (Public-cum-Private Sector)
6 industries viz. coal, iron & steel, aircraft manufacturing, ship-building, manufacture of telephone, telegraph & wireless apparatus, and mineral oil were designated as "Key Industries" or "Basic Industries".
These industries were to be set-up by the Central Government.
However, the existing private sector enterprises were allowed to continue.

Important Industries (Controlled Private Sector)
It included 18 industries including heavy chemicals, sugar, cotton textile & woollen industry, cement, paper, salt, machine tools, fertiliser, rubber, air and sea transport, motor, tractor, electricity etc.
These industries continue to remain under the private sector however, the central government, in consultation with the state government, had general control over them.

INDUSTRIAL POLICY STATEMENT OF 1956

- Government revised its first Industrial Policy (i.e.the policy of 1948) through the Industrial Policy of 1956.
- It was regarded as the "Economic Constitution of India" or "The Bible of State Capitalism".
- The 1956 Policy emphasised the need to expand the public sector, to build up a large and growing cooperative sector and to encourage the separation of ownership and management in private industries and, above all, prevent the rise of private monopolies.
- It provided the basic framework for the government's policy in regard to industries till June 1991.

IPR, 1956 classified industries into three categories

Schedule A consisting of 17 industries was the exclusive responsibility of the State. Out of these 17 industries, four industries, namely arms and ammunition, atomic energy, railways and air transport had Central Government monopolies; new units in the remaining industries were developed by the State Governments.

Schedule B, consisting of 12 industries, was open to both the private and public sectors; however, such industries were progressively State-owned.

Schedule C- All the other industries not included in these two Schedules constituted the third category which was left open to the private sector. However, the State reserved the right to undertake any type of industrial production.

- The IPR 1956, stressed the importance of cottage and small scale industries for expanding employment opportunities and for wider decentralisation of economic power and activity
- The Resolution also called for efforts to maintain industrial peace; a fair share of the proceeds of production was to be given to the toiling mass in keeping with the avowed objectives of democratic socialism.
- Criticism: The IPR 1956 came in for sharp criticism from the private sector since this Resolution reduced the scope for the expansion of the private sector significantly.
- The sector was kept under state control through a system of licenses.

Industrial Licenses

- In order to open new industry or to expand production, obtaining a license from the government was a prerequisite.
- Opening new industries in economically backward areas was incentivised through easy licensing and subsidization of critical inputs like electricity and water. This was done to counter regional disparities that existed in the country.
- Licenses to increase production were issued only if the government was convinced that the economy required more of the goods.
- Industrial Policy Statement, 1977- In December 1977, the Janata Government announced its New Industrial Policy through a statement in the Parliament.
- The main thrust of this policy was the effective promotion of cottage and small industries widely dispersed in rural areas and small towns.
- In this policy the small sector was classified into three groups—cottage and household sector, tiny sector and small scale industries.
- The 1977 Industrial Policy prescribed different areas for large scale industrial sector- Basic industries,Capital goods industries, High technology industries and Other industries

outside the list of reserved items for the small scale sector.

- The 1977 Industrial Policy restricted the scope of large business houses so that no unit of the same business group acquired a dominant and monopolistic position in the market.
- It put emphasis on reducing the occurrence of labour unrest. The Government encouraged the worker's participation in management from shop floor level to board level.

Criticism

- The industrial Policy 1977, was subjected to serious criticism as there was an absence of effective measures to curb the dominant position of large scale units and the policy did not envisage any socioeconomic transformation of the economy for curbing the role of big business houses and multinationals.
- Industrial Policy of 1980 sought to promote the concept of economic federation, to raise the efficiency of the public sector and to reverse the trend of industrial production of the past three years and reaffirmed its faith in the Monopolies and Restrictive Trade Practices (MRTP) Act and the Foreign Exchange Regulation Act (FERA).

NEW INDUSTRIAL POLICY DURING ECONOMIC REFORMS OF 1991

The long-awaited liberalised industrial policy was announced by the Government of India in 1991 in the midst of severe economic instability in the country. The objective of the policy was to raise efficiency and accelerate economic growth.

Features of New Industrial Policy

De-reservation of Public Sector

Sectors that were earlier exclusively reserved for public sector were reduced. However, pre-eminent place of public sector in 5 core areas like arms and ammunition, atomic energy, mineral oils, rail transport and mining was continued.

Presently, only two sectors- Atomic Energy and Railway operations- are reserved exclusively for the public sector.

De-licensing

Abolition of Industrial Licensing for all projects except for a short list of industries.

There are only 4 industries at present related to security, strategic and environmental concerns, where an industrial license is currently required-

- Electronic aerospace and defence equipment
- Cigars and cigarettes of tobacco and manufactured tobacco substitutes
- Specified hazardous chemicals
- Industrial explosives

Disinvestment of Public Sector:
Government stakes in Public Sector Enterprises were reduced to enhance their efficiency and competitiveness.

Liberalisation of Foreign Investment:

- This was the first Industrial policy in which foreign companies were allowed to have majority stake in India. In 47 high priority industries, upto 51% FDI was allowed. For export trading houses, FDI up to 74% was allowed.
- Today, there are numerous sectors in the economy where government allows 100% FDI.
- Foreign Technology Agreement: Automatic approvals for technology related agreements.
- MRTP Act was amended to remove the threshold limits of assets in respect of MRTP companies and dominant undertakings. MRTP Act was replaced by the Competition Act 2002.

Outcomes of New Industrial Policies

- The 1991 policy made 'Licence, Permit and Quota Raj' a thing of the past. It attempted to liberalise the economy by removing bureaucratic hurdles in industrial growth.

- Limited role of Public sector reduced the burden of the Government.
- The policy provided easier entry of multinational companies, privatisation, removal of asset limit on MRTP companies, liberal licensing.
- All this resulted in increased competition, that led to lower prices in many goods such as electronics prices. This brought domestic as well as foreign investment in almost every sector opened to private sector.
- The policy was followed by special efforts to increase exports. Concepts like Export Oriented Units, Export Processing Zones, Agri-Export Zones, Special Economic Zones and lately National Investment and Manufacturing Zones emerged. All these have benefitted the export sector of the country.

Limitations of Industrial Policies in India

Stagnation of Manufacturing Sector

Industrial policies in India have failed to push manufacturing sector whose contribution to GDP is stagnated at about 16% since 1991.

Distortions in Industrial PatternOwing to Selective Inflow of Investments

In the current phase of investment following liberalisation, while substantial investments have been flowing into a few industries, there is concern over the slow pace of investments in many basic and strategic industries such as engineering, power, machine tools, etc.

Displacement of Labour

Restructuring and modernisation of industries as a sequel to the new industrial policy led to displacement of labour.

Absence of Incentives for Raising Efficiency

Focussing attention on internal liberalisation without adequate emphasis on trade policy reforms resulted in 'consumption-led growth' rather than 'investment' or 'export-led growth'.

Vaguely Defined Industrial Location Policy

The New Industrial Policy, while emphasised the detrimental effects of damage to the environment, failed to define a proper industrial location policy, which could ensure a pollution free development of industrial climate.

Way Forward

- Industrial policies in India have taken a shift from predominantly Socialistic pattern in 1956 to Capitalistic since 1991.
- India now has a much liberalised industrial policy regime focusing on increased foreign investment and lesser regulations.
- India ranked 77th on World Bank's Doing Business Report 2018. Reforms related to insolvency resolution (Bankruptcy and Insolvency Act, 2017) and the Goods and Services Taxes (GST) are impressive and will result in long-term gains for the industrial sector.
- Campaigns such as Make in India and Start up India have helped to enhance the business ecosystem in the country.
- However, electricity shortages and high prices, credit constraints, high unit labour costs due to labour regulations, political interference and other regulatory burdens continue to remain challenges for firm growth of the industrial sector in India.
- There is a need for a new Industrial Policy to boost the manufacturing sector in the country. Government in December 2018 also felt the need to introduce a new Industrial Policy that would be a road map for all business enterprises in the country.

Make in India

Make in India campaign was launched by the Prime Minister of India on September 25, 2014.

OBJECTIVES

- To attract foreign investment for new industrialisation and develop the already existing industry base in India to surpass that of China.
- Target of an increase in manufacturing sector growth to 12-14% per annum over the medium term.
- To increase the share of manufacturing sector in the country's Gross Domestic Product from 16% to 25% by 2022.
- To create 100 million additional jobs by 2022.
- To promote export-led growth.

OUTCOMES

- Foreign direct investment (FDI) has increased from $16 billion in 2013-14 to $36 billion in 2015-16 but it has not increased further and is not contributing to Indian industrialisation.
- FDIs in the manufacturing sector are becoming weaker than before. It has come down to $7 billion in 2017-18 as compared to $9.6 billion in 2014-15.
- FDIs in the service sector is $23.5 billion, more than three times that of the manufacturing sector which shows Indian economy's traditional strong points of having remarkably developed computer services.
- India's share in the global exports of manufactured products remains around 2% which is far less than 18% share of China.

ISSUES

Investment from Shell Companies

- Large part of the Indian FDI is neither foreign nor direct but comes from Mauritius-based shell companies which are suspected to be investing black money from India only, which is routed via Mauritius.

Low Productivity

- Productivity of Indian factories is low and workers have insufficient skills.
- McKinsey report states that Indian workers in the manufacturing sector are, on average, almost four and five times less productive than their counterparts in Thailand and China.

Small Industrial Units

- Size of the industrial units is small for attaining the desired economies of scale, investing in modern equipment and developing supply chains.
- An economy of scale is achieved when increasing the scale of production decreases long-term average costs. In other words, the cost of production per unit decreases as a company produces more units. Reducing the cost per unit of production is the most significant advantage created by economies of scale.

Complicated Labour Laws

- One of the major reasons behind small companies is the complicated labour regulations for plants with more than 100 employees.
- Government approval is required under the Industrial Disputes Act of 1947 before laying off any employees and the Contract Labour Act of 1970 requires government and employee approval for simple changes in an employee's job description or duties.

Infrastructure

- Electricity costs are almost the same in India and China but power outages are much higher in India.

Transportation

- Average speeds in China are about 100 km per hour, while in India, they are about 60 km per hour. Indian railways have saturated and Indian ports have been outperformed by a lot of Asian countries.

- The 2016 World Bank's Global Performance Index ranked India 35th among 160 countries. Singapore was ranked fifth, China 25th and Malaysia 32nd. The average ship turnaround time in Singapore was less than a day and in India, it was 2.04 days.

Red Tapism

- Bureaucratic procedures and corruption make India less attractive for investors. India has made progress in the World Bank's Ease of Doing Business (EDB) Index, but even then, is ranked 77 among 190 countries.
- While the EDB rank has improved, the Make in India campaign has not succeeded in increasing the size of the manufacturing sector relative to domestic output.
- India ranks 78 out of 180 countries in Transparency International's Corruption Perception Index. To acquire land to build a plant is very difficult here. India has slipped 10 places in the latest annual Global Competitiveness Index compiled by Geneva-based World Economic Forum (WEF).

Insufficient Rules and Regulations

- Labour reforms and land acquisition laws were not completed before making attempts to attract foreign investors to Make in India.
- Capital Outflow: In future India will have to face another external challenge in the form of capital fleeing the country. The net outflow of capital has jumped as the rupee has dropped from 54 a dollar in 2013 to more than 70 a dollar in 2019 and the rising prices of oil add to it.

STEPS TAKEN

- Government has taken steps to revise the FDI norms to make India more attractive for FDI.
- For export-oriented growth and to compete with Southeast Asian countries, especially in attracting FDIs, the reduction of the corporate tax from about 35 to about 25% is a significant move.

- The US-China trade dispute has given the competition a new dimension. After the tariffs have been increased on Chinese exports to the US, companies might shift their plants from China to other Asian countries.
- According to the Japanese financial firm Nomura's report, only three of the 56 companies that decided to relocate from China, moved to India. Foxconn is one of them which will be assembling iPhones in India.

Manufacturing Purchasing Managers' Index (PMI) & Index of Industrial Production (IIP)

There are two key parameters that the government and private sector analysts use to gauge the level of activity in the manufacturing sector. They are the Index of Industrial Production (IIP) and the Manufacturing Purchasing Managers' Index (PMI).

Index of Industrial Production

- The Index of Industrial Production (IIP) is an index which details out the growth of various sectors in an economy such as mineral mining, electricity,manufacturing, etc.
- It is compiled and published monthly by the Central Statistical Organisation (CSO), Ministry of Statistics and Programme Implementation six weeks after the reference month ends, i.e a lag of six weeks
- The Base Year of the Index of Eight Core Industries has been revised from the year 2004-05 to 2011-12 from April, 2017t

DIFFERENCE BETWEEN IIP AND PMI

- PMI is a private sector survey while the IIP is gauged by the government (CSO).
- The IIP is a measure of output. PMI measures activity at the purchasing or input stage.
- PMI is based on the survey.

Industry /Manufacturing Purchasing Managers' Index (PMI) and Index of Industrial Production (IIP)

- The Nikkei India Manufacturing PMI is based on data compiled from monthly survey responses by purchasing managers in more than 400 manufacturing companies.
- The manufacturing sector is divided into eight broad categories — basic metals, chemicals and plastics, electrical and optical, food and drink, mechanical engineering, textiles and clothing, timber and paper and transport.
- The survey responses reflect month-to-month changes based on the data collected mid-month.
- Based on the responses the PMI is calculated with the weightage under 5 indices- new orders (weightage 0.3), output (0.25), employment (0.2), suppliers' delivery times (0.15), stock of items purchased (0.1) and the delivery times index inverted so that it moves in a comparable direction.
- A score above 50 denotes expansion while one below 50 signifies contraction.
- As with the IIP, the PMI suffers from the lacuna of not measuring informal sector activity. PMI is also susceptible to sampling errors, errors in assigning weights to various indicators and errors that creep in due to inaccurate responses. One important advantage the PMI has over the IIP is how quickly the data for any reporting period comes out.

CORE SECTOR INDUSTRIES

- The eight core sector industries include coal, crude oil, natural gas, refinery products, fertiliser, steel, cement and electricity
- The eight core industries comprise 40.27% of the weight of items included in the Index of Industrial Production (IIP).
- The eight Core Industries in decreasing order of their weightage: Refinery Products> Electricity> Steel> Coal> Crude Oil> Natural Gas> Cement> Fertilizers.

Industry	Weight (In percentage)
Petroleum & Refinery production	28.04
Electricity generation	19.85
Steel production	17.92
Coal production	10.33

Industry	Weight
Crude Oil production	8.98
Natural Gas production	6.88
Cement production	5.37
Fertilizers production	2.63

Micro, Small and Medium Enterprises (MSME)

INTRODUCTION

- Worldwide, MSMEs have been accepted as the engine of economic growth and for promoting equitable development.
- They constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth.
- With low investment requirements, operational flexibility and the capacity to develop appropriate indigenous technology, SMEs have the power to propel India to new heights.
- Hence, it seems like there is a silent revolution happening in India powered by MSMEs.

IMPORTANCE OF MSMES FOR INDIAN ECONOMY

Employment

It is the second largest employment generating sector after agriculture. It provides employment to around 120 million persons in India.

Contribution to GDP

With around 36.1 million units throughout the geographical expanse of the country, MSMEs contribute around 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities.

MSME ministry has set a target to up its contribution to GDP to 50% by 2025 as India becomes a $5 trillion economy.

Exports

It contributes around 45% of the overall exports from India.

Inclusive growth

MSMEs promote inclusive growth by providing employment opportunities in rural areas especially to people belonging to weaker sections of the society.

For example: Khadi and Village industries require low per capita investment and employs a large number of women in rural areas.

Financial inclusion

Small industries and retail businesses in tier-II and tier-III cities create opportunities for people to use banking services and products.

Promote innovation

It provides opportunity for budding entrepreneurs to build creative products boosting business competition and fuels growth.

Thus, Indian MSME sector is the backbone of the national economic structure and acts as a bulwark for Indian economy, providing resilience to ward off global economic shocks and adversities.

MSME REDEFINED

- The Micro Small and Medium Enterprises (MSME) Ministry has issued consolidated notification for classification and registration of MSMEs to be effected from July 1 2020.
- This notification would supersede all earlier notifications with regard to classification or registration of MSMEs.

As per the latest notification:

- An MSME would hereafter been referred to as Udyam and the registration process as Udyam Registration.
- The Registration can be filed online based on self-declaration. Uploading of documents, papers or certificate as proof would not be necessary henceforth.
- The basic criteria for MSME classification would be on investment in plant, machinery and equipment and turnover.

- Export of goods or services or both would be excluded while calculating the turnover of any enterprise and investment calculation linked to the IT return of the previous year.
- Champions Control Room across the country have been made legally responsible for facilitating entrepreneurs in registration and thereafter.
- As per the latest classification:
- Micro enterprises would be those with investments not exceeding Rs one crore and turnover of Rs 5 crore.
- Small enterprises would be those with investment up to Rs 10 crore and turnover of up to Rs 50 crore.
- Medium enterprises – as those with investments not exceeding Rs 50 crore and turnover of Rs 250 crore.

OLD

Existing MSME Classification **Criteria : Investment in Plant & Machinery or Equipment**			
Classification	**Micro**	**Small**	**Medium**
Mfg. Enterprises	Investment<Rs. 25 lac.	Investment<Rs. 5 cr.	Investment<Rs. 10 cr.
Services Enterprise	Investment<Rs. 10 lac.	Investment<Rs. 2 cr.	Investment<Rs. 5 cr.

NEW

Revised MSME Classification **Composed Criteria : Investment & Annual Turnover**			
Classification	**Micro**	**Small**	**Medium**
Manufacturing & Services	Investment<Rs. 1 cr. and Turnover<Rs. 5 cr.	Investment<Rs. 10 cr. and Turnover<Rs. 50 cr.	Investment<Rs. 20 cr. and Turnover<Rs. 100 cr.

SIGNIFICANCE & IMPLICATIONS OF THESE MEASURES

The measures would completely change the way MSMEs work, ensuring they compete globally besides resulting in newer enterprises entering the fray.

With the stimulus, these enterprises will be in a position to lead to a fast V-shaped recovery the moment the pandemic is brought under control.

FACTORS WHICH LED TO GROWTH OF MSMEs

- Campaigns like Skill India, Startup India, Digital India and Make in India aim to provide MSME players with a level playing field and a definitive push towards enhanced productivity.
- **Digitization**: Increasing internet penetration, customer's familiarization with digital payments fuelled by B2C ecommerce players facilitate MSME sector growth.
- Tie-ups with new-age non-banking finance (FinTech) companies allowed access to timely collateral free finance to MSMEs.
- **Changing employment patterns:** Younger generation shifting from agriculture towards entrepreneurial activities creating job prospects for others.

GOVERNMENT SCHEMES TO PROMOTE MSMEs

Udyami Mitra Portal

launched by SIDBI to improve accessibility of credit and handholding services to MSMEs.

MSME Sambandh

To monitor the implementation of the public procurement from MSMEs by Central Public Sector Enterprises.

MSME Samadhaan

MSME Delayed Payment Portal –– will empower Micro and Small entrepreneurs across the country to directly register their cases relating to delayed payments by Central Ministries/Departments/ CPSEs/State Governments.

Digital MSME Scheme

It involves usage of Cloud Computing where MSMEs use the internet to access common as well as tailor-made IT infrastructure

Prime Minister Employment Generation Programme

It is a credit linked subsidy program under the Ministry of MSME.

Revamped Scheme of Fund for Regeneration Of Traditional Industries (SFURTI)

organizes traditional industries and artisans into clusters and make them competitive by enhancing their marketability & equipping them with improved skills.

A Scheme for Promoting Innovation, Rural Industry & Entrepreneurship (ASPIRE)

creates new jobs & reduce unemployment, promotes entrepreneurship culture, facilitates innovative business solution etc.

National Manufacturing Competitiveness Programme (NMCP)

to develop global competitiveness among Indian MSMEs by improving their processes, designs, technology and market access.

Micro & Small Enterprises Cluster Development Programme (MSE-CDP)

adopts cluster development approach for enhancing the productivity and competitiveness as well as capacity building of MSEs.

Credit Linked Capital Subsidy Scheme (CLCSS)

is operational for upgradation of technology for MSMEs.

07

Financial Market

Introduction

Capital Market is a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities.

So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising capital by issuing various securities such as shares, debentures, bonds, etc.

Capital Market

CLASSIFICATION

Capital market can be classified into – Primary and Secondary Market.

Primary Market	Secondary Market
The primary market is a market for new shares. The companies have to follow well defined procedures when they are auctioning their shares for the first time. This is called Initial Public Offer. At this stage, the investment banks are involved in setting a price for the shares which the company is issuing. The major players in the primary market are merchant bankers, mutual funds, financial institutions, and individual investors.	The secondary market is a market for trading of existing securities. The secondary market known as stock market or stock exchange plays an equally important role in mobilising long-term funds by providing the necessary liquidity to holdings in shares and debentures. It is an organised market where shares and debentures are traded regularly with high degree of transparency and security.

Functions of the Capital Market

Mobilisation of Savings

Capital market is an important source for mobilising idle savings from the economy. It activates the ideal monetary resources and puts them in proper investments.

Capital Formation

Capital market helps in capital formation. Capital formation is net addition to the existing stock of capital in the economy.

Speed up Economic Growth and Development

Capital market enhances production and productivity in the national economy. As it makes funds available for a long period of time, the financial requirements of business houses are met by the capital market.

Proper Regulation of Funds

Capital market also helps in proper allocation of these resources. It can have regulation over the resources so that it can direct funds in a qualitative manner.

Continuous Availability of Funds

Capital market is a place where the investment avenue is continuously available for long-term investment. This is a liquid market as it makes funds available on a continuing basis. Both, the buyers and the sellers can easily buy and sell securities.

DEVELOPMENT FINANCIAL INSTITUTIONS

Development financial institutions were set up to meet the medium and long-term requirements of industry, trade and agriculture. These are IFCI, ICICI, IDBI, SIDBI, IRBI, UTI, LIC, GIC etc.
All these institutions have been called Public Sector Financial Institutions.

FINANCIAL INTERMEDIARIES

Financial Intermediaries include Merchant banks, Mutual Fund, Leasing companies, etc. ▪ They help in mobilising savings and supplying funds to the capital market.

Securities Market

The securities market is divided into a. Government Securities Market and Corporate or industrial securities market.

Government Securities Market – Gilt-Edged Market

- The gilt-edged market is also known as the securities guaranteed (both principal and interest) by the government apart from government securities. The government securities are risk free because the government can‘t default on its payment obligations and are hence known as gilt-edged (which means of the best quality).

- The important characteristics of the government securities are:
- It is without risk and returns are guaranteed.
- Government securities market consists of the new issues market and the secondary market.
- R.B.I. is responsible for all the new issues of government loans, as it manages entirely the public debt operations of both the central and state governments.
- The secondary market deals in old issues.
- Government securities are the most liquid debt instruments.
- The transactions in the government securities market are large.

Industrial Securities Market

Securities issued by firms (i.e. shares, bonds and debentures) can be bought and sold freely in the corporate securities market. It comprises the new issues market (the primary market) and the secondary market (stock exchanges).

Primary Market	Secondary Market/ Stock Exchange
▪ The new issues market is concerned with the issue of new securities-bonds debentures, shares and soon. ▪ Funds are often raised by the public limited companies from the primary market for setting up or expanding their business. However, the company has to fulfil various requirements and decide upon the appropriate timing and method of issue for selling its securities. ▪ The various methods through which capital can be raised are: By Prospectus, By Offer for Sale, By Private Placing, By offering Rights Issue	▪ The stock exchange or the secondary market is a highly organised market for the purchase and sale of second-hand quoted or listed securities. ▪ Quoting or listing of a particular security implies incorporating that security in the register of the stock exchange so that it can be bought and sold there. ▪ A stock exchange is an association or a body of individuals, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities

Share Capital

The companies registered under the Companies Act, 2013 are of three types as follows:

Unlimited Company

The unlimited company is a company where there is no limit on the liability of its members. This means that if the company suffers a loss and the company's property is not enough to pay off its debts, the private property of its members is used to meet the claims of the creditors. This means that there is a huge risk in such companies.

Company Limited by Guarantee

In such a company, the liability of the members is limited to the extent of guarantee given by them in the event of winding up of the company.

Company Limited by Shares

In this the liability of the members is strictly limited to the extent of nominal value of shares held by each of them. If a member has already paid the full amount of the shares, he shall not be liable to pay any amount. If a member has partly paid the shares, he can be forced to pay the remaining amount during the existence of the company as well as during the winding up. Such companies are of two kinds, private and public.

Private Company

A private company is the one which has a minimum paid up share capital of Rs.100000 or such higher capital as prescribed by the Companies Act. Its Article of association mentions that the company –

- Restricts the right to transfer its shares.
- Limits the number of its members from 2 to 50.
- Cannot go for invitation from public to subscription to any of its shares.
- Cannot accept deposits from persons other than its members, directors and relatives.

Public Company

A public company means a company which is not a private company and has minimum of 7 shareholders/subscribers. It has to have a minimum paid-up share capital of 5 Lakh.

TYPES OF SHARE CAPITAL OF THE COMPANY

There are various terms used in connection with the share capital of the company. They are as follows:

Authorised / Registered / Nominal Capital

This is the Maximum Capital which the company can raise in its life time. This is mentioned in the Memorandum of the Association of the Company. This is also called as Registered Capital or Nominal Capital.

Issued Capital

This is the part of the Authorised Capital which is issued to the public for Subscription. The act of creating new issued shares is called issuance, allocation or allotment. After allotment, a subscriber becomes a shareholder. The number of issued shares is a subset of the total authorised shares.[Shares authorised = Shares issued + Shares unissued]

Subscribed Capital

The issued Capital may not be fully subscribed by the public. Subscribed Capital is that part of issued Capital which has been taken off by the public i.e. the capital for which applications are received from the public. So, it is a part of the Issued Capital as follows [Issued Capital = Subscribed Capital + Unsubscribed Capital]. Once the shares have been issued and purchased by investors and are held by them, they are called Shares Outstanding.

These outstanding shares have rights and represent ownership in the corporation by the person that holds the shares.

Called – up Capital

The Company may not need to receive the entire amount of capital at once. It may call up only part of the subscribed capital as and when needed in instalments. Thus, the called – up Capital is the part of - subscribed capital which the company has actually called upon the shareholders to pay.

Paid-up Capital

The Called-up Capital may not be fully paid. Some Shareholders may pay only part of the amount required to be paid or may not pay at all. Paid-up Capital is the part of called-up capital which is actually paid by the shareholders. The remaining part indicates the default in payment of calls by some shareholders, known as Calls in Arrears.

Paid-up Capital = Called-up Capital – Calls in Arrears

Reserve Capital

As mentioned above, the company by special resolution may determine that a portion of the uncalled capital shall not be called up, except in the event of the winding up of the company. This part is called Reserved Capital. It is kept reserved for the Creditors in case of the winding up of the company.

Stock Markets

- A stock market or equity market is the aggregation of buyers and sellers of stocks and shares.
- A stock exchange is a place to trade stocks.
- Companies may want to get their stock listed on a stock exchange. Other stocks may be traded - over the counter, that is, through a dealer.
- To be able to trade a security on a certain stock exchange, it must be listed there.
- A large company will usually have its stock listed on many exchanges across the world. Comparison between Bull Market and Bear Market.

- There are two ways to describe the general conditions of the stock market. It can be a bull market or a bear market.
- A bear market indicates the continuous downward movement of the stock market. Conversely, a bull market indicates the constant upward movement of the stock market.
- A particular stock that seems to be increasing in value is described to be bullish while a stock that seems to be decreasing in value is described to be bearish.
- A bear market is the stock market wherein the prices of the key stocks have fallen by 20% or more over a period of at least two months.
- Bull markets, being the opposite of bear markets, indicate a rise in the prices of the key stocks over a certain period of time.

Stock Indices and Stock Exchanges

S&P BSE SENSEX

- The S&P BSE SENSEX (S&P Bombay Stock Exchange Sensitive Index), also called the BSE 30 or simply the SENSEX, is a free-float market-weighted stock market index of 30 well-established and financially sound companies listed on Bombay Stock Exchange.
- The 30 component companies which are some of the largest and most actively traded stocks are representative of various industrial sectors of the Indian economy.
- Published since 1 January 1986, the S&P BSE SENSEX is regarded as the pulse of the domestic stock markets in India.
- The base value of the S&P BSE SENSEX is taken as 100 on 1st April 1979, and its base year as 1978-79.
- On 25 July 2001 BSE launched DOLLEX-30, a dollar-linked version of S&P.

Nifty 50

- The CNX Nifty, also called the Nifty 50 or simply the Nifty, is National Stock Exchange of India's benchmark Index for Indian Equity market. 'CNX' in its name stands for 'CRISIL NSE Index'. b. The CNX Nifty covers 22 sectors of the Indian economy.
- Credit Rating Information Services of India Limited (CRISIL) is a global analytical company providing ratings, research, and risk and policy advisory services.

Carbon Index

The Bombay Stock Exchange (BSE) in collaboration with the UK government has launched the first ever 'Carbon Indexing Project'. The Carbon Indexing Project will rate BSE- listed companies on the basis of their carbon emissions and compare it to their performance on the stock exchange.

Over the Counter Exchange of India (OTCEI)

The Over the Counter 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.

Instruments of stock market

Forward contracts

A customised contract between two parties to buy or sell an asset at a specified price on a future date. A forward contract can be used for hedging or speculation, although its non-standardised nature makes it particularly apt for hedging. Unlike standard futures contracts, a forward contract can be customised to any commodity, amount and delivery date.

Futures contracts

A contractual agreement, generally made on the trading floor of a futures exchange, to buy or sell a particular commodity or financial instrument at a pre-determined price in the future. Futures contracts detail the quality and quantity of the underlying asset; they are standardised to facilitate trading on a futures exchange.

Options contracts

A contract that allows the holder to buy or sell an underlying security at a given price, known as the strike price. The two most common types of options contracts are put and call options, which give the holder-buyer the right to sell or buy respectively, the underlying at the strike if the price of the underlying crosses the strike. Typically each options contract is written on 100 shares of the underlying.

Debentures

Debentures are bonds that are not secured by specific property or collateral. Instead, they are backed by the full faith and credit of the issuer, and bondholders have a general claim on assets that are not pledged to other debt.

Stock Trading

Buying and selling of stocks is called stock trading. Mainly there are two ways of doing stock trading.

Online Stock Trading

Doing stock trading with help of computer, internet connection and with trading/demat account is called Online Stock Trading.

Offline Stock Trading

Doing stock trading with the help of broker or through phone is called Offline trading. In other words trading will be done by another person on your behalf based on the instructions given by you, and then the other person can be a broker. The broker will do buying and selling of stocks on your behalf depending on the instructions given by you. If you want to do offline stock trading then you need to open the dematerialisation account.

Investment in Short term, Mid-term and Long term trading

Short-term Trading

Stock trading done from one week to couple of months is called short term. Companies or sectors having some breaking news will be used for short term trading.

Mid-term Trading

Stock trading done from one month to couple of months, say six to eight months is called midterm trading. Companies' announcements of quarterly results or some big foreign acquisitions will be used for midterm trading.

Long-term Trading

Stock trading done form couple of months to couple of years is called long term trading. Companies whose fundamentals are good and have good future plans then the stocks of these companies are used for long term trading. Generally traders having good capital go for long term trading.

Stock Market Regulator

SEBI

The Securities and Exchange Board of India is the regulator for the securities market in India. It was established in the year 1988 and given statutory powers on 12 April 1992 through the SEBI Act, 1992. The SEBI is managed by its members, which consists of a Chairman who is nominated by Union Government of India; two members who are officers from Union Finance Ministry; one member from The Reserve Bank of India and the remaining 5 members are nominated by Union Government of India, out of them at least 3 are whole-time members.

The role or functions of SEBI are discussed below:

- To protect the interests of investors through proper education and guidance as regards their investment in securities.
- To regulate and control the business on stock exchanges and other security markets.
- To make registration and to regulate the functioning of intermediaries such as stock brokers, sub- brokers, share transfer agents, merchant bankers and other intermediaries operating on the securities market.
- To register and regulate the working of mutual funds including UTI (Unit Trust of India).
- To promote self-regulatory organisation of intermediaries. SEBI is given wide statutory powers. However, self-regulation is better than external regulation.
- To regulate mergers, takeovers and acquisitions of companies in order to protect the interest of investors.
- To prohibit fraudulent and unfair practices of intermediaries operating on securities markets.
- To issue guidelines to companies regarding capital issues. Separate guidelines are prepared for first public issue of new companies, for public issue by existing listed companies and for first public issue by existing private companies.
- To conduct inspection, inquiries & audits of stock exchanges, intermediaries and self-regulating organisations and to take suitable remedial measures wherever necessary.
- To restrict insider trading activity through suitable measures.

Terminologies Associated With Capital Market

Floating Rate Bonds

Floating Rate Bonds are securities which do not have a fixed coupon rate. The coupon is re-set at pre-announced intervals (say, every six months or one year) by adding a spread over a base rate. Floating Rate Bonds were first issued in September 1995 in India.

State Development Loans

State Governments also raise loans from the market. SDLs are dated securities issued through an auction similar to the auctions conducted for dated securities issued by the Central Government. Interest is serviced at half-yearly intervals and the principal is repaid on the maturity date. Like dated securities issued by the Central Government, SDLs issued by the State Governments qualify for SLR. They are also eligible as collaterals for borrowing through market repo as well as borrowing by eligible entities from the RBI under the Liquidity Adjustment Facility (LAF).

Equity

Equity is the money invested in a firm to finance its operations. It generally has a lock-in period during which they are not traded on the stock exchange. When listed, equity is in the form of shares and provides ownership of the company to the shareholder.

Debt

To finance its operations, the company can resort to either infusing equity or raising debt. Debt is essentially borrowing from an institution or an individual which necessarily has to be paid at a future date.

Mutual Funds

An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors.

Venture capital

It is the money provided by investors to startup firms and small businesses with perceived long-term growth potential. This is a very important source of funding for startups that do not have access to capital markets. It typically entails high risk for the investor, but it has the potential for above-average returns. Most venture capital comes from a group of wealthy investors, investment banks and other financial institutions that pool such investments or partnerships.

Angel investors

An angel Investor or angel (also known as a business angel or informal investor) is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.

External Commercial Borrowings

Any money that has been borrowed from foreign sources for financing the commercial activities in India is called External Commercial Borrowings.

Foreign Currency Convertible Bonds

FCCBs mean a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency. The ECB policy is applicable to FCCBs.

American Depository Receipts

Introduced to the financial markets in 1927, an American Depository Receipt (ADR) is a stock that trades in the United States but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on American markets just like regular stocks, and are issued/sponsored in the U.S. by a bank or brokerage.

Global Depository Receipts

In order to ensure that investors from different countries and not one country alone may invest in a corporate entity, it was essential to make available stocks on an international level. A Global Depository Receipt (GDR) is when a bank issued certificate in more than one country for shares in a foreign company. The shares are held by a foreign branch of an international branch.

Euro issues

Euro issues are simply means of raising finances in the international market. It is a misnomer as initially they were aimed at European markets and were located on the Luxemburg or London exchanges but now they have expanded to tap the global market. They include ADRs, GDRs and FCCBs.

Buy-back of shares

The repurchase of outstanding shares by a company in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available (reducing supply), or to eliminate any threats by shareholders who may be looking for a controlling stake.

Foreign Institutional Investors

FII is an investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds. The term is used most commonly in India to refer to outside companies investing in the financial markets of India. International institutional investors must register with the Securities and Exchange Board of India to participate in the market.

The recent boom in the stock market was due to huge FII inflows because of a bullish market. Due to their high volatility, FIIs are sometimes called as Hot Money. Such a scenario was seen during the East Asian crisis in 1997 when FIIs withdrew investments from ASEAN nations resulting in a financial crisis.

Qualified Foreign Investors

A QFI is an individual, group or association resident n a foreign country that is compliant with the Financial Action Task Force standards. Till 2012, they were investing in India trough the FIIs registered with SEBI. From 2012, they are allowed to invest directly for which SEBI and RBI have made the necessary rules.

P-Notes

Participatory Notes — or P-Notes or PNs — are instruments issued by registered foreign institutional investors to overseas investors, who wish to invest in the Indian stock markets without registering themselves with the market regulator, the Securities and Exchange Board of India. P-Notes are issued to the real investors on the basis of stocks purchased by the FII. The registered FII looks after all the transactions, which appear as proprietary trades in its books. It is not obligatory for the FIIs to disclose their client details to the SEBI, unless asked specifically.

Hedge funds

Hedge funds, which invest through participatory notes, borrow money cheaply from Western markets and invest these funds into stocks in emerging markets. Financial instruments used by hedge funds that are not registered with Sebi to invest in Indian securities.

Initial Public Offering

An initial public offering (IPO) is the first sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking the capital to expand, but can also be done by large privately owned companies looking to become publicly traded.

Offer for Sale

OFS mechanism facilitates the promoters of an already listed company to sell or dilute their existing shareholdings through an exchange based bidding platform.

Follow on Public Offer

A follow on public offer (FPO) is an issuing of shares to investors by a public company that is already listed on an exchange. An FPO is essentially a stock issue of supplementary shares made by a company that is already publicly listed and has gone through the IPO process.

Money Markets

- The money market is that part of a financial market which deals in the borrowing and lending of short term loans generally for a period of less than or equal to 365 days. It meets the short term requirements of borrowers and provides liquidity or cash to the lenders.
- It is a place where short term surplus investible funds at the disposal of financial institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government.
- The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialised financial institutions. The Reserve Bank of India is the leader of the money market in India.
- Money market does not refer to any specific market place. Rather it refers to the whole networks of financial institutions dealing in short-term funds, which provides an outlet to lenders and a source of supply for such funds to borrowers.
- It should be noted that money market does not deal in cash or money but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money.

- Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

Structure of Indian Money Market

Indian money market is characterised by two sectors –
Organised sector- The organised sector is within the direct purview of RBI regulations.

Unorganised sector – The unorganised sector consists of indigenous bankers, money lenders, non- banking financial institutions, etc.

Major Functions of Money Market

1
To maintain monetary equilibrium
It means to keep a balance between the demand for and supply of money for short term monetary transactions.

2
To promote economic growth
Money market can do this by making funds available to various units in the economy such as agriculture, small scale industries, etc.

3
To provide help to Trade and Industry
Money market provides adequate finance to trade and industry. Similarly, it also provides facility of discounting bills of exchange for trade and industry.

4
To help in implementing Monetary Policy
It provides a mechanism for an effective implementation of the monetary policy.

5
Money market provides noninflationary sources of finance to government. It is possible by issuing treasury bills in order to raise short loans.

Instruments of Money Market

Call Money

- Call money is mainly used by the banks to meet their temporary requirement of cash. It is also known as money at call and money at short notice.

- In this, market money is demanded for an extremely short period. The duration of such transactions is from a few hours to 14 days. These transactions help stock brokers and dealers to fulfil their financial requirements. The rate at which money is made available is called as call rate. Rate is fixed by the market forces such as the demand for and supply of money.

Treasury Bill

- It is a market for sale and purchase of short-term government securities.
- These securities are called as Treasury Bills, which are promissory notes or financial bills issued by the RBI on behalf of the Government of India.

Ad Hoc Treasury Bills

- Treasury bills are highly liquid instruments. At any time the holder of treasury bills can transfer or get it discounted from RBI.
- The maturity period of these securities range from as low as 14 days to as high as 364 days. f. They have become very popular due to high level of safety involved in them.

Cash Management Bills

- The Government of India, in consultation with the RBI, decided to issue a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatches in the cash flow of the Government.
- The CMBs have the generic character of T-bills but are issued for maturities less than 91.

Certificate of Deposits (CDs)

- The certificate of deposits is issued by the Commercial Banks
- They are worth the value of Rs. 25 lakh and in multiple of Rs. 25 lakh
- The minimum subscription of CDs should be worth Rs. 1 Crore.
- The maturity period of CD is as low as 3 months and as high as 1 year.

- These are the transferable investment instrument in a money market.
- The government initiated a market of CDs in order to widen the range of instruments in the money market and to provide a higher flexibility to investors for investing their short term money.

Commercial Papers (CPs)

- Commercial paper (CP) is an investment instrument which can be issued by a listed company having working capital more than or equal to Rs. 5 cr.
- The CPs can be issued in multiples of Rs. 25 Laths. However, the minimum subscription should at least be Rs. 1 cr.
- The maturity period for the CP is a minimum of 3 months and maximum 6 months.
- Commercial paper (CP) is a popular instrument for financing working capital requirements of companies.
- It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery.

Repurchase Agreements

- A repurchase agreement, also known as a repo, is the sale of securities together with an agreement for the seller to buy back the securities at a later date.
- The repurchase price should be greater than the original sale price, the difference effectively representing interest, sometimes called the repo rate.
- The party that originally buys the securities effectively acts as a lender. The original seller is effectively acting as a borrower, using their security as collateral for a secured cash loan at a fixed rate of interest

Short Term Loan

- It is a market where the short term loan requirements of corporate are met by the Commercial banks.
- Banks provide short term loans to corporates in the form of cash credit or in the form of overdraft. Cash credit is given to industrialists and overdraft is given to businessmen.

Insurance

Insurance sector is one the most important financial intermediary in India. This sector helps in mobilising savings of general public to financial assets. Insurance sector also act as a stabiliser and it helps people in the situation of crisis. Insurance penetration is very low in India; it is well below the standards of U.S.A.

Before liberalisation Public sector insurance companies had the monopoly over the market. Due to lot of private sector Company's entry post liberalisation number of people with insurance cover have improved significantly but it still fall below the satisfactory levels.

Indian insurance sector at present has 52 companies. Insurance sector can be broadly divided into two sectors-

1. Life insurance Sector
2. Non-life insurance sector.

Out of these 52 companies 24 are working in life insurance sector and 28 are working in non-life sector. Private sector entry in insurance sector was allowed in 1999. Before that sector had only public sector players like life insurance cooperation, General insurance cooperation etc.

WHO CAN MAKE LAWS ON INSURANCE?

Insurance is a subject listed in the Union list in the Seventh Schedule to the Constitution of India.
That means only Union Government can make laws on insurance (a state Government cannot make law on this subject).

Insurance Policies: Types

Two main types: General Insurance and Life Insurance

GENERAL INSURANCE

- General Insurance means Every Insurance plan EXCEPT life insurance plan

- Personal Insurance policies – medical insurance, accident, property and vehicle insurance
- Rural Insurance policies protection against natural and climatic disasters for agriculture and rural businesses
- Industrial Insurance policies – coverage for project, construction, contracts, fire, equipment loss, theft, etc.
- Commercial Insurance policies protection against loss and damage of property during transportation, transactions, marine insurance etc.

LIFE INSURANCE

Life insurance is a contract between an insurance policy holder and an insurer or assurer, where the insurer promises to pay a designated beneficiary a sum of money (the benefit) in exchange for a premium, upon the death of an insured person.

Life Insurance Types

1. Whole life plan
2. Endowment Plan
3. Term Plan
4. ULIP (Unit Linked Insurance Policy)

Life Insurance Corporation of India LIC

- Started in 1956 and 100% owned by Government.
- Provides Life Insurance, Health Insurance
- Reforms of 1999 in insurance sector can be divided as following:
- Opening of sector for private companies.
- Foreign direct investment up to 26 percent was allowed in this sector.
- IRDA – Insurance regulatory and development authority was created to regulate and develop this sector.
- After reforms first decade of 21st century has been very good for the insurance sector in India.
- Insurance sector witnessed many remarkable changes after the reforms. In the case of general insurance industry the premium had grown from Rs.9450 crore in 1999-2000 to Rs.25,000 crore in 2006- 07.

- The private sector has acquired a market share of 40% and most of it came by reducing the percentage share of the public sector. Insurance sector faces new challenges of 21st century and it is in dire need for another set of reforms.

MAJOR PROBLEMS IN INSURANCE SECTOR ARE:-

- Rising cost of insurance products.
- Slowing growth and insufficient penetration throughout India. ▪ No new major reforms for almost a decade.
- In order to remove the shortcomings of insurance sector government in 2012 announced 12-point revival package for this sector. Important among those are:-
- IRDA to consider 30-Day norm for clearing the product.
- All banking correspondents will be allowed to sell the insurance products.
- Reduction in service tax on first year regular premium as well as single premium policies.
- Some insurance products will be used for tax exemption.
- Exemption of premium for social security insurance schemes from service tax.
- IRDA to evolve and notify guidelines for reduction in arbitrage between UNITS and traditional products 49% FDI allowed in Insurance Industry
- The government has relaxed FDI norms for the insurance sector to attract more foreign investment, by permitting overseas companies to buy 49 per cent stake in domestic insurers without prior approval.
- Earlier, up to 26 per cent FDI was permitted through the automatic approval route.
- Now, the foreign investment proposals up to 49 per cent of the total paid up equity of the Indian insurance company shall be allowed on the automatic route subject to verification by the Insurance Regulatory and Development Authority of India. There are 52 insurance companies operating in India, of which 24 are in the life insurance business and 28 in general insurance.

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDA)

- Created on the recommendations of the Malhotra Committee report
- Started in 2000, it is a statutory body (i.e. made through an Act

of parliament).

WHAT ARE THE FUNCTIONS OF IRDA?

- To run insurance business, a company has to register itself with IRDA.
- IRDA regulates the insurance industry and protects the customers.
- IRDA has the power to frame regulations regarding Insurance market (just like SEBI for Capital market)
- promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums. (for example IRDA allowed Health Insurance Portability).

08

Economic Reforms

Introduction

The reform process in India was initiated with the aim of accelerating the pace of economic growth and eradication of poverty.

Late 1970s - The process of economic liberalisation in India can be traced back to the late 1970s.
July 1991- This is when the process began.

- There was a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of Government. To free the domestic economy from the control regime.

- Reforms emphasized gradualism and evolutionary transition rather than rapid restructuring or shock therapy.

First Generation Reforms (1991 onwards)

1985

1985

It had its origin when the New Economic Policy declared emphasised on improvement in productivity, absorption of modern technology and fuller utilisation of capacity and finally on the greater role for the private sector.

The reforms introduced far-reaching measures, which changed the working and machinery of the economy. It has unlocked India's enormous growth potential and unleashed powerful entrepreneurial forces.

1991

From 1991

The successive governments successfully carried forward the country's economic reform agenda in response to the changes in the nature of markets and institutions, industrial organisation and structures and social relations of production.

These changes were pertinent to the following:

- Dominance of the public sector in the industrial activity.
- Discretionary controls on industrial investment and capacity expansion.
- Trade and exchange controls.
- Limited access to foreign investment.
- Public ownership and regulation of the financial sector.
- The focus of reforms was mostly on stabilisation with a little stress on structural reforms.
- Changes regarding industrial licensing, technology up-gradation, elimination of controls and restrictions, foreign capital, fiscal policy, rationalising and simplifying the system of fiscal and administrative regulation and export-import policy in order to provide greater scope to private sector.
- Big boost in private sector investments, particularly in the corporate segment of manufacturing industry which would, in turn usher in rapid growth of the economy was expected.

Broader Reforms among First Generation were as follows:

- Chelliah Committee suggestions in Taxation, focus was on broadening the Tax Base.
- Narasimham Committee suggestions for Financial Sector, focus was on increasing stability.
- LPG reforms through New Industrial Policy, focus was on freeing the economy from clutches of ageing public sector.
- Partial convertibility of Rupee in Current Account.

Second Generation Reforms

1999

1999

- This is when the Second Generation Reforms began. India embarked on an exercise of cutting personal taxes, investing in infrastructure and creating world class companies.
- Stress on fiscal reforms, financial reforms, structural reforms, labour law reforms etc was specially done. Reforms to broaden the income tax base and streamline the excise and customs duty structures.
- Major financial sector reforms undertaken by the government include allowing private companies to enter into insurance sector, allowing foreign banks to open their branches in India.
- The focus was on structural reforms through institutional strengthening. Overall, the objective was to push the economy on a higher growth trajectory & the second generation reforms did pushed India to 8% growth path as against 6% growth path that was guided by first generation reforms.

Broader Reforms among Second Generation were as follows

Foreign Exchange – Abolition of (FERA) Foreign Exchange Regulation Act and creation of (FEMA) Foreign Exchange Management Act; Partial convertibility of Rupee in Capital Account on the basis of Second Tarapore Committee.

Labour – Voluntary Retirement Scheme (VRS); Board for Industrial and Financial Reconstruction (BIFR); National Renewal Fund.

Financial Sector – Narasimham Committee II suggestions regarding prudential norms and the Capital Adequacy Ratio (CAR)

Taxation – Value Added Tax (VAT); Kelkar Panel Suggestions on Direct tax; Provision of Minimum Alternate Tax (MAT), Fringe Benefit Tax (FBT) and other tax avoidance aspects; Introduction of service tax.

Third Generation Reforms

- Currently India is under 3rd generation of reforms.
- The First & Second generation of reforms had a few downsides. The GDP had been growing but the GDP per capita still left a lot to be desired. India ranks much lower than Asian and Latin American peers when compared on parameters like GDP per capita and Tax/GDP. This is one of the first challenges before the Indian government.
- The second challenge was the creation of world class infrastructure. We are not only referring to infrastructure in terms of roads, railways and ports; but also in terms of manufacturing and manpower infrastructure.
- The third area of focus is on creating, encouraging and nurturing the spirit of entrepreneurship.

Broader Reforms among Third Generation were as follows:

- GST (Goods and Service Tax)
- Exit Policy/ Bankruptcy Code
- Capital easing norms for start-ups or entrepreneurs through Mudra Bank

09

External Sector

Introduction

The external sector of the economy refers to the international transactions that both the private and public sector conduct with the rest of the world. Such transactions are systematically recorded in detail within a framework that groups them into accounts, where each account represents a separate economic process or phenomenon of the external sector.

The external accounts form part of an integrated system of statistics of the economy, and thus all definitions, classifications and accounting rules must be harmonised so that external sector aggregates can be compared and summed with other macroeconomic data, such as those of national accounts, monetary statistics and government statistics. In the goods market, the external sector involves exports and imports. In the financial market it involves capital flows.

What Are The Economic Features Related to the External Sector?

Forex Reserves

- Foreign-exchange reserves or Forex reserves is money or other assets held by a central bank or other monetary authority so that it can pay if need be its liabilities, such as the currency issued by the central bank, as well as the various bank reserves deposited with the central bank by the government and other financial institutions.
- Reserves are held in mostly the United States dollar and to a lesser extent the EU's Euro, the British Pound sterling, and the Japanese Yen.
- In a strict sense, foreign-exchange reserves should only include foreign banknotes, foreign bank deposits, foreign treasury bills, and short and long-term foreign government securities. However, the term in popular usage commonly also adds gold reserves, special drawing rights (SDRs), and the International Monetary Fund (IMF) reserve positions.
- Foreign-exchange reserves are called reserve assets in the balance of payments and are located in the capital account.

External Debt

- It is that portion of a country's debt that was borrowed from foreign lenders including commercial banks, governments or international financial institutions such as the International Monetary Fund (IMF) and World Bank.
- According to the IMF, -Gross external debt is the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to nonresidents to repay principal, with or without interest, or to pay interest, with or without principal.
- Sustainable debt is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding accumulation of arrears, while allowing an acceptable level of economic growth.

- There are various indicators for determining a sustainable level of external debt. These indicators can be thought of as measures of the country's solvency. Examples of debt burden indicators include the external debt-to-GDP ratio, external debt-to-total debt ratio etc.

Balance of Payment

- Balance of Payment is a systematic record of all the transactions that a nation carries out with the outside world. It is the difference between what a nation gets from the eoutside world and what it pays to the outside world. Balance of Payment (BoP) comprises current account, capital account, errors, omissions, changes in foreign exchange reserves.
- **Current Account** – Under current account of the BoP, transactions are classified into merchandise goods (exports and imports) and invisibles.
- **Capital Account** – Under capital account, capital inflows can be classified by instrument (debt or equity) and maturity (short or long-term). The main components of capital account include foreign investment, loans and banking capital.
- Foreign investment comprising Foreign Direct Investment (FDI) and portfolio investment consisting of Foreign Institutional Investors (FIIs) investment, American Depository Receipts/ Global Depository Receipts (ADRs/GDRs) represents non-debt liabilities, while loans (external assistance, external commercial borrowings and trade credit) and banking capital including non-resident Indian (NRI) deposits are debt liabilities.

Under the current account of BoP, how are the Invisible transactions further classified?

They are classified into three categories:

1. Services – travel, transportation, insurance, Government not included elsewhere (GNIE) and miscellaneous (such as, communication, construction, financial, software, news agency, royalties, management and business services),
2. Income.
3. Transfers (grants, gifts, remittances, etc. which do not have any quid pro quo).

Foreign Investment

Foreign investment is when a firm or an individual from another Nation invests in assets or ownership stakes of another Nation. This is done when the interest rate in another country is higher than the firm or individual's country of origin. Globalisation has amplified foreign investment since many businesses are branching out to diversify their investment horizon.

What are the Two Components of Foreign Investment?

FOREIGN DIRECT INVESTMENT

- FDI is foreign investment with aim of profit motive and provide unique mixture of resources, technology, knowledge, professionalism and management techniques.
- India's economy has been opening for more FDI. 100% FDI is permitted in sectors like petroleum sector, road building, power, drugs and pharmaceuticals hotels and tourism.
- No FDI is allowed in gambling, betting, lottery, atomic energy etc.
- FDI in India is allowed under Automatic Route i.e. without prior approval of government/RBI whereas other is government route which requires approval of FIPB.

FOREIGN INSTITUTIONAL INVESTMENT

- FII or Foreign institutional Investment is done in the stock market with the purpose of only trading in shares of companies, in corporate debt and in government securities. Such investments are volatile in nature.
- There is no restriction on FII in the stock market except for the maximum percent shares of a company including in corporate debt instruments and government securities.
- FII also comes in the form of participatory notes (PN) (unregistered FII) and round tipping. Through round tipping, capital goes out of the country only to return from a different route to avoid incidence of tax on profit earned. Much of FII invested in India comes from Mauritius taking advantage of the Double Taxation Avoidance Treaty.

Trade Deficit: Trade deficit is an economic measure of a negative balance of trade in which a country's imports exceeds its exports. A trade deficit represents an outflow of domestic currency to foreign markets.

Current Account Deficit: A current account deficit represents negative net sales abroad. The current account also includes net income, such as interest and dividends, as well as transfers, such as foreign aid, though these components tent to make up a smaller percentage of the current account than exports and imports. The current account is a calculation of a country's foreign transactions, along with the capital account is a component of a country's balance of payment.

Exchange Rate

Exchange rate is the value for domestic currency with respect to foreign currency and vice-versa. In India, exchange rates are managed and any capital inflows would be mopped up by RBI to prevent rupee from appreciating thus resulting in building of reserves. They can be either fixed exchange rate or market determined exchange rates.

What are the different types of exchange rates?

1 Fixed Exchange Rate System

Fixed exchange rate system is a system wherein it is applied by a government or central bank ties the country's currency official exchange rate to another country's currency or the price of gold. The purpose of a fixed exchange rate system is to keep a currency's value within a narrow band.

What are the two types of Fixed exchange rate systems?

1. Currency Board System

- It is done in inflated economies.
- The central bank pegs the home currency to a stronger currency on a 1:1 basis or some different but fixed ratio.
- Home currency will be in circulation equal to inflowing foreign currency. for Example: Argentina.

2. Crawling pegged exchange rate

- Fixed rate but Central Bank allows it float between ceiling and floor rates. For Example: Russia and China.

2 Flexible Exchange Rate System

Flexible exchange rates are determined by the market forces. It is established depending upon the supply and demand of currency.

What are the two types of Flexible exchange rate system?

Full float

- Determined by the forces of demand and supply of foreign currency in the home country.
- No role of Central Bank. For examples are USA, EU.
- Market determined rates are seen as maturity of economics and a test for globally competitive economy.

Managed exchange rate

- Also referred as dirty floating as central bank intrude indirectly in influencing exchange rate.
- In managed exchange rate, even though the exchange rate is market determined, there is active indirect intervention by the central bank to bring exchange rate closer to its own perception. – Example:India
- If the exchange rate is market determined and currency make portions in terms of trade volume, it is known as hard currency. Examples are USA, Japan and UK, etc.

Nominal Effective Exchange Rate and Real Effective Exchange Rate

- The nominal effective exchange rate (NEER) and real effective exchange rate (REER) indices are used as indicators of external competitiveness of the country over a period of time.
- NEER is the weighted average of bilateral nominal exchange rates of the home currency in terms of foreign currencies, while REER is defined as a weighted average of nominal exchange rates, adjusted for home and foreign country relative price differentials.
- REER captures movements in cross-currency exchange rates as well as inflation differentials between India and its major trading partners and reflects the degree of external competitiveness of Indian products.
- The RBI has been constructing six currency (US Dollar, Euro for Eurozone, Pound Sterling, Japanese Yen, Chinese Renminbi and Hong Kong Dollar) and 36 currency indices of NEER and REER.

Convertibility of Rupee

Currency convertibility is the ease with which the currency of a country can be freely converted into any other foreign currency or gold at market determined exchange rate based on demand and supply for that currency. For example, convertibility of Indian rupee is the ease with which rupee be converted into any foreign exchange like US dollars, Pound sterling, Euro etc and vice versa. The government can put restrictions on foreign exchange convertibility which can lead to low currency convertibility.

To ensure faster growth of the world trade and the flow of capital between different economies, easy convertibility of currency is necessary. The restrictions on the convertibility of different currencies create roadblocks in the flow of capital between different countries which negatively impacts the economic growth and world trade.

Easy convertibility of currency is necessary for achieving rapid economic growth and ensuring improvement in the living standards of the people. Earlier, fixed exchange rate system was followed by various countries under the Bretton Woods system. For maintaining the exchange rate in terms of gold or US dollar, countries imposed various controls on currency convertibility. In 1971, the Bretton Woods system collapsed and many countries switched over to the floating exchange rate system from the fixed exchange rate system. The floating exchange rate system allows the exchange rates determined by the market demand and supply of that currency. However, many countries Still imposed restrictions on free currency convertibility due to the difficult balance of payment position.

Current Account Convertibility

Current account convertibility refers to the freedom in payments and transfers in the current account international transactions. Article VIII, section 2, section 3 and section 4 of the International Monetary Fund (IMF) puts an obligation on the member countries for restoring the current account convertibility of their currencies. It puts obligation for removing the restrictions on current payments, avoiding any kind of discriminatory currency practices such as multiple exchange rates etc. However, capital account restrictions are allowed.

CURRENT ACCOUNT CONVERTIBILITY OF INDIAN RUPEE

After the collapse of the Bretton Woods system in 1971, many countries switched over to the system of free currency convertibility on current account. By 1991 around 80 countries had introduced currency convertibility on current account.

In India, after the economic reforms of 1991, the rupee was made partially convertible under the liberalised exchange rate management scheme from March 1992 onwards. Under this scheme, 60% of all receipts on current account was to be freely converted into rupees whereas 40% was on the basis of official exchange rate fixed by the RBI. India acquired the article VIII status of IMF in 1994.

The 40% of fixed exchange rate convertibility was meant for fulfilling the government's exclusive requirements for the import of essential commodities. In March 1993, the foreign exchange budget was abolished and the exchange rate was unified, and transactions on the trade account were made free from the exchange control. The exchange rate of rupee was now left to be determined by the market forces of demand and supply.

In August 1994 rupee was made fully convertible on the current account. In January 1997, the RBI announced some major relaxation in the currency exchange control. The RBI removed the monetary ceilings prescribed for remittances of foreign exchange for various purposes. The authorised dealers could not allow remittances without having to take prior clearance from the Reserve Bank of India.

Indian rupee is now fully convertible in any foreign currency for the current account transactions. However, some restrictions from the Foreign Exchange Management Act, 1999 (FEMA) is still applicable. These restrictions include non-convertibility for activities such as betting, gambling and on prohibited items.

Different limits have been imposed on convertibility in the current account for traveling to other countries, sending gifts, educational purposes, employment, and medical treatment etc.

Capital Account Convertibility

Capital account convertibility refers to the ease and freedom in converting a country's currency into any other foreign currency (such as US dollar, pound sterling, Euro etc) and vice versa for the capital account transactions. It is the freedom to convert the local financial assets into foreign financial assets at the market determined exchange rates. Full capital account convertibility would ultimately lead to unrestricted movement of capital.

Full capital account convertibility of Indian rupee was not introduced because the prevailing conditions were not in its favour as India was facing a large current account deficit. The government wanted to ensure the availability of foreign exchange at lower prices for the input of essential goods and commodities.

India adopted a cautious approach in the full capital account convertibility of rupee in the view of the Mexican crisis. The subsequent East Asian crisis justified the approach of partial capital account convertibility. Earlier also partial capital account convertibility was allowed under certain conditions.

Complete capital account convertibility can increase the inflow of capital in the country but if the conditions become unfavourable there is a great risk of the outflow of capital from the home country. This can lead to higher volatility in the exchange rates and can even create a crisis like situation as happened during the East Asian crisis.

Preconditions For Full Currency Convertibility Including the Capital Account Convertibility

- Macroeconomic stability in the domestic economy and sufficient degree of competitiveness of the domestic sector firms and companies.
- Trade oriented development strategy must be adopted beforehand along with sufficient incentives by the government for the growth of exports.
- The industrial policy of the country should be attractive for investments and the government should provide a favourable investment climate.
- There should be sufficient foreign exchange reserves and the current account position should also be comfortable.

Merits of Full Currency Convertibility

- The full currency convertibility will give the true value of rupee against the foreign currencies. If the market foreign exchange rate is higher than the previous officially fixed exchange rate, the profitability of Indian exports would increase.

- Higher market determined exchange rate would also promote import substitution as imports would become more expensive which would ultimately encourage the domestic industries.
- Higher market determined exchange rate would provide more incentives to the Indian workers living abroad and NRI to send remittances of foreign exchange. It would make illegal remittances such as Hawala money etc unattractive and the remittances would take place through proper channels.
- Full currency convertibility provides a self balancing mechanism. If a country is facing a balance of payment (BoP) deficit due to the overvalued exchange rate, full currency convertibility would depreciate the exchange rate which would ultimately boost exports and discourage imports. This will allow the BoP to get automatically corrected without the intervention of the central bank. The opposite would happen in the case of surplus BoP due to the undervalued exchange rate.
- It would lead to greater integration of the domestic economy with the global economy. It would also allow Indians to invest globally, and hold an internationally diversified investment portfolio.

Demerits of Full Convertibility of Rupee

- Full currency convertibility can lead to the appreciation of rupee which can cause a reduction in the Indian exports overseas. Appreciation of rupee would also increase imports which can have negative impacts on the balance of payment deficit.
- Full currency convertibility may also lead to the depreciation of rupee which would ultimately increase the prices of imports. Imports like oil etc cannot be substituted for domestic production which could ultimately intensify the inflationary pressures.
- Full currency convertibility would lead to the exchange rate of rupee being based on the market forces of demand and supply. This can strengthen the speculative tendencies in the market which could lead to instability in the financial system.

Tarapore Committee on Capital Account Convertibility

In 1997, RBI appointed a committee on the capital account convertibility under the chairmanship of Mr. S.S. Tarapore, the former Deputy Governor of The Reserve Bank of India. As per the committee, capital account convertibility refers to the freedom to convert the foreign financial assets with the local financial assets and vice versa at the exchange rate determined by the market forces of demand and supply. The ultimate aim of capital account convertibility is to allow foreign investors to easily move in and move out of the Indian market and to make it clear to the foreign investors that India has sufficient Foreign Exchange Reserves for meeting any outflow of capital from India to any extent.

Full capital account convertibility would ensure availability of large funds for promoting the economic growth of India. It would provide the Indian economy easy access to the international financial markets and can reduce the cost of capital. It would incentivize the Indian investors for acquiring the international assets and securities which would ultimately improve India's position in the global competition.

Conditions To Be Fulfilled Before Full Capital Account

Tarapore committee gave the following conditions to be fulfilled before adopting full capital account convertibility in India.

- The government should reduce the fiscal deficit to 3.5 percent of the GDP. The committee recommended setting up the Consolidated Sinking Fund (CSF) for the reduction of government debt.
- It recommended mandated inflation targeting between 3% to 5 . The RBI was to be given full freedom for using monetary policy tools for achieving this inflation target.
- The committee recommended strengthening the financial sector by deregulating the interest rates, reducing the non-performing assets to 5 , and the cash reserve ratio to 3%. It recommended either the liquidation of weak banks or their merger with other strong banks.

- The current account deficit should be brought down to manageable limits and the debt service ratio to be reduced to 20 % from the present 25% of the export earnings.
- The Reserve Bank of India should have the exchange rate band of 5 of the real effective exchange rate. The RBI should intervene in the exchange rate market only when the real effective exchange rate is outside this band.
- To have adequate foreign exchange reserves in the range between $22 billion and $32 billion for meeting the import and debt service payments.
- The restrictions on the movement of gold need to be removed completely by the government.

Features Under Full Capital Account Convertibility Proposed By The Tarapore Committee

- The Indian corporate sector to be allowed to issue the foreign currency denominated bonds to the domestic investors, to issue the Global depository receipts, to invest in such securities and deposits, and to go for external commercial borrowings with certain limitations without the approval of the Reserve Bank of India.
- Allowing Indian residents to have foreign currency denominated deposits with Indian banks, allowing capital transfer to other countries with certain limitations etc.
- To allow the Indian banks to borrow from the foreign markets for short term and long term within certain limits, to accept and extend loans denominated in any foreign currency, and allowing them to invest in the foreign money markets etc.
- All India Financial Institutions which fulfill the specified prudential and regulatory requirements would be allowed to participate in the forex market with the authorized dealers.
- The banks and financial Institutions which would be allowed to participate in the international markets would also be allowed to freely purchase and sell gold and offer the gold denominated deposits and loans.

The committee had given a period of 3 years to achieve targets like current account convertibility etc which was too short to meet the preconditions and the macroeconomic indicators. Further, the political instability and the East Asian financial crisis did not allow the recommendations of the Tarapore committee to be implemented completely at that time.

Second Tarapore committee

In 2006, the RBI constituted the second Tarapore committee on the fuller capital account convertibility. The committee submitted its report in September 2006 and had drawn roadmap for 2011 for full capital convertibility of Indian rupee. At that time, Indian economy was having certain strong fundamentals such as forex reserves of $165 billion, liberalised foreign exchange system, a prudent financial system for dealing with external capital flows etc.

However, certain economic events such as the global financial crisis of 2007-09 etc could not allow the RBI to go for full capital account convertibility. The partial capital account convertibility had helped India to cope up with the extreme capital outflows which could have taken place during 2008-09.

Future Prospects of Full Capital Account Convertibility of Rupee

In 2015, former deputy governor of the RBI, HR Khan had said that India is not yet ready for full capital account convertibility of rupee. This is because the Indian economy is expanding and it needs stability on the external front. According to him, India needs an eclectic combination of some capital account openness and some flexibility in the exchange rate.

However, the former RBI governor Raghuram Rajan in April 2015, had said that India may have full capital account convertibility in a short number of years. Therefore, it is expected that India would gradually move towards full capital account convertibility depending upon the macroeconomic indicators of the economy.

10

Important International Economic Organisations

Introduction

The World Trade Organisation (WTO) is an international trade institution. The WTO superseded and replaced the GATT. The GATT was a provisional, multilateral agreement governing international trade from 1947 until January 1, 1995. The creation of the WTO was negotiated in the final GATT round, the Uruguay Round. The WTO inherited a number of core principles from the GATT.

WHAT WERE THE CORE PRINCIPLES OF GATT INHERITED BY WTO?

- Non–discrimination, which in practice means two things. The first principle is MFN–most favoured nation treatment. Any trade concession a nation offers to one member, it must offer to all. The second principle is national treatment. This means that imported products must be treated the same as domestic goods.
- Reciprocity of Trade Concessions.
- Trade Liberalisation.
- Transparency and predictability in import and export rules and regulations.
- Favourable treatment to less developed countries.
- Although built on the GATT legacy, the Uruguay Round and WTO added many new issues and features.
- Agreement on Agriculture is one such new provision added in WTO.
- The WTO's Agreement on Agriculture (AoA) was negotiated in the 1986-94. This multilateral trade negotiations during the Uruguay Round of the General Agreement on Tariffs and Trade (GATT and marked a significant first step towards bringing agricultural subsidies (domestic support in the language of the AoA) under international disciplines. Specific commitments set out in the AoA were implemented over a 6-year period (10 years for developing countries), starting in 1995.

WHAT WERE THE OBJECTIVES?

- It is to establish a fair, transparent and market oriented agricultural trading system, to strengthen more operationally effective GATT disciplines.
- The agreement does allow governments to support their rural economies, but preferably through policies that cause less distortion to trade.
- It also allows some flexibility in the way commitments are

implemented. Developing countries do not have to cut their subsidies or lower their tariffs as much as developed countries, and they are given extra time to complete their obligations. Least-developed countries don't have to do this at all. Special provisions deal with the interests of countries that rely on imports for their food supplies, and the concerns of least-developed economies.

WHAT ARE THE MAIN THREE PILLARS OF AOA?

The Agreement on Agriculture has three pillars.

Domestic Support

It includes the classification of agricultural subsidies into boxes depending on their effects on production and trade.

Market Access

Market access refers to the reduction of tariff (or non-tariff) barriers to trade by WTO members. The 1995 Agreement on Agriculture required tariff reductions of: 36% average reduction by developed countries, with a minimum per-tariff line reduction of 15% over six years. 24% average reduction by developing countries with a minimum per-tariff line reduction of 10% over ten years.

Least developed countries (LDCs) were exempt from tariff reductions, but they either had to convert non-tariff barriers to tariffs—a process called tariffs or "bind" their tariffs, creating a ceiling that could not be increased in future.

Export Subsidies

The Agriculture Agreement prohibits export subsidies on agricultural products unless the subsidies are specified in a member's lists of commitments. Where they are listed, the agreement requires WTO members to cut both the amount of money they spend on export subsidies and the quantities of exports that receive subsidies. Taking averages for 1986-90 as the base level, developed countries agreed to cut the value of export subsidies by 36% over the six years starting in 1995 (24% over 10 years for developing countries). Developed countries also agreed to reduce the quantities of subsidised exports by 21% over the six years (14% over 10 years for developing countries). Least-developed countries do not need to make any cuts.

WHAT ARE THE THREE BOXES OF AGRICULTURE SUBSIDIES?

Amber Box

Provides Aid to avoided and reduced, Measures to support prices, subsidies most directly linked to production level and quantities meanwhile, all domestic support considered to distort production and trade (with some exceptions like except that placed in the Green and Blue Box.

It subject to limits expressed in terms of a "Total Aggregate Measurement of Support" (Total AMS) which combines all supports for specified products, together with supports that are not for specific products, into one single figure.

For example- When European Union buys up cereals and dairy products at guaranteed prices from its producers; (Like Indian Minimum Support Prices but AOA didn't object to Indian MSP programmes) it is amber-box aid.

Blue Box

Production limiting programmes that still distort trade. Subsidy is permitted under the blur box, cover certain direct payments to farmers where the farmers are required to limit production called' Blue Box' measures, comprises government assistance programmes to encourage agricultural and rural development in developing countries. Any support that would normally be in the amber box is placed in the blue box if the support also requires farmers to limit production.

For e.g. Blue box contains aid to livestock or land not linked to prices but to fixed figures for surface and yield.

Green Box

It follows under the Permitted subsidies, Minimal Distortion, and typically includes those to research and development (R&D), environmental protection and animal welfare. Blue box subsidies are also permitted, but on the condition that they must not lead to increased production as amount spent on government services. Green subsidies allow in terms of support example: MSP or subsidies. It includes the payments made directly to farmers that off limits stimulate production, such as certain forms of direct income support, assistance to help farmers to restructure the agriculture, direct payment under environmental and regional assistance programmes.

STRUCTURAL MECHANISM FOR SAFEGUARD

A Special Safeguard Mechanism (SSM) empowers developing countries to levy additional safeguard duties in the event of an abnormal surge in imports of the entry of unusually cheap imports.

MATTER OF CONCERN

Subsidies deserve to be placed in the green or blue box, rather than the amber box, is sometimes a matter of contention at the WTO.

Within the current negotiations, many developing country members have expressed concern over "box-shifting": the movement of subsidies from the amber to the blue box without significant changes in the nature of the subsidy.

The G-20, a group of 20 developing country WTO members, has pushed for rules that would help ensure that amber box subsidies are completely transformed before gaining access to the blue box.

OVERVIEW AND FACTUAL DETAILS FACILITATION

The draft of Trade Facilitation Agreement (TFA) is finalised at the 9th WTO Ministerial Conference which was held in Bali in 2013. The Trade Facilitation Agreement is about making trade easier all across the world by removing or reducing the barriers and obstacles of clearances and customs.

Trade facilitation came into the light of discussion at WTO Singapore Ministerial Conference in Dec, 1996 and after 7 or 8 years in 2004, WTO members officially agreed to start negotiations on trade.

In Nov 2014, WTO members adopted a Protocol of Amendment to insert TFA as an agreement under WTO agreement. TFA shall come into existence once two thirds of members ratified the agreement.

The 10th WTO Ministerial Conference is held at Nairobi Kenya in Dec 2015. But no decision has been taken regarding TFA or TFA is once again blocked by developing countries for not reaching a permanent solution on agriculture subsidies.

THE THREE SECTIONS OF AGRICULTURAL SUBSIDIES:

Section 1: It contains provisions in relation to expediting the movement, release and clearance of goods and some of the major provisions are as follows:

- Every member shall ensure that all information related to trade available online.
- E Payment method shall be provided for all types of fees and taxes like customs etc.
- Simplify procedures and documentation required for customs clearance.
- Single window system shall be in place for all clearances in relation to trading of goods.
- Fast track process for clearance of perishable goods like Fruits or Vegetables etc.
- Online submission of documents shall be available for traders as far as possible.
- Category I: Provisions to be implemented at time of ratifying the agreement.
- Category II: Provisions to be implemented after a transitional period.

Section 2: This section contains provisions for Special and Differential Treatment (SDT) that allows developing and least developed countries (LDCs) to determine when they will implement the provisions of the agreement. To avail the benefits of SDT, members have to categorise the provisions into three categories that are as follows:

- Category I: Provisions to be implemented at time of ratifying the agreement.
- Category II: Provisions to be implemented after a transitional period.
- Category III: Provisions to be implemented on a date after a transitional period and requires assistance and support.

Section 3: It contains provisions about setting up a permanent committee on trade facilitation at WTO and necessary to set up a national committee for coordination and implementation of the provisions of the agreement.

IMPORTANCE: NATIONAL & INTERNATIONAL

- It is believed that this agreement has the potential of adding more than 1 trillion dollar in world GDP.
- The global GDP growth may be boosted by approx 0.5% per annum.
- It can also generate more than 21 million jobs worldwide by removing the hurdles of red tapism and rationalising the customs.
- Trade Facilitation is all about reducing the cost of trade which is still in higher range despite the large decline in transportation cost and huge progress in IT. It is estimated that trade cost of members can be reduced up to an average of 14.5%.

DEVELOPING COUNTRIES AND LDC PERSPECTIVE

- It is estimated that exports of these countries may increase by between $170 billion to $730 billion per annum.
- Developing countries have the possibility of entering 30% more foreign markets and LDCs have 60% more entering.

Associated Topics

Food Security and AOA

It is said that trade distorting domestic support (under Amber Box) given to agriculture sector shall be limited up to 10% of the total value of farm produce in developing and 5% in developed countries. But India's contention is that 5% min quota of developed country say USA is much bigger than 10% min quota for India. India is opposing the TFA only for the reason of restrictions on agriculture subsidies provided under AOA.

Peace Clause

This clause was an integrative part of 'Bali Package' in 2013. This clause allows countries to avoid commitments or restrictions under Amber Box of AOA. But it is also said that the permanent solution shall be taken at least before 11th WTO Ministerial Conference in 2017.

Doha Round

It is 9th negotiation round after World War 2 and first since WTO came in place in 1995. This round was officially launched at WTO 4th Ministerial Conference in Doha, Qatar in 2001. It is also known as the Doha Development Agenda (DDA) because of its aim to achieve major reform in international trading system. The subjects of Doha Round include Agriculture, Non Agriculture Market Access (NAMA), Trade Facilitation or Services etc.

Special Safeguard Mechanism (SSM)

It is a tool under Doha Round of Agriculture that will allow developing countries to raise tariffs temporarily to deal with import surges or price falls.

Trade Agreements

A trade agreement is an arrangement between two or more countries or trading blocs that primarily agree to reduce or eliminate customs tariff and non-tariff barriers on limited/ substantial trade between them. It also includes tax benefits and investment guarantees.

The most common trade agreements are of the preferential and free trade types in order to reduce (or eliminate) tariffs, quotas and other trade restrictions on items traded between the signatories.

How can trade agreements create opportunities to help and promote growth with respect to the Indian economy?

India is a Member of the WTO which sets out rules governing trade among the member states. India is currently engaged in Doha Development Round of world trade talks, and a strong, market-opening Doha agreement for both goods and services would be an important contribution to addressing the global economic crisis.

India has trade agreements with many countries which build on the foundation of the WTO Agreement, with more comprehensive and stronger disciplines than the WTO Agreement.

Many of our trade agreements are bilateral agreements between the two governments. But some, like the South Asian Free Trade Agreement (SAFTA), Asia Pacific Trade Agreement (APTA), and the India-ASEAN Trade in Goods Agreement are multilateral agreements among several parties.

India also has signed a series of Bilateral Investment Treaties (BITs) help protect private investment, develop market-oriented policies in partner countries, and promote exports.

TRADE AND INVESTMENT FRAMEWORK AGREEMENT (TIFA)

(TIFA) which provide frameworks for governments to discuss and resolve trade and investment issues at an early stage. These agreements are also a means to identify and work on capacity-building.

What are the Various Stages of Economic Integration?

What are the various stages of economic integration?
Preferential Trade Agreement
Free Trade Agreement
Trade & Economic Partnership
Customs Union
Common Market
Economic Union

Preferential Trade Area

Preferential Trade Areas (PTAs) exist when countries within a geographical region agree to reduce or eliminate tariff barriers on selected goods imported from other members of the area. This is often the first small step towards the creation of a trading bloc. Agreements may be made between two countries (bi-lateral), or several countries (multilateral).

Free Trade Area

Free Trade Areas (FTAs) are created when two or more countries in a region agree to reduce or eliminate barriers to trade on all goods coming from other members. The North Atlantic Free Trade Agreement (NAFTA) is an example of such a free trade area, and includes the USA, Canada, and Mexico.

Customs Union

A customs union involves the removal of tariff barriers between members, together with the acceptance of a common (unified) external tariff against non-members.

Countries that export to the customs union only need to make a single payment (duty), once the goods have passed through the border. Once inside the union goods can move freely without additional tariffs. Tariff revenue is then shared between members, with the country that collects the duty retaining a small share.

The advantages of a customs union

Without a unified external tariff, trade flows would become distorted. If, for example, Germany imposes a 10% tariff on Japanese cars, while France imposes a 2% tariff, Japan would export its cars to French car dealers, and then sell them on to Germany, thereby avoiding 80% of the tariff. This is avoided if a common tariff is shared between Germany and France (and other members of the customs union.)

A common external tariff effectively removes the possibility of arbitrage and, some would argue, is one of the fundamental building blocks of economic integration.

The disadvantages of a customs union

Union members must negotiate collectively with non-members or organisations like the WTO as a single group of countries. While this is essential to maintain the customs union, it means that members are not free to negotiate individual trade deals.

For example, if a member wishes to protect a declining or infant industry it cannot do so through imposing its own tariffs. Equally, if it wishes to open up to complete free trade, it cannot do so if a common tariff exists.

Also, it makes little sense for a particular member to impose a tariff on the import of a good that is not produced at all within that country. For example, the UK does not produce its own bananas, so a tariff on banana imports only raises price and does not protect domestic producers. The current EU tariff on bananas imported from outside the EU is 10.9%.

There is also a potential disadvantage to a single member in how the tariff revenue is allocated. Members that trade relatively more with countries outside the union, such as the UK, may not get their 'fair share' of tariff revenue.

The UK's status as a customs union member is one of the dilemmas facing the UK as a result of Brexit. If it wishes to create individual trade deals with, say the USA and China, it cannot retain its current status as a full member of the customs union.

Common Market

A common (or single) market is the most significant step towards full economic integration. In the case of Europe, the single market is officially referred to a the 'internal market'.

The key feature of a common market is the extension of free trade from just tangible goods, to include all economic resources. This means that all barriers are eliminated to allow the free movement of goods, services, capital, and labour.

In addition, as well as removing tariffs, non-tariff barriers are also reduced and eliminated.

For a common market to be successful there must also be a significant level of harmonisation of micro-economic policies, and common rules regarding product standards, monopoly power and other anti-competitive practices. There may also be common policies affecting key industries, such as the Common Agricultural Policy (CAP) and Common Fisheries Policy (CFP).

Economic union

Economic union is a term applied to a trading bloc that has both a common market between members, and a common trade policy towards non-members, although members are free to pursue independent macro-economic policies.

The European Union (EU) is the best known Economic union, and came into force on November 1st 1993, following the signing of the Maastricht Treaty (formally called the Treaty on European Union.)

Monetary Union

Monetary union is the first major step towards macro-economic integration, and enables economies to converge even more closely. Monetary union involves scrapping individual currencies, and adopting a single, shared currency, such as the Euro for the Euro-17 countries, and the East Caribbean Dollar for 11 islands in the East Caribbean. This means that there is a common exchange rate, a common monetary policy, including interest rates and the regulation of the quantity of money, and a single central bank, such as the European Central Bank or the East Caribbean Central Bank.

Fiscal Union

A fiscal union is an agreement to harmonise tax rates, to establish common levels of public sector spending and borrowing, and jointly agree national budget deficits or surpluses.

The majority of EU states agreed a fiscal compact in early 2012, which is a less binding version of a full fiscal union.

Economic and Monetary Union

Economic and Monetary Union (EMU) is a key stage towards complete integration, and involves a single economic market, a common trade policy, a single currency and a common monetary policy.

Complete Economic Integration

Complete economic integration involves a single economic market, a common trade policy, a single currency, a common monetary policy, together with a single fiscal policy, including common tax and benefit rates – in short, complete harmonisation of all policies, rates, and economic trade rules.

World Bank and Associated Institutions

The World Bank Group (WBG) is a family of five international organisations that make leveraged loans to developing countries. It is the largest and most famous development bank in the world and is an observer at the United Nation Development Group.

The World Bank

The International Bank for Reconstruction and Development (IBRD), better known as the World Bank, was established under the Bretton Woods System along with the International Monetary Fund.

The role of the IMF was to provide the international liquidity in the International Economy which was hampered due to World War 2. The aim of the IMF was to correct Balance of Payment difficulties.

In the similar vein, the aim of the World Bank was to provide long term development assistance to and loans in reasonable terms to the nations.

The World Bank or IBRD is a multilateral level inter-governmental Institution. All the member countries have their shares in the capital stock of the World Bank.

ORGANISATION STRUCTURE OF THE WORLD BANK

The World Bank works on a cooperative structure and currently has 189-member countries. These member countries represented by a 'Board of Governor' are the ultimate policy makers of the World Bank. The Boards of Governors consist of one Governor and one Alternate Governor appointed by each member country. The office is usually held by the country's minister of finance, governor of its central bank, or a senior official of similar rank.

The governors delegate specific duties to Executive directors, who works at the Bank premises. The five largest shareholders appoint an executive director, while other member countries are represented by elected executive directors.

World Bank Group Current President is Jim Yong Kim who chairs the meetings of the Boards of Directors and is responsible for overall management of the Bank. The President is selected by the Board of Executive Directors for a five-year, renewable term.

The Executive Directors make up the Board of Directors of the World Bank. They normally meet at least twice a week to oversee the Bank's business, including approval of loans and guarantees, new policies, the administrative budget, country assistance strategies and borrowing and financial decisions.

IS THE WORLD BANK BIASED TOWARDS DEVELOPED COUNTRIES?

It has been a complaint of many developing countries that the bank provides developmental loans at discretionary high-interest rates. For example, some of the loans which India has received in recent years bear an interest of 53.4 percent including the commission at 1 per cent which is credited to the Bank's special reserves.

The financial aids given by the Bank accounts for a minuscule part of the financial requirement essential for various development projects in developing countries.

The bank usually asks for the collateral from the under-developed countries which are difficult to provide by such countries due to their low level of income and development. The logical question is 'if the poor and underdeveloped countries have an asset to provide as collateral, why would they approach institutions like the World Bank for loans at a concessional rate?

The working, structure and operations of the World Bank are dominated by the Western countries led by the USA, who are also one of the highest stakeholders at the Bank. The bank has often been criticized for not being multilateral in the true sense and works more like a unilateral institution of the Western countries with the main aim of providing profits to them.

With the World Bank, there are concerns about the types of development projects funded. Many infrastructure projects financed by the World Bank Group have social and environmental implications for the populations in the affected areas, and the criticism has centred on the ethical issues of funding such projects. For example, World Bank-funded construction of hydroelectric dams in various countries has resulted in the displacement of indigenous peoples of the area.

The approach adopted by the bank is not suitable for all the countries. The bank follows the 'One Size Fits All' strategy while providing development assistance and policies. Such strategies cannot work effectively in a real-life World since problems and situations vary country wise, and a common solution to all of them is not possible and utopian in nature. For example, The problem of Stunting (low height of Children as per their age) for an Indian child can't be compared with that of an African child. The African child will be much longer in height as compared to its Indian counterpart in the same age group. Thus, they both need different types of calories intake as per their geography.

International Development Assistance

The International Development Association (IDA) is the part of the World Bank group that helps the world's poorest countries. Overseen by 173 shareholder nations, IDA aims to reduce poverty by providing loans (called "credits") and grants for programs that boost economic growth, reduce inequalities, and improve people's living conditions.

IDA complements the World Bank's original lending arm—the International Bank for Reconstruction and Development (IBRD). IBRD was established to function as a self-sustaining business and provides loans and advice to middle-income and credit-worthy poor countries. IBRD and IDA share the same staff and headquarters and evaluate projects with the same rigorous standards.

IDA is one of the largest sources of assistance for the world's 75 poorest countries, 39 of which are in Africa, and is the single largest source of donor funds for basic social services in these countries.

IDA lends money on concessional terms. This means that IDA credits have a zero or very low-interest charge and repayments are stretched over 25 to 40 years, including a 5- to 10-year grace period. IDA also provides grants to countries at risk of debt distress.

In addition to concessional loans and grants, IDA provides significant levels of debt relief through the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative.

IDA is a multi-issue institution, supporting a range of development activities, such as primary education, basic health services, clean water and sanitation, agriculture, business climate improvements, infrastructure, and institutional reforms. These interventions pave the way toward equality, economic growth, job creation, higher incomes, and better living conditions. For the period July 1, 2014–June 30, 2017 (IDA17), IDA operations are placing a special emphasis on four thematic areas: climate change, fragile and conflict affected countries, gender equality, and inclusive growth.

IDA17 financing is expected to provide, among other things, electricity for an estimated 15-20 million people, life-saving vaccines for 200 million children, microfinance loans for more than 1 million women, and basic health services for 65 million people. Some 32 million people will benefit from access to clean water and another 5.6 million from better sanitation facilities.

Many of the issues developing countries face do not respect borders. By helping address these problems, IDA supports security, environmental and health concerns, and works to prevent these threats from becoming global issues.

International Finance Corporation

The IFC was established in 1956 to support the growth of the private sector in the developing world. IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector in developing countries.

The IFC's stated mission is "to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives."

While the World Bank (IBRD and IDA) provides credit and non-lending assistance to governments, the IFC provides loans and equity financing, advice, and technical services to the private sector. The IFC also plays a catalytic role, by mobilizing additional capital through loan syndication and by lessening the political risk for investors, enabling their participation in a given project. The IFC has worked with more than 3319 companies in 140 countries since its inception in 1956.

It is a public entity, although its clientele consists of transnational, national, and local private sector companies, operating in a competitive and fast-moving business environment.

Multilateral Investment Guarantee Agency

- MIGA is a member of the World Bank Group. Its mission is to promote FDI into developing countries to help support economic growth, reduce poverty and improves people's lives.
- At the centre of MIGA's new FY18-20 strategy are three elements:
- A re-affirmed focus on the poorest through support for projects in IDA countries
- A continuing emphasis on Fragile and Conflict-affected States, where MIGA has opportunity to have impact where private PRI insurers are unwilling to go, and
- An expanded commitment to climate change mitigation and adaptation, targeting 28% of new issuance related to climate change mitigation or adaptation in 2020.

To deliver on these targets, MIGA's FY18-20 strategy has four pillars:

- **Grow core business:** MIGA will enable new investments across sectors and regions through building on past efforts to improve operations and delivery in current segments.

- **Innovate applications:** MIGA will continue to create new ways of using its suite of products to create impact, especially through the use of new vehicles, including the IDA 18 Private Sector Window.
- **Create projects for impact:** MIGA will develop, structure and launch new projects by playing a proactive role early in the pipeline through working with governments, state-owned enterprises, and investors.
- **Create markets:** MIGA will drive comprehensive country solutions and spur private sector investment and development by working as part of the WBG's Cascade Approach.

MIGA is owned and governed by its member states, but has its own executive leadership and staff which carry out its daily operations. Its shareholders are member governments which provide paid-in-capital and have the right to vote on its matters. It insures long-term debt and equity investments as well as other assets and contracts with long-term periods. The agency is assessed by the World Bank's Independent Evaluation Group each year.

International Monetary Fund

- The IMF is an organization of 189-member countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth along with poverty reduction.
- The IMF was conceived at a United Nation Conference in Bretton Woods, New Hemisphere, United States in July 1944 along with the World Bank. The initial 44-member countries at the conference sought to build a framework for economic cooperation and to avoid a repetition of competitive devaluation of currency which has contributed to 'Great Depression of the 1930s'.
- The IMF's primary responsibility is to ensure the stability of the international monetary system remains safe, to safeguard the system of the exchange rate and international payments so that countries could transact with each other freely.

- The IMF's mandate was updated in the year 2012, to include all macroeconomic and financial sector issues that can affect global financial stability.

IMF at Glance

Total Member	189 Countries
Headquarter	Washington DC, USA
Executive Board	24 Directors each representing a single or group of countries
Total Resources	US $668 Billion
Currency	Special Drawings Rights (SDR consists of 5 Key World currencies: US Dollar, Euro, Japanese Yen, UK Pound and Chinese Renminbi.
Biggest Borrowers	Portugal, Greece, Ukraine and Pakistan (as on 31/08/2016)

Role of IMF in Promoting Global Economic Stability

The IMF advises member countries on economic and financial matters that promote stability, reduce vulnerability to crises, and encourages sustained growth and high living standards. It also monitors global economic trends and developments that affect the health of the international monetary and financial system.

Economic stability implies avoiding economic and financial crises, volatility in economic activity, high inflation and excessive volatility in foreign exchange and financial markets. Economic instability can increase uncertainty, discourage investment, obstruct economic growth and living standards. The biggest challenge for policy makers is to minimize instability in their own country and abroad without reducing the economy's ability to improve living standards through rising productivity, employment and sustainable growth.

HOW DOES IMF HELP IN ACHIEVING STABILITY?

The IMF helps countries achieve stability through Surveillance, Assistance and Lending.

Surveillance

Every country joining the IMF accepts the obligation to subject its economic and financial policies to the scrutiny of the international community. The IMF oversees the international monetary system and monitors the economic and financial developments of its 189-member countries. The surveillance takes place at the global and individual country level. The IMF assesses the domestic policies and risk associated with domestic and balance of payment stability and advises for the same.

The IMF produces periodic reports known as "World Economic Outlook" and the "Global Financial Stability Report" regarding the same. The report analyses global and regional macroeconomic and financial developments.

Technical Assistance

The IMF helps countries strengthen their capacity to design and implement sound economic policies. It provides advice and training in areas of core expertise—including fiscal, monetary, and exchange rate policies; the regulation and supervision of financial systems; statistics; and legal frameworks.

Lending

Even the best economic policies cannot completely eradicate instability or avert crises. If a member country faces a balance of payment crisis, the IMF can provide financial assistance to support policy programs that will correct underlying macro economic problems, limit disruption to both the domestic and the global economy, and help restore confidence, stability, and growth. The IMF also offers precautionary credit lines for countries with sound economic fundamentals for crisis prevention.

IMF's Special Drawing Rights

The SDR is an international reserve asset created by IMF in 1969 to supplement its member countries official reserves. The value of SDR is based on a basket of five major currencies- the US Dollar, the Euro, the Japanese Yen, the UK Pound and the Chinese Renminbi.

THE CREATION OF SDR:

A country participating in foreign exchange market needs official foreign exchange reserves. The domestic governments hold these foreign exchange reserves in the form of Gold and widely accepted foreign currencies like the US dollar or the Euro. The domestic countries use their foreign exchange reserves during the crisis period or when they need to provide support to their respective currencies and exchange rate. The countries do so by buying their currency in the foreign exchange rate markets by paying through dollar or gold. But the supply of two key international reserve assets- the US dollar and the gold is inadequate for supporting the needs and expansion of the financial flows. Therefore, the international community decided to create a new international reserve asset called 'SDR' under the leadership of the IMF.

IMF Quota System

Quotas are central to IMF's financial resource. Each member country of the IMF is assigned a quota of resources based broadly on its relative position in the World Economy. A member country's quota determines its maximum financial commitment to the IMF, its voting rights and its access to IMF lending's.

When a country joins the IMF, it is assigned an initial quota based on its size of the economy. The current quota formula is a weighted average of:

- Country's GDP (50 percent weight)
- Openness of the economy (30 percent weight)
- Economic variability (15 percent)
- International/Foreign reserves (5 percent)
- Quotas are determined in SDR terms. The largest member of the IMF is the United States, with a current quota of SDR 82.99 Billion and the smallest member is Tuvalu, with a quota of SDR 2.5 Million. India's current quota is SDR 13.1 Billion.
- The quota plays a key role in determining a country's financial and organisational relationship with the IMF. A member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF. The quota determines the member voting power inside the IMF decision making. A number of finances a member can access from the IMF is also based on its share of quota.
- The 14th General Quota review which met on January 2016 decided to increase the quota of each of the IMF 189 members to a combined SDR of 477 Billion from about SDR 238.5 Billion. With the move, the IMF has implemented its long pending quota reforms (under pressure from the emerging economies) which will give more voting rights to emerging economies such as India and China in the functioning of the IMF.
- With these reforms, India's quota in the IMF would rise to 2.7 percent, from the existing 2.44 percent. The voting share of Indian in IMF would also increase to 2.6 percent from 2.34 percent. The reforms reflected the increasing role of dynamic emerging and developing countries in the World economy. For the first-time key emerging countries of the BRIC bloc (Brazil, India, China and Russia) will be among the 10 largest members of the IMF. China has become the third largest country in the IMF.
- Other top 10 countries include the US, Japan, Germany, France, UK and Italy. Also for the first time, the IMF board will consist entirely of elected executive directors, ending the past tradition of having appointed executive directors.
- The reforms shifted more than 6 percent of quota shares from over represented to under-represented countries. The reforms also shifted more than 6 percent quota shares to emerging and developing countries.

11

Poverty

Introduction

The UN Human Rights Council has defined poverty as "A human condition characterized by the sustained or chronic deprivation of the resources, capabilities, choices, security and power necessary for the enjoyment of an adequate standard of living and other civil, cultural, economic, political and social rights". Poverty manifests itself in the form of both absolute poverty as well as relative poverty.

Absolute Poverty	Relative Poverty
This concept is based on absolute needs of the people and people are defined as poor when some absolute needs are not sufficiently satisfied. It is also defined in terms of insufficiency of basic needs. In India, these basic needs are measured in terms of calorie intake of 2400 in rural areas per person per day and 2100 in urban areas. The corresponding monetary yardstick for calorie intake is based on per capita monthly household expenditure.	This concept is related to the general standard of living in a society. Thus, according to this concept, people are poor because they are deprived of the opportunities, comforts and self-respect regarded as normal in the community to which they belong. In relative poverty, poor are defined as, a person or family whose incomes are less than the average income of the community. Thus relative poverty relates to inequalities in a society. India is characterised by both in extreme measures, i.e., absolute and relative poverty.

Causes of Poverty

The extent of poverty in an economy is due to a wide range of factors as follows:

i. Underdeveloped nature of economy.
ii. Rapid growth of population in an overpopulated country; even if the national income increases, the per capita income remains the same due to increase in population.
iii. Large inequalities in the ownership of earning assets such as land, buildings, industry etc.
iv. Low level of productivity in agriculture and industry.
v. Large scale unemployment and under-employment.
vi. Inequality of opportunity in acquiring education and skills.
vii. State Policies.
viii. Regional disparities

Multi-Dimensional Poverty Index

The Multidimensional Poverty Index (MPI) reflects the deprivations that a poor person faces simultaneously with respect to education, health and living standards. This reflects the same three dimensions of welfare as the HDI but the indicators are different in each case and are linked to the MDGs. The components of MPI are:

1 Education (each indicator is weighted equally at 1/6)

- **Years of Schooling:** deprived if no household member has completed five years of schooling
- **Child Enrolment:** deprived if any school-aged child is not attending school in years 1 to 8

2 Health (each indicator is weighted equally at 1/6)

- **Child Mortality:** deprived if any child has died in the family
- **Nutrition:** deprived if any adult or child for whom there is nutritional information is malnourished.

3 Standard of Living (each indicator is weighted equally at 1/18)

- **Electricity:** deprived if the household has no electricity
- **Drinking water:** deprived if the household does not have access to clean drinking water or clean water is more than 30 minutes walk from home
- **Sanitation:** deprived if they do not have an improved toilet or if their toilet is shared
- **Flooring:** deprived if the household has dirt, sand or dung floor
- **Cooking Fuel:** deprived if they cook with wood, charcoal or dung
- **Assets:** deprived if the household does not own more than one of: radio, TV, telephone, bike, or motorbike, and do not own a car or tractor

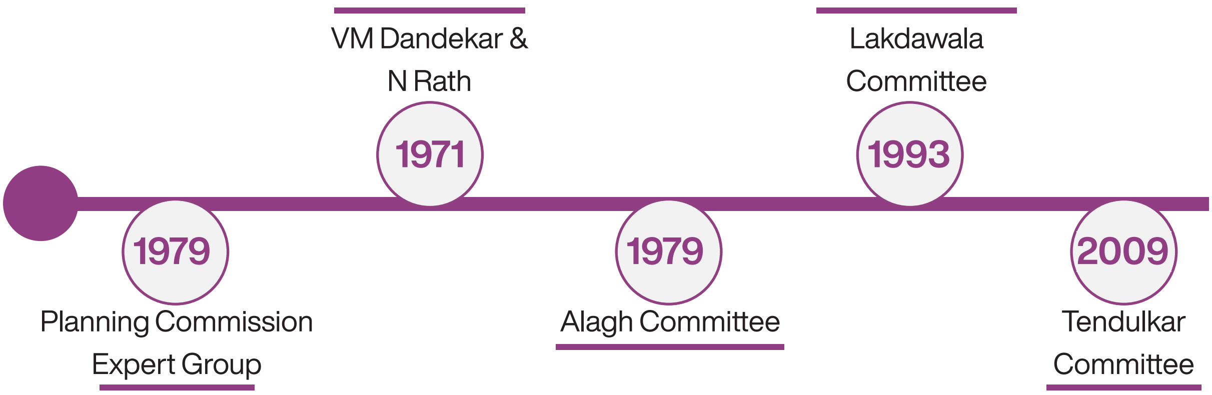
Hence, poverty is determined with regard to not only income or expenditure but also access to a number of other necessities.

The MPI can be used to create a comprehensive picture of people living in poverty, and permits comparisons both across countries, regions and the world and within countries by ethnic group, urban/ rural location, as well as other key household and community characteristics.

These characteristic make the MPI useful as an analytical tool to identify the most vulnerable people – the poorest among the poor, revealing poverty patterns within countries and over time, enabling policy makers to target resources and design policies more effectively.

Poverty Estimation

Planning Commission Expert Group (1962), working group constituted by the Planning Commission formulated the separate poverty lines for rural and urban areas (₹20 and ₹25 per capita per year respectively).



VM DANDEKAR AND N RATH (1971)

VM Dandekar and N Rath (1971) made the first systematic assessment of poverty in India, based on National Sample Survey (NSS) data.

- Unlike previous scholars who had considered subsistence living or basic minimum needs criteria as the measure of poverty line, VM Dandekar and N Rath were of the view that poverty line must be derived from the expenditure that was adequate to provide 2250 calories per day in both rural and urban areas.
- Expenditure based Poverty line estimation, generated a debate on minimum calorie consumption norms.

ALAGH COMMITTEE (1979):

Task force constituted by the Planning Commission under the chairmanship of YK Alagh, constructed a poverty line for rural and urban areas on the basis of nutritional requirements and related consumption expenditure.

Poverty estimates for subsequent years were to be calculated by adjusting the price level for inflation.

LAKDAWALA COMMITTEE (1993):

Task Force chaired by DT Lakdawala, based on the assumption that the basket of goods and services used to calculate Consumer Price Index-Industrial Workers (CPI-IW) and Consumer Price Index- Agricultural Labourers (CPI-AL) reflect the consumption patterns of the poor, made the following suggestions:

- Consumption expenditure should be calculated based on calorie consumption as earlier.
- State specific poverty lines should be constructed and these should be updated using the CPI-IW in urban areas and CPI-AL in rural areas.
- Discontinuation of scaling of poverty estimates based on National Accounts Statistics.

TENDULKAR COMMITTEE (2009)

Expert group constituted by the Planning Commission and, chaired by Suresh Tendulkar, was constituted to review methodology for poverty estimation and to address the following shortcomings of the previous methods:

Obsolete Consumption Pattern

Consumption patterns were linked to the 1973-74 poverty line baskets (PLBs) of goods and services, whereas there were significant changes in the consumption patterns of the poor since that time, which were not reflected in the poverty estimates.

Inflation Adjustment

There were issues with the adjustment of prices for inflation, both spatially (across regions) and temporally (across time).

Health and Education Expenditure

Earlier poverty lines assumed that health and education would be provided by the state and formulated poverty lines accordingly.

Recommendations

Shift from Calorie Consumption based Poverty Estimation: It based its calculations on the consumption of the items like cereal, pulses, milk, edible oil, non-vegetarian items, vegetables, fresh fruits, dry fruits, sugar, salt & spices, other food, intoxicants, fuel, clothing, footwear, education, medical (non-institutional and institutional), entertainment, personal & toilet goods.

Uniform Poverty line Basket: Unlike Alagh committee (which relied on separate PLB for rural and urban areas), Tendulkar Committee computed new poverty lines for rural and urban areas of each state based on the uniform poverty line basket and found that all India poverty line (2004-05) was:

- ₹446.68 per capita per month in rural areas
- ₹578.80 per capita per month in urban areas

Private Expenditure: Incorporation of private expenditure on health and education while estimating poverty.

Price Adjustment Procedure: The Committee also recommended a new method of updating poverty lines, adjusting for changes in prices and patterns of consumption (to correct spatial and temporal issues with price adjustment), using the consumption basket of people close to the poverty line.

Mixed Reference Period: The Committee recommended using Mixed Reference Period based estimates, as opposed to Uniform Reference Period based estimates that were used in earlier methods for estimating poverty.

The Tendulkar committee computed poverty lines for 2004-05 at a level that was equivalent, in Purchasing Power Parity (PPP) terms to Rs 33 per day.

Purchasing Power Parity: The PPP model refers to a method used to work out the money that would be needed to purchase the same goods and services in two countries.

RANGARAJAN COMMITTEE

The committee was set up in the backdrop of national outrage over the Planning Commission's suggested poverty line of ₹22 a day for rural areas.

Objectives

To review international poverty estimation methods and indicate whether based on these, a particular method for empirical poverty estimation can be developed in India.

To recommend how these estimates of poverty can be linked to eligibility and entitlements under the various schemes of the Government of India.

Recommendations

Methodology Used:

The Rangarajan committee estimation is based on an independent large survey of households by Center for Monitoring Indian Economy (CMIE).

It has also used different methodology wherein a household is considered poor if it is unable to save.

Normative and Behavioural level:

Poverty line should be based on:

- **Normative level of adequate nutrition:** Ideal and desirable level of nutrition.
- **Behavioral determination of non-food expenses:** What people use or consume as per general behavior.

Nutritional Requirement: For normative levels of adequate nutrition – average requirements of calories, proteins and fats based on Indian Council of Medical Research (ICMR) norms, differentiated by age, gender and activity for all-India rural and urban regions is considered:

Calories: 2090 kcal in urban areas and 2155 Kcal in rural areas.

Protein: For rural areas 48 gm and for urban areas 50 gm.

Fat: For urban areas 28 gm and for rural areas 26 gm.

Poverty Threshold: Persons spending below ₹47 a day in cities and ₹32 in villages be considered poor.

- Based on this methodology, Rangarajan committee estimated that the number of poor were 19% higher in rural areas and 41% more in urban areas than what was estimated using Tendulkar committee formula.
- Modified Mixed reference period: Instead of Mixed reference Period (MRP) it recommended Modified Mixed Reference Period (MMRP) in which reference periods for different items were taken as:
- 365-days for clothing, footwear, education, institutional medical care, and durable goods.
- 7-days for edible oil, egg, fish and meat, vegetables, fruits, spices, beverages, refreshments, processed food, pan, tobacco and intoxicants
- 30-days for the remaining food items, fuel and light, miscellaneous goods and services including non-institutional medical; rents and taxes.

Criticism: Rangarajan committee missed the opportunity to go beyond the expenditure-based poverty rates and examine the possibility of a wider multi-dimensional view of deprivation.

INTERNATIONAL POVERTY LINE

The World Bank defines a person as extremely poor if she is living on less than 1.90 international dollars a day, which are adjusted for inflation as well as price differences between countries.

Asian Development Bank too has its own poverty line which is currently at $ 1.51 per person per day.

Programmes for Poverty Alleviation

Salient features of various employment generation of poverty alleviation programme are given below:

MGNREGA

This flagship programme of the Government of India aims at enhancing livelihood security of households in rural areas of the country by providing at least 100 days of guaranteed wage employment in a financial year to every household whose adult members volunteer to do unskilled manual work. It also mandates 1/3rd participation for women. The primary objective of the scheme is to augment wage employment. This is to be done, while also focusing on strengthening natural resource management through works that address causes of chronic poverty like drought, deforestation, soil erosion and thus encourage sustainable development.

DEENDAYAL UPADHYAY ANTYODAYA YOJANA (DAY)

To reduce poverty and vulnerability of the urban poor households by enabling them to access gainful self employment and skilled wage employment opp-ortunities, resulting in an appreciable improvement in their livelihoods on a sustainable basis, through building strong grassroots level institutions for the poor.

The mission would aim at providing shelters equipped with essential services to the urban homeless in a phased manner.

In addition, the mission would also address livelihood concerns of the urban street vendors by facilitating access to suitable spaces, Institutional credit, social security and skills to the urban street vendors for accessing emerging market opportunities.

NATIONAL HEALTH MISSION

The National Health Mission (NHM)with its two Sub-Missions, namely the National Urban Health Mission (NUHM) and National Rural Health Mission (NRHM) covering both the rural and urban areas came into effect with Cabinet approval of 1st May,2013.

The main programmatic components of NHM include Health System Strengthening in both rural and urban areas, Reproductive-Maternal- Neonatal-Child and Adolescent Health (RMNCH+A) interventions, and control of Communicable and Non-Communicable Diseases.

PRADHAN MANTRI SURAKSHA BIMA YOJNA

Pradhan Mantri Suraksha Bima Yojana is available to people between 18 and 70 years of age with bank accounts. It has an annual premium of Rs. 12 (18¢ US) excluding service tax, which is about 14% of the premium. The amount will be automatically debited from the account. In case of accidental death or full disability, the payment to the nominee will be Rs.2 lakh (US$3,000) and in case of partial Permanent disability Rs.1 lakh (US$1,500). Full disability has been defined as loss of use in both eyes, hands or feet. Partial Permanent disability has been defined as loss of use in one eye, hand or foot.

This scheme will be linked to the bank accounts opened under the Pradhan Mantri Jan Dhan Yojana scheme. Most of these accounts had zero balance initially. The government aims to reduce the number of such zero balance accounts by using this and related schemes.

ATAL PENSION YOJANA

Under the Atal Pension Yojna Scheme (APY), the subscribers, under the age of 40, would receive the fixed monthly pension of Rs. 1000 to Rs. 5000 at the age of 60 years, depending on their contributions.

To make the pension scheme more attractive, the government would co-contribute 50% of a subscriber's contribution or Rs. 1,000 per annum, whichever is lower to each eligible subscriber account for a period of 5 years from 2015-16 to 2019-20. The benefit of government's co- contribution can be availed by those who subscribed to the scheme before December 31, 2015.

PRADHAN MANTRI JEEVAN JYOTI BIMA YOJANA

Pradhan Mantri Jeevan Jyoti Bima Yojana is a low cost life insurance policy provided by the government of India. Maximum sum offered under this scheme is Rs. 2 Lakh Premium payable for this insurance scheme is Rs. 330 per year or less than 1 rupee per day.

It is Available to people in the age group of 18 to 50 and having a bank account. People who join the scheme before completing 50 years can, however, continue to have the risk of life cover up to the age of 55 years subject to payment of premium.

PRADHAN MATRI AWAAS YOJANA

The Mission will be implemented during 2015-2022 and will provide central assistance to Urban Local Bodies (ULBs) and other implementing agencies through States/UTs for:

- In-situ Rehabilitation of existing slum dwellers using land as a resource through private participation
- Credit Linked Subsidy
- Affordable Housing in Partnership
- Subsidy for Beneficiary-led individual house construction/ enhancement.

Credit linked subsidy component will be implemented as a Central Sector Scheme while other three components will be implemented as Centrally Sponsored Scheme (CSS).

GARIB KALYAN ROJGAR ABHIYAAN

'Garib Kalyan Rojgar Abhiyaan' is a massive rural public works scheme of Government of India to empower and provide livelihood opportunities to the returnee migrant workers and rural citizens.

The Abhiyaan was launched on 20th June, 2020 from Village – Telihar, Block- Beldaur of Khagaria District of Bihar.

Objectives

The objectives of this 125 days Abhiyaan, with a resource envelop of Rs. 50,000 Crore are:

- Provide livelihood opportunities to returning migrants and similarly affected rural citizens
- Saturate villages with public infrastructure - Anganwadis, Panchayat Bhawans, Community Sanitary Complexes etc.
- Set stage for enhancing longer term livelihood opportunities.

Coverage

A total of 116 Districts with more than 25,000 returnee migrant workers across six States, namely Bihar, Uttar Pradesh, Madhya Pradesh, Rajasthan, Jharkhand and Odisha have been chosen for the campaign which includes 27 Aspirational Districts. These districts are estimated to cover about 2/3 of such migrant workers.

Duration of the scheme

Garib Kalyan Rojgar Abhiyaan (GKRA) will be operational for a period of 125 days, commencing from 20th June, 2020.

Intended Beneficiaries

Returning migrant workers similarly affected the rural population of 6 States namely Bihar, Jharkhand, Odisha, Rajasthan, Madhya Pradesh and Uttar Pradesh.

Focus on 25 Works

Abhiyaan involves intensified and focused implementation of 25 target driven works to provide employments and create infrastructure in the rural areas of 116 Abhiyaan Districts with a resource envelope of Rs 50,000 crore. Following is the list of 25 works & activities from participating Ministries/Departments.

1. Community Sanitary Complexes
2. Gram Panchayat Bhawans
3. Works under Finance Commission funds
4. National Highway works
5. Water conservation & Harvesting works
6. Wells
7. Plantation works (including CAMPA Funds)
8. Horticulture
9. Anganwadi Centers
10. Rural housing works (PMAY-G)
11. Rural connectivity works (PMGSY)& Border road works

12. Railway works
13. Shyama Prasad Mukherjee RURBAN Mission
14. PM KUSUM works
15. Laying of Optic Fiber under Bharat Net
16. Works under Jal Jeevan Mission
17. PM Urja Ganga Project
18. Training through KVK for Livelihoods
19. Works through District Mineral Fund
20. Solid and liquid waste management works
21. Farm ponds
22. Cattle sheds
23. Goat Sheds
24. Poultry sheds
25. Vermi-composting

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Unemployment

Introduction

Unemployment occurs when a person who is actively searching for employment is unable to find work. Unemployment is often used as a measure of the health of the economy. The most frequent measure of unemployment is the unemployment rate, which is the number of unemployed people divided by the number of people in the labor force.

National Sample Survey Organization (NSSO) defines employment and unemployment on the following activity statuses of an individual:

- Working (engaged in an economic activity) i.e. 'Employed'.
- Seeking or available for work i.e. 'Unemployed'.
- Neither seeking nor available for work.

The first two constitute the labour force and unemployment rate is the percent of the labour force that is without work.

Unemployment rate = (Unemployed Workers / Total labour force) × 100

Types of Unemployment in India

1
Disguised Unemployment:
- It is a phenomenon wherein more people are employed than actually needed.
- It is primarily traced in the agricultural and the unorganised sectors of India.

2
Seasonal Unemployment:
- It is an unemployment that occurs during certain seasons of the year.
- Agricultural labourers in India rarely have work throughout the year.

3
Structural Unemployment:
- It is a category of unemployment arising from the mismatch between the jobs available in the market and the skills of the available workers in the market.
- Many people in India do not get jobs due to lack of requisite skills and due to poor education level, it becomes difficult to train them.

4
Cyclical Unemployment:
- It is the result of the business cycle, where unemployment rises during recessions and declines with economic growth.
- Cyclical unemployment figures in India are negligible. It is a phenomenon that is mostly found in capitalist economies.

5
Technological Unemployment:
- It is the loss of jobs due to changes in technology.
- In 2016, World Bank data predicted that the proportion of jobs threatened by automation in India is 69% year-on-year.

6
Frictional Unemployment:
- The Frictional Unemployment also called Search Unemployment, refers to the time lag between the jobs when an individual is searching for a new job or is switching between the jobs.
- In other words, an employee requires time for searching a new job or shifting from the existing to a new job, this inevitable time delay causes frictional unemployment. It is often considered as a voluntary unemployment because it is not caused due to the shortage of jobs, but in fact, the workers themselves quit their jobs in search of better opportunities.

7
Vulnerable Employment:
- This means, people working informally, without proper job contracts and thus sans any legal protection. These persons are deemed 'unemployed' since records of their work are never maintained.
- It is one of the main types of unemployment in India.

Related Terms

Unemployment trap is a situation when unemployment benefits discourage the unemployed from going to work. People find the opportunity cost of going to work too high when one can simply enjoy the benefits by doing nothing.

Description: While the purpose of social security and welfare systems is to provide relief to the unemployed, they end up providing them with an incentive not to return to work. An unemployment trap arises when the opportunity cost of going to work is higher than the income received, discouraging people from returning to work and being productive.

Harmonised unemployment rates define the unemployed as people of working age who are without work, are available for work, and have taken specific steps to find work. The uniform application of this definition results in estimates of unemployment rates that are more internationally comparable than estimates based on national definitions of unemployment.
This indicator is measured in numbers of unemployed people as a percentage of the labour force and it is seasonally adjusted.

The labour force is defined as the total number of unemployed people plus those in civilian employment.

Measurement of Unemployment in India

National Sample Survey Office (NSSO), an organization under Ministry of Statistics and Programme Implementation (MoSPI) measures unemployment in India on following approaches:

Usual Status Approach

This approach estimates only those persons as unemployed who had no gainful work for a major time during the 365 days preceding the date of survey.

Weekly Status Approach

This approach records only those persons as unemployed who did not have gainful work even for an hour on any day of the week preceding the date of survey.

Daily Status Approach

Under this approach, unemployment status of a person is measured for each day in a reference week. A person having no gainful work even for 1 hour in a day is described as unemployed for that day.

Unemployment Stats (based on findings from CMIE's latest data)

- The unemployment rate in India rose to 7.2 percent in February 2019, the highest since September 2016, and up from 5.9 percent in February 2018.
- The total number of employed persons in February 2019 is estimated at 400 million against 406 million in the year-ago period and 407.5 million employed in February 2017.
- The labour participation rate fell from 43.2% in January 2019 to 42.7% in February 2019.
- Labour Participation Rate defines that section of working population in the economy which is currently employed or seeking employment.

Causes of Unemployment

- Large population.
- Low or no educational levels and vocational skills of the working population.
- Inadequate state support, legal complexities and low infrastructural, financial and market linkages to small/ cottage industries or small businesses, making such enterprises unviable with cost and compliance overruns.

- Huge workforce associated with informal sector due to lack of required education/ skills, which is not captured in any employment data. For ex: domestic helpers, construction workers etc.
- The syllabus taught in schools and colleges, being not as per the current requirements of the industries. This is the main cause of structural unemployment.
- Inadequate growth of infrastructure and low investments in manufacturing sector, hence restricting employment potential of secondary sector.
- Low productivity in agriculture sector combined with lack of alternative opportunities for agricultural worker which makes transition from primary to secondary and tertiary sectors difficult.
- Regressive social norms that deter women from taking/ continuing employment.

Impact

- The problem of unemployment gives rise to the problem of poverty.
- Young people after a long time of unemployment indulge in illegal and wrong activities for earning money. This also leads to increase in crime in the country.
- Unemployed persons can easily be enticed by antisocial elements. This makes them lose faith in democratic values of the country.
- It is often seen that unemployed people end up getting addicted to drugs and alcohol or attempts suicide, leading losses to the human resources of the country.
- It also affects the economy of the country as the workforce that could have been gainfully employed to generate resources actually gets dependent on the remaining working population, thus escalating socioeconomic costs for the State. For instance, 1 percent increase in unemployment reduces the GDP by 2 percent

Steps Taken by Government

Integrated Rural Development Programme (IRDP)

was launched in 1980 to create full employment opportunities in rural areas.

Training of Rural Youth for Self-Employment (TRYSEM):

This scheme was started in 1979 with the objective to help unemployed rural youth between the age of 18 and 35 years to acquire skills for self-employment. Priority was given to SC/ST Youth and Women.

RSETI/RUDSETI:

With the aim of mitigating the unemployment problem among the youth, a new initiative was tried jointly by Sri Dharmasthala Manjunatheshwara Educational Trust, Syndicate Bank and Canara Bank in 1982 which was the setting up of the "RURAL DEVELOPMENT AND SELF EMPLOYMENT TRAINING INSTITUTE" with its acronym RUDSETI near Dharmasthala in Karnataka. Rural Self Employment Training Institutes/ RSETIs are now managed by Banks with active co-operation from the Government of India and State Government.

By merging the two erstwhile wage employment programme – National Rural Employment programme (NREP) and Rural Landless Employment Guarantee Programme (RLEGP) the Jawahar Rozgar Yojana (JRY) was started with effect from April, 1, 1989 on 80:20 cost sharing basis between the centre and the States.

Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA):

- It is an employment scheme that was launched in 2005 to provide social security by guaranteeing a minimum of 100 days paid work per year to all the families whose adult members opt for unskilled labour-intensive work.This act provides Right to Work to people.

Pradhan Mantri Kaushal Vikas Yojana (PMKVY)

launched in 2015 has an objective of enabling a large number of Indian youth to take up industry-relevant skill training that will help them in securing a better livelihood.

Start Up India Scheme

launched in 2016 aims at developing an ecosystem that promotes and nurtures entrepreneurship across the country.

Stand Up India Scheme, launched in 2016 aims to facilitate bank loans between Rs 10 lakh and Rs. 1 crore to at least one SC or ST borrower and at least one women borrower per bank branch for setting up a greenfield enterprise.

Way Forward

- There are a number of labour intensive manufacturing sectors in India such as food processing, leather and footwear, wood manufacturers and furniture, textiles and apparel and garments. Special packages, individually designed for each industry are needed to create jobs.
- Public investment in sectors like health, education, police and judiciary can create many government jobs.
- Decentralisation of Industrial activities is necessary so that people of every region get employment.
- Development of the rural areas will help mitigate the migration of the rural people to the urban areas thus decreasing the pressure on the urban area jobs.
- Entrepreneurs generate employment to many in a country; therefore the government needs to encourage entrepreneurship among the youth.
- Concrete measures aimed at removing the social barriers for women's entry and their continuous participation in the job market is needed.
- Government needs to keep a strict watch on the education system and should try to implement new ways to generate a

skilled labour force.

- Effective implementation of present programs like Make in India, Skill India, Start up and Stand-Up India.
- There is a need for National Employment Policy (NEP) that would encompass a set of multidimensional interventions covering a whole range of social and economic issues affecting many policy spheres and not just the areas of labour and employment. The policy would be a critical tool to contribute significantly to achieve the goals of the 2030 Agenda for Sustainable Development.

The underlying principles for the National Employment Policy may include

- enhancing human capital through skill development;
- creating sufficient number of decent quality jobs for all citizens in the formal and informal sectors to absorb those who are available and willing to work;
- strengthening social cohesion and equity in the labour market;
- coherence and convergence in various initiatives taken by the government;
- supporting the private sector to become the major investor in productive enterprises;
- supporting self-employed persons by strengthening their capabilities to improve their earnings;
- ensuring employees' basic rights and developing an education training and skill development system aligned with the changing requirements of the labour market.

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